ADB INDIA
Economic Bulletin

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India: Key Economic Indicators

Variables	Unit	Reporting Date	Current	Percentage Change[1]
GDP at Factor Cost (1993–94 prices)	Rs. Billion	FY2002	13,207	4.4
• GDP in Agriculture	Rs. Billion	FY2002	2,926	-3.1
• GDP in Industry	Rs. Billion	FY2002	3,580	6.1
• GDP in Services	Rs. Billion	FY2002	6,701	7.1
Industrial Production - General (1993–94 = 100)	Index	April–November 2002	170.5	5.3
Industrial Production - Manufacturing (1993–94 = 100)	Index	April–November 2002	176.2	5.4
Wholesale Price–All Commodities (1993–94 = 100)	Index	April–December 2002	165.8	2.8
• Primary Articles	Index	April–December 2002	173.3	2.6
• Manufactured Articles	Index	April–December 2002	147.4	2.1
Consumer Price (Industrial Worker) (1982–83 = 100)	Index	April–December 2002	481	4.0
Broad Money (M3)	Rs. Billion	10 January 2003	16,891	15.7
RBI's credit to Commercial Sector	Rs. Billion	31 March 2003	30	-50.0
RBI's credit to General Government	Rs. Billion	31 March 2003	1,201	-22.2
Consolidated Fiscal Deficit / GDP	Per cent	FY2002	9.3	-7.0
Domestic Public Debt	Rs. Billion	FY2001	16,077	15.1
Exports	$ Billion	April–September 2002	24	11.4
Imports	$ Billion	April–September 2002	31	6.3
Trade Balance / GDP	Per cent	April–September 2002	-2.5	-26.5
Current Account Balance / GDP	Per cent	April–September 2002	0.6	185.7
International Reserve	$ Billion	31 January 2003	70	48.9
External Debt	$ Billion	FY2001	98	-2.6
External Debt to GDP Ratio	Per cent	FY2001	20.9	-7.2
Debt Service Ratio	Per cent	FY2001	14.1	-18.5
Foreign Exchange Rate, Spot	(Rs./$)	April–December 2002	48.5	2.4
Nominal Effective Exchange Rate (1993–94 = 100)	Index	December 2002	36.8	4.3
Real Effective Exchange Rate (1993–94 = 100)	Index	December 2002	72.6	6.6

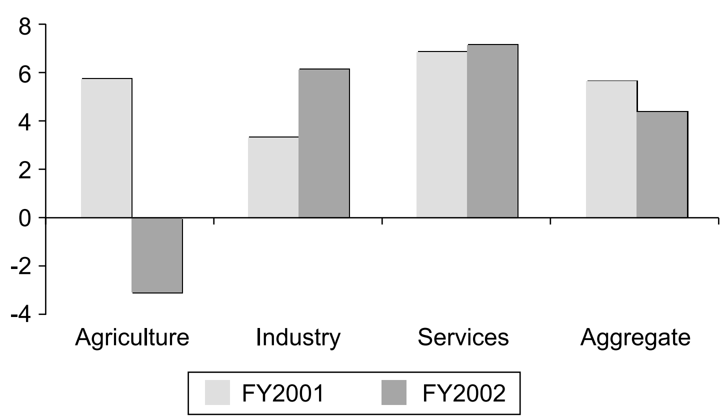
[1] Percentage change over the corresponding reporting date a year ago.

Contents

I. Macroeconomic Scenario

1. Aggregate growth declined to 3.2% in the last quarter of FY2002[1], down from 5.9% during the first half of the year, mainly on account of the setback in agriculture. The decline in quarterly growth has exacerbated the deceleration in annual growth observed since the late 1990s. The comprehensive market-oriented reforms pursued in India through the 1990s aimed to rationalize resource allocation, improve efficiency and move the economy to a high growth path. The economy did attain very high rates of growth of around 7% to 8% between FY1994 and FY1996, led by services, which is now the largest sector of the economy. However, this trend did not last. GDP growth was disappointing at an average of 5.0% in FY2000 and FY2001, and is now estimated to have further declined to 4.4% in FY2002 (Figure 1).

Figure 1
Sectoral Composition of Growth (%)



2. The primary factors that have contributed to lower growth in recent years include exogenous effects, such as global recession and drought, as well as the impact of the slow progress of reforms in some sectors and a large and persistent fiscal deficit, which have adversely impacted investment. Recent average rates of investment and savings of around 24% and 23%, respectively, are lower than the peak rates of around 27% and 25% achieved in 1995. In the past, economic growth was led by public investment. However, the situation changed significantly during the late 1990s with declining rates of public investment. The growing burden of servicing a burgeoning public debt, a large

[1] Year ended 31 March 2003.

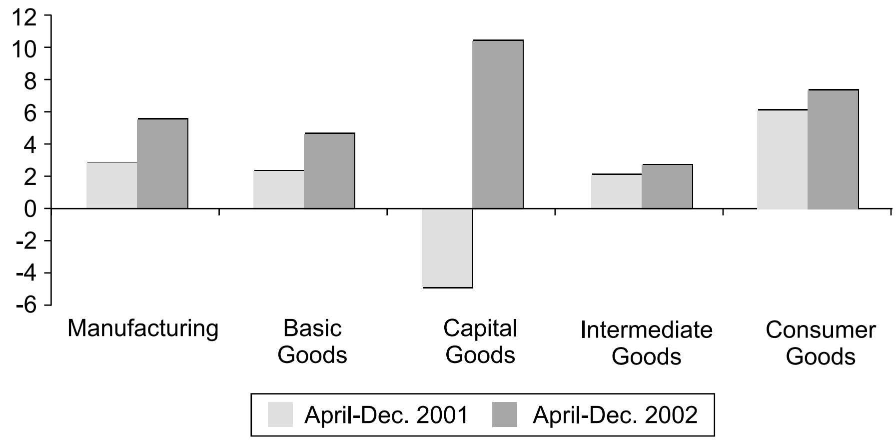
volume of subsidies and a sharp increase in the government salary bill following the recommendations of the Fifth Pay Commission eroded public savings, thereby crowding out public investments in infrastructure. The share of public sector investment in GDP declined from 11.2% in FY1986 to 8.2% in FY1993 and further to 6.6% in FY1998, and has now settled at 6.3% of GDP. Private investment failed to fully replace public investment since it was also crowded out by large transfers of private savings for public expenditure through the financial sector. Thus, private savings amounted to 26.5% of GDP in FY2001, while private investment amounted to only 16% of GDP, implying that the deficit-prone public sector has effectively siphoned off almost 40% of private savings. The effect of this crowding out has been further exacerbated by policy uncertainties and slow progress of reforms in some sectors.

II. Sectoral Performance

3. Agriculture performed poorly in FY2002 because of the weak monsoon. By the end of the monsoon season, 21 out of 36 meteorological subdivisions in the country, covering more than 55% of the total land area, had received less than normal rainfall, with 19 of them in the "deficient" category. The shortfall in total rainfall was 20% during June–November. Winter rains were also deficient and adversely affected the *rabi* crop. As a result, annual agricultural production has declined significantly, especially in cereals and pulses. After growing at over 6% in the first quarter of FY2002, agricultural growth dipped to zero in the following quarter, and production declined by around 3% for the year as a whole. To moderate the impact of instability in agricultural production, the government has introduced a price stabilization fund for cash crop growers. A task force has also been appointed to examine the feasibility of inter-linking India's river systems as a means of balancing water surplus and deficit regions.

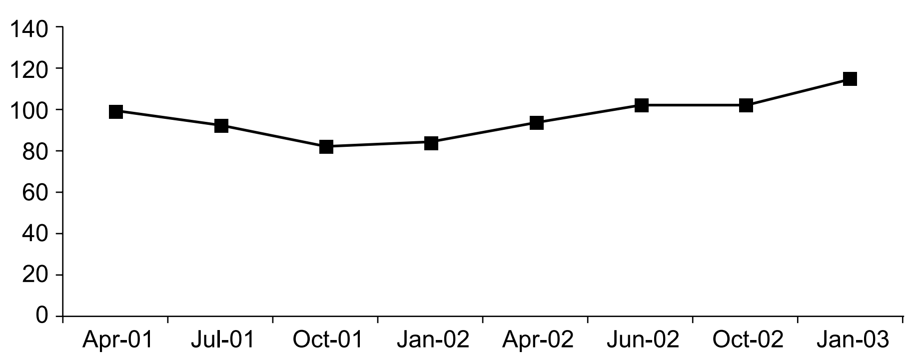
4. The decline in overall growth in FY2002 masks a recovery in industry. Manufacturing growth of 5.4% during April–December 2002 was higher than the 2.7% growth registered during the same period in the previous year (Figure 2). Improved performance was evident across all subsectors. While the turnaround in capital goods production, especially in transport equipment, was the most significant, that for intermediate goods was marginal. The growth rates of non-durable consumer goods, such as food products, beverages, and textile products, especially wearing apparel, also

Figure 2
Industrial Growth (%)



rose in FY2002. The upturn in the basic goods sector is attributable to a sharp rise in construction activities. The recovery was also evident in six `core' infrastructure industries, namely, cement, steel, coal, electricity, crude oil and petroleum products. These infrastructure industries registered a combined growth rate of 5.4% in April–December 2002 as against 2.5% in the corresponding period of 2001. Industrial recovery is mainly attributable to softer interest rates; a revival of merchandise export growth; large foreign exchange reserves; and large foodstocks that have contained inflation despite the supply shock in agriculture. These factors have triggered an upturn in the industrial business cycle. NCAER's business confidence index, which stayed level between June and October 2002, showed a marked improvement in January 2003 (Figure 3).

Figure 3
NCAER Business Confidence Index



5. In addition to reviving business confidence, enhancing efficiency and improving corporate governance are the other major priorities of industrial policy. The Competition Bill is an important step in this direction. The Bill is designed to replace the existing Monopolies and Restrictive Trade Practices Act, which has been a barrier to investment by large corporations. The Bill redefines anti-competitive trade practices, such as abuse of a dominant position, cartels, predatory pricing, bid-rigging, boycotts, and refusal to deal. In accordance with internationally accepted practice, the Bill seeks to promote competition by abolishing the requirement to register business agreements, regulating mergers and acquisitions, and prohibiting both horizontal and vertical agreements between firms that affect competition. A Competition Commission has also been proposed to ensure effective implementation.

III. Fiscal Development

6. On the fiscal front, the Central government deficit showed a small improvement to 5.9% of GDP in FY2002 compared to 6.1% in the previous year; the budgeted target was 5.3%. The deficit would have been much higher but for an impressive 23% increase in net tax revenues. In addition to the Central government deficit, the estimated combined deficit of the state governments is 4.2%, resulting in a consolidated (net) deficit of 9.3% in FY2002. Though slightly lower compared to the 10% level in FY2001, the overall fiscal deficit remains large and a major challenge for macroeconomic management. Excessive public borrowing has led to rapid growth of public debt. The combined outstanding public debt of the Central and the state governments is estimated at 72.6% of GDP in FY2001; consolidated data are not yet available for FY2002. However, net market borrowings of $23.3 billion, or approximately 5% of GDP, by the Central government in FY2002 exceeded the budget estimate by 17.7%.

7. Reducing the deficit will depend on both raising revenue and better management of public expenditure. On the revenue side, using the average of Asia-Pacific countries as a benchmark, there is a potential for increasing tax revenues by around 3-5% of GDP. At the central level, there is significant scope for broadening the tax base, especially through taxation of services and reduced exemptions. Improved tax administration and better tax compliance will also help in this direction. Expenditure reforms at the Center should aim at a phased reduction of subsidies, rationalization of government staff, and reduction of budgetary support to public enterprises. Finally, keeping in view the

burgeoning debt stock of the Government, the associated crowding out of private investment, and the recent decline in interest rates, the Government should examine options for further debt restructuring to reduce the debt service burden.

8. The Task Forces on Direct and Indirect Taxes headed by Dr. Vijay Kelkar, Adviser to the Finance Minister, has recommended wide-ranging reforms in tax policy as well as tax administration. The budget for FY2003 initiated a phased implementation of some of these proposals, starting with major reforms in tax administration for both direct and indirect taxes. Among the important revenue proposals, the taxation of services has been extended to cover a larger number of items, and the tax rate has been revised upward to 8.0%. Moreover, a constitutional amendment has been proposed that will empower state governments to levy a tax on services.

9. The most important expenditure consolidation measure announced in the FY2003 budget is debt restructuring. High interest public debt will be prepaid to take advantage of the recent decline in nominal interest rates. About $3 billion of external debt to ADB and the World Bank has been prepaid in this way. Moreover, the Government has announced a $21 billion debt swap scheme for the states to restructure their debt to the Central government over a period of three years. Under the scheme, states will borrow from the market at low interest rates to repay high cost old debt to the Central government. These measures should significantly reduce the debt-servicing burden of the Government. However, India's basic macroeconomic problem of a large fiscal deficit has not been adequately addressed. The projected Central government fiscal deficit for FY2003 is 5.6%. Since the actual deficit usually overshoots the projected deficit by at least 0.5%, it is likely that FY2003 will end with a Central government deficit of about 6%. After adding the combined deficit of the state governments, the total fiscal deficit in FY2003 is likely to exceed 9.5%.

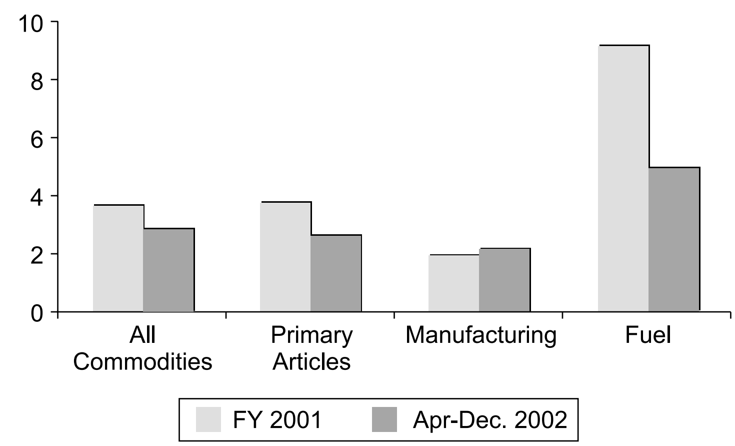
10. With regard to fiscal consolidation at the state level, a Medium-Term Fiscal Reform Program for States has been negotiated between the Central government and several state governments. The program offers incentives for state fiscal reforms through performance-linked transfers from the Central government. However, this scheme needs to be rationalized and considerably strengthened. Also at the level of the states, it is essential to raise revenues to contain the revenue deficit and shift expenditures toward better provision of social services. The transition to VAT and its effective administration is

the crux of tax reforms at the subnational level. States also need to seriously consider untapped revenue sources, such as taxation of agriculture and enforcement of rational user charges for water and power. Restructuring of public expenditures at the state level should attempt to reduce unproductive and poorly targeted expenditures, while making sufficient provision for investment in infrastructure and human capital. Accelerating the pace of reforms of the state electricity boards, road transport corporations, and other public enterprises should be a high priority.

IV. Inflation, Money and Financial Market Developments

11. Inflation, as measured by the wholesale price index (WPI), declined from 3.6% in FY2001 to 2.8% in April–December 2002 (Figure 4). This was despite the setback in agriculture, high international oil prices, and a transition to market-determined prices in the hydrocarbon sector. Annual inflation as measured by changes in the consumer price index (CPI) for industrial workers was somewhat higher at 4.0% in April–December 2002. The easing of the price situation despite adverse factors was primarily due to the large surplus stock of foodgrains in the country and global deflationary trends. However, prices have again started firming up as a consequence of the crisis in Iraq. The WPI inflation rate had risen to 4.9% by February 2003 and may have risen further in March.

Figure 4
Rate of Inflation (%)



12. Money supply (M3) growth in FY2001 was in line with the projected trajectory at 14.2%. In FY2002, money supply grew by 15.7% up to January 2003. Through 2001 and 2002, the Reserve

Bank of India (RBI) progressively eased its monetary policy stance in an attempt to revive growth. It has also been encouraging commercial banks to reduce their spreads. This was reflected in the Monetary and Credit Policy for 2002 and the mid-year review of credit policy. The RBI reduced the cash reserve ratio from 5.0% to 4.75% and the bank rate from 6.5% to 6.25% with effect from 16 November 2002. With a cut in the bank rate, commercial banks reduced their prime lending rates by 0.25-0.5 percentage points. The prime lending rates of the major banks were in the range of 10.75-11.5% as of 22 November 2002. This is still very high in real terms, given an inflation rate of around 5.0%. The cost of money is even higher for non-prime borrowers. Commercial banks have continued to maintain relatively high interest rates mainly on account of significant provisioning for non-performing loans (NPLs).

13. Financial sector reforms, including interest rate deregulation, and entry of commercial banks into term lending have increased the competitive pressure on development financial institutions (DFIs). Consequently, many DFIs are being restructured, following RBI guidelines, to enter retail banking. Thus, for example, the Industrial Credit and Investment Corporation of India has transformed itself into a bank.

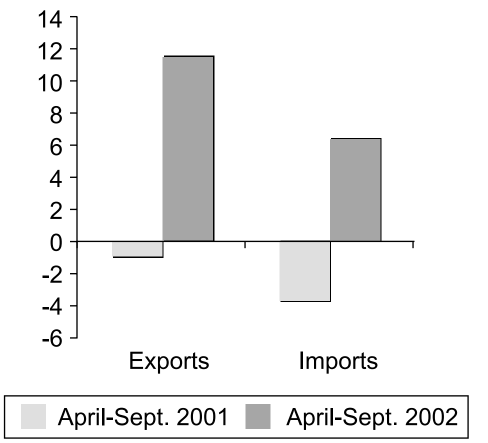
14. The Government enacted the landmark "Securitization, Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002" that provides a comprehensive legislative framework for foreclosure of assets by lenders, formation of private Asset Reconstruction Companies (ARCs), and securitization of assets with an emphasis on foreclosed assets to address the problem of a high level of NPLs. The new Act empowers banks to foreclose collateral assets for NPLs and it is expected to lead to a significant reduction in NPLs. The Act also creates a framework for ARCs, including capital ownership and issue of securities; regulation under the RBI; transfer of ownership and management rights to the ARCs; and creation of a centralized depository for registering securities. In another important financial sector development the Unit Trust of India, the largest mutual fund in the country, hitherto controlled by the Government, has been restructured into two entities, one dealing only with schemes based on net asset values, and the other dealing with assured return schemes. Another major policy development in the financial sector is legislation on money laundering. Parliament has approved a law that allows confiscation of property derived from or involved in money laundering. The law also makes it mandatory for banking companies, financial institutions, and

intermediaries to maintain a record of all transactions exceeding a prescribed value and to furnish information to authorized government agencies whenever sought within a prescribed time period.

V. Balance of Payments

15. On the external front, export growth is showing signs of revival after poor performance in FY2001. The growth of merchandise exports and imports at 11.4% and 6.3%, respectively, in April–September 2002 is a marked improvement over the contraction witnessed in the corresponding period in 2001 (Figure 5). The trade deficit narrowed to $6.9 billion in this period from $7.5 billion during April–September 2001. The turnaround in exports was largely due to a partial recovery of global demand, with an upturn in GDP and final consumption expenditure in the US, and a revival of growth in many Asian countries. The rise in consumer expenditure in the US, in particular, has pushed growth in exports of consumer items, such as textiles and garments, as well as gems and jewelry, to high rates. The growth in imports mainly reflects the recovery of domestic industrial activity. While capital goods imports have revived, those of consumer goods continue to decline. Moreover, with international crude oil prices hardening, the import value of petroleum and its related products has risen sharply.

Figure 5
Growth of Exports and Imports (%)

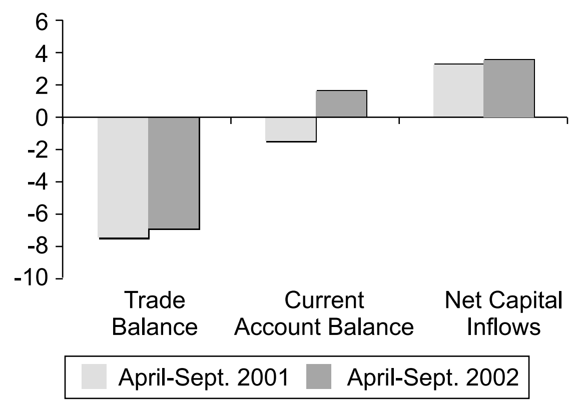


16. In foreign trade, the medium-term prospects of merchandise export growth will depend, to a large extent, on the removal of infrastructural bottlenecks, reduction in transaction costs arising from procedural delays or other bureaucratic impediments, and, most importantly, improvements in the competitiveness of exports by moving up the value chain to high-value capital goods. The Medium-Term Export Strategy for 2002–07 has attempted to address most of these issues. The strategy aims at a compound growth rate of 11.9% for exports to achieve a 1% share of world exports by 2007. The strategy identifies products and markets for potential export

growth and suggests product-wise strategies that are beneficial for overall export growth. The instruments discussed in the strategy include tariffs, FDI, and exchange rate policies, as well as measures for reducing transaction costs and setting up an appropriate environment for export growth. The last point includes special economic zones, marketing support, free trade agreements with potential trade partners, and participation of the states in export promotion.

17. The current account realized a small surplus of 0.3% of GDP for the first time in 23 years in FY2001, and has continued to improve during the first half of FY2002 with a surplus of $1.7 billion (Figure 6), mainly due to a surplus in the invisibles account. There is a risk that the recent appreciation of the nominal exchange rate might reverse this trend, and lower the current account surplus. Net capital inflows in FY2001 were led by a 67% increase in FDI inflows. However, total foreign investment inflows declined to $1.1 billion during April–September 2002 compared to $2.6 billion during the same period in 2001 (Figure 6). This is the result of a drop in FDI inflows to $1.7 billion from $1.8 billion in April–September 2001 and a reversal in net portfolio investment by foreign institutional investors to a net outflow of $0.4 billion in April–September 2002, from a positive net inflow of $1.2 billion during the same period in 2001.

Figure 6
Trade Balance, Current Account Balance and Net Capital Inflows ($ billion)



18. Despite the deceleration of foreign investment inflows, foreign exchange reserves have continued to rise steadily from around $51 billion at the end of 2001 to nearly $70 billion as of 31 January 2003. The recent accretion of foreign exchange reserves is mainly attributed to banking capital and other capital account transfers induced by a weak dollar and India's positive interest rate differential compared with international rates. Such large increases in reserves caused the exchange rate of the Indian rupee to appreciate by

about 0.4% against the dollar in January 2003 over the same month in 2002. Armed with large foreign exchange reserves, the RBI has recently liberalized the foreign exchange market. Moreover, since late FY2002 the Government has embarked on prepayments of high-cost external debt. These moves notwithstanding, India is yet to achieve the conditions for capital account convertibility laid down by the Tarapore Committee on Capital Account Convertibility in 1997, i.e., fiscal consolidation and a strong domestic financial system.

VI. Short-term Outlook

19. The industry sector is on the upswing of a business cycle, which is expected to continue in FY2003 and lead to a moderate revival in aggregate growth. Assuming normal monsoon conditions, the economy is projected to grow by 6.0% in FY2003 with agriculture and services growing at average rates (see Table 1). Exports are expected to grow at over 15% in 2003, based on a moderate revival in world demand. The current account surplus should be maintained, assuming fairly stable oil prices, a positive net trade balance in invisibles, and a marginally appreciating currency due to large foreign exchange reserves. However, projections for the external account, especially for oil prices, as well as macro projections, will have to be revised in due course, taking into account the full impact of the war in Iraq and the emerging SARS epidemic. Inflation will likely remain moderate at around 5%. Tax measures in the FY2003 budget are expected to enhance buoyancy and raise the revenue-to-GDP ratio. However, in the absence of strong measures to contain the rapid growth in expenditures, the consolidated fiscal deficit is expected to remain at the average level of 9.5% of GDP.

20. The projected macroeconomic trends of FY2003 are likely to continue through the following year with an expected GDP growth of 6.3%. Inflation should remain at around 5%. The current account balance will likely remain positive, despite a higher rate of import growth, again depending on the situation in the Middle East. Strong fiscal consolidation is expected during the post-election phase of the political cycle in the latter half of FY2004, leading to a decline in the consolidated fiscal deficit to 9.0% of GDP. In the medium- to long-term, sustained high growth will require higher investments in capacity creation for infrastructure development as well as technology development to enhance competitiveness, removal of various rigidities in labor laws and, especially, strong fiscal consolidation.

Table 1

Short-Term Projections of Major Economic Indicators: India (%)

Indicators	2003	2004
Real GDP Growth	6.0	6.3
Inflation	5.0	5.0
Gross Domestic Investment/GDP	24.0	25.0
Gross Domestic Saving/GDP	24.1	25.2
Money Supply (M3) Growth	16.0	16.0
Consolidated Fiscal Balance/ GDP[a]	-9.5	-9.0
Export Growth	15.1	16.6
Import Growth	11.8	12.2
Current Account/ GDP	0.1	0.2
External Debt/GDP	18.0	16.0

Note: a: This includes the combined fiscal deficit of the Central government and all state governments.

VII. Government's Medium-Term Development Strategy

21. The recently approved Tenth Five - Year Plan (10th Plan) observes that "there is growing impatience in the country at the fact that a large number of our people continue to live in abject poverty and there are alarming gaps in social attainments even after five decades of planning." The 10th Plan emphasizes that development must be defined not just in terms of increased GDP, but also more broadly in terms of human well-being, i.e., reduction in 'income poverty' as well as 'human poverty.' Hence, the 10th Plan's strategy combines high growth with equitable growth and social development and it has specified, for the first time, a set of specific monitorable targets for key indicators of human development (see Box1). The 10th Plan also attempts a new kind of planning that focuses not just on the quantitative exercise of targets, resource requirements, and allocations but also on the policy and institutional measures to implement the allocations and accomplish the specified targets, i.e., good governance. The 10th Plan indicates that the role of government in production will continue to decline but increase in provision of better public services and a better regulatory environment for private enterprise. Thus, the strategy of the 10th Plan consists of four basic themes: high growth, equitable growth, human development, and reforms. The first three themes each have associated sectoral priorities. The last is a crosscutting theme, woven in with the other themes. This strategic approach is summarized in Figure 7.

Box 1

Monitorable Human Development Targets for the Tenth Five-Year Plan and beyond

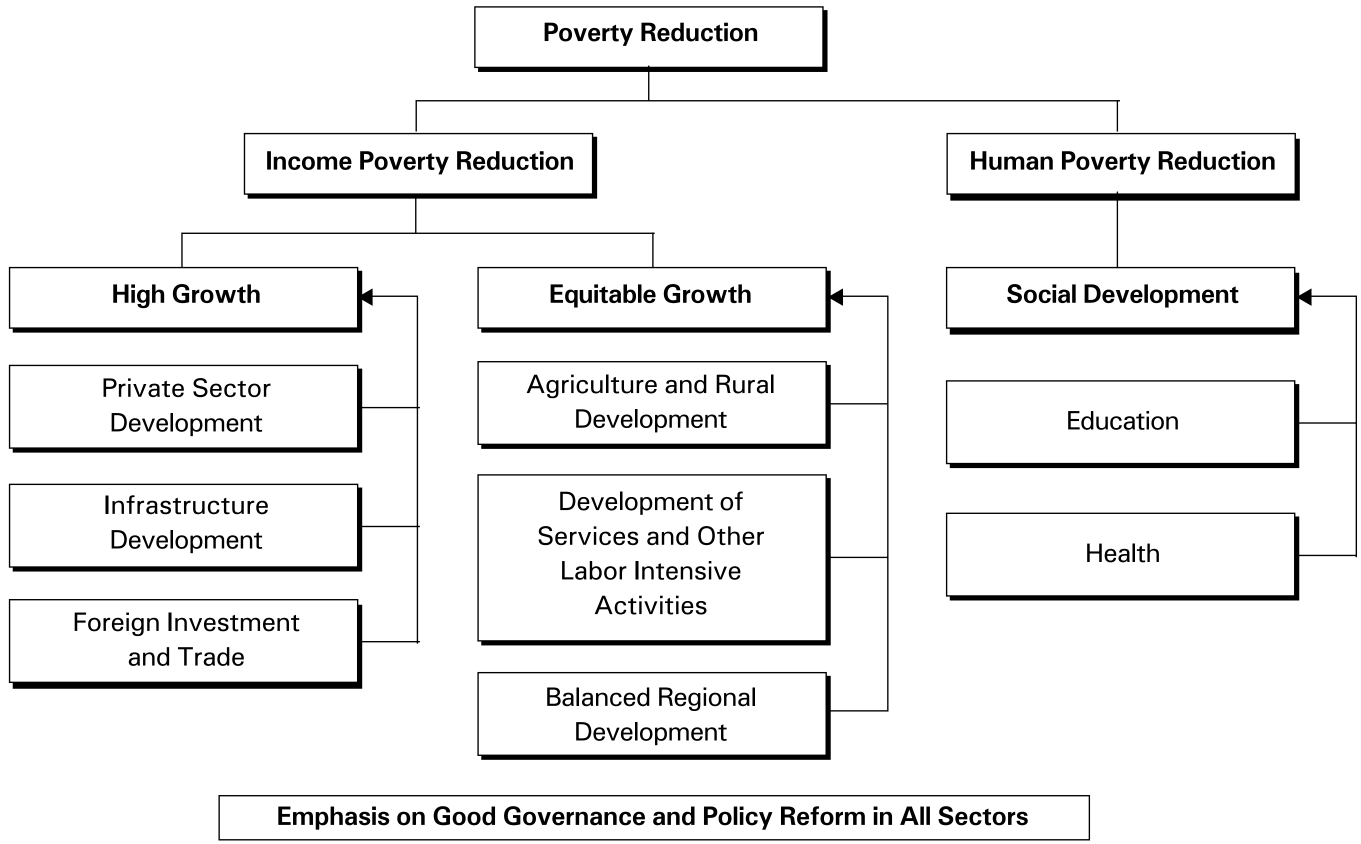
- Reduce the poverty ratio by 5 percentage points by 2007, and by 15 percentage points by 2012.
- Provide gainful and high-quality employment.
- Ensure that all children are in school by 2003, and that all children complete 5 years of schooling by 2007.
- Reduce the gender gaps in literacy and wage rates by at least 50% by 2007.
- Reduce the decadal population growth rate to 16.2%.
- Increase literacy rates to 75%.
- Reduce the infant mortality rate to 45 per 1,000 live births by 2007, and to 28 by 2012.
- Reduce the maternal mortality rate to 2 per 1,000 live births by 2007, and to 1 by 2012.
- Increase forest and tree cover to 25% by 2007, and 33% by 2012.
- Ensure that all villages have sustained access to potable drinking water.
- Clean all major polluted rivers by 2007, and other river stretches notified by the government by 2012.

22. The strategy to achieve a high annual growth target of 8.00% combines accelerated capital accumulation to raise the average investment rate from 24.23% to 28.41% with an increase in capital-use efficiency to reduce the ratio of incremental capital to output from 4.00 to about 3.55. Private sector development, infrastructure development, and increased foreign investment and trade are key to increasing efficiency. The strategy for equitable growth gives high priority to employment-intensive sectors such as agriculture, rural development, and services, and promotes balanced regional growth. Agriculture and rural development are critically important to meet the 10th Plan poverty reduction target[2] since 75% of the poor live in rural areas. Finally, to achieve the specific monitorable human development targets listed in Box 1, the 10th Plan programs an increase of almost 80% in social sector expenditure. However, increased public spending for social services is necessary but not sufficient for accelerated social development. The quality of social services delivered also has to be significantly improved. The 10th Plan observes that this can only be accomplished through greater accountability of service providers to their clients, decentralization, and more participatory service management.

[2] Rural poverty is targeted to decline almost 5 percentage points from current levels to 21.1% by the end of the 10th Plan.

Figure 7

Tenth Five-Year Plan Development Strategy



23. The 10th Plan assumes a step-up in the investment rate to 28.41% of GDP. Of this, 1.57% is to be covered by foreign capital inflows, a significant increase from 0.91% observed during the Ninth Five-Year Plan (9th Plan). The public investment rate is set at 8.44%, to be financed by public savings to the tune of only 0.44%. Thus, large preemption of private savings is assumed to continue to finance the bulk of public investment. Even the 0.44% public savings implies a significant turn-around in public savings compared to –2.5% in FY2001. Clearly, achievement of the 10th Plan target will be critically dependent on strong fiscal consolidation, at the Central government level and in the states.

24. Net external capital flows are projected at 1.57% of GDP for the 10th Plan period, as against 0.91% in the 9th Plan, or about $22 billion in FY2006, the terminal year of the 10th Plan. However, the bulk will consist of FDI, portfolio investment, commercial borrowing, and nonresident deposits. Gross official development assistance is estimated to be around $5.1 billion in FY2006. Focusing on the financial flow, however, understates the total development impact of such assistance. India has often emphasized the importance of the transfer of international best practices that are typically embodied in external assistance. ADB, the World Bank, and Japan account for about 90% of gross external assistance, mostly in the form of loans. The balance amount is made up of highly concessional international development assistance (IDA) resources and grant assistance from a large number of bilateral donors and United Nations agencies.

25. The emphasis of the 10th Plan on combining high growth with equitable growth and social development, leveraged by improved governance, is a sound strategy to maximize the poverty-reducing impact of development. The strategy is similar to ADB's poverty reduction strategy, based on pro-poor growth, social development, and good governance. The strategies of the Government and ADB thus fit well together. The 10th Plan's strong emphasis on increased resource allocation for social services and improving their quality is especially commendable, as is the shift away from excessive reliance on agriculture subsidies to investment in irrigation to increase cropping intensity and crop diversification through agribusiness development. Another important feature of the 10th Plan is its recognition that growth and investment will be led by the private sector. The role of Government has accordingly redefined as that of regulator, provider of public services, and creator of an enabling environment for private

sector development. The candid assessment of the poor quality of governance and the emphasis on policy reforms and capacity building in Government is remarkable for an official government document. Although the 8% growth target will be difficult to achieve, the basic strategy of the 10th Plan is sound and merits strong support from India's development partners. Their most important contribution would be to introduce international best practices to strengthen fiscal and other structural reforms highlighted in the 10th Plan.

Special Feature

The Approach To Poverty Reduction In India's Tenth Five-Year Plan

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Introduction

1. The last decade of the 20th century has seen a visible shift in the focus of development planning from the mere expansion of production of goods and services, and the consequent growth of per capita income, to planning for enhancement of human well being. The notion of human well being itself is more broadly conceived to include not only consumption of goods and services in general, but more specifically to ensuring that the basic material requirements of all sections of the population, especially those below the poverty line, are met and that they have access to basic social services such as health and education. This approach is most succinctly captured in the International Development Goals (IDGs) adopted by the United Nations in its Millennium Declaration. In brief, these Goals aim at achieving the following by 2015:

- To cut in half the proportion of people living in extreme poverty, of those that are hungry, and of those who lack access to safe drinking water.
- To achieve universal primary education and gender equality in education
- To achieve a three-fourths decline in maternal mortality and two-thirds decline in mortality among children below the age of 5.
- To halt and reverse the spread of HIV/AIDS and to provide special assistance to AIDS orphans.
- To improve the lives of 100 million slum dwellers.

2. In order to achieve these goals, the development process must be viewed in terms of the efficiency with which it uses an economy's productive capacities, involving both physical and human resources, as means to attain the desired social ends – not just on average, but especially for the deprived. The material attainments of the economy then become the means to the end, rather than an end in itself. It becomes imperative, therefore, to pursue a development strategy that builds on a policy focus on exploiting synergies between economic growth, desirable social attainments and growing opportunities for all.

3. The Tenth Five - Year Plan also reflects this shift in emphasis and recognizes that economic growth cannot be the only objective of national planning, and development objectives need to be defined not just in terms of increases in GDP or per capita income but in more broader terms of enhancement of human well being. Although

the Plan does specify a growth target of 8% per annum, in order to reflect the importance of these dimensions it also identifies specific and monitorable targets for a few key indicators of human development. These targets are not exactly the same as the IDGs, reflecting as they do national imperatives and constraints, they are not entirely dissimilar either. A few of the targets should illustrate the point:

- Reduction of poverty ratio by 5 percentage points by 2007 and by 15 percentage points by 2012.
- All children in school by 2003; and all children to complete 5 years of schooling by 2007.
- Reduction in gender gaps in literacy and wage rates by at least 50% by 2007.
- Reduction in infant mortality rate to 45 per 1000 live births by 2007; and to 28 by 2012.
- Reduction in maternal mortality ratio to 2 per 1000 live births by 2007; and to 1 by 2012.

4. Setting such specific targets, and emphasizing that their attainment is as important as the growth target, is a path-breaking decision. Although such objectives have been mentioned in earlier Plans, in no case were specific targets set. As a result, these were viewed as being desirable, but not essential; which diluted the importance accorded to them.

The Broad Approach to Poverty Reduction

5. It is important to emphasize that the 10th Plan views the social and equity-related objectives as being intimately linked to the growth objective; and that attainment of one may not be possible without the attainment of the others. For example, high rates of growth are essential to provide a sufficient expansion of sustainable employment opportunities to the expanding labor force and to ensure a sufficient increase in incomes of the poor and the disadvantaged. However, the relationship is not just a one-way relationship. It is also true that sustained high growth rates may not be sustainable if they are not accompanied by a dispersion of purchasing power which can provide the demand needed to support the increase in output without having to rely excessively on external markets.

6. Similarly, improvements in the social indicators require, on the one hand, sufficient investments, which can occur only with high growth rates; and are, on the other hand, essential for the productivity

improvement that underlies the growth target. Thus, the growth and social development targets are not only internally consistent, they are also mutually reinforcing.

7. Although growth has strong direct poverty reducing effects, the frictions and rigidities in the Indian economy can make these processes less effective, and the 10th Plan is therefore formulated in a manner, which explicitly addresses the need to ensure equity and social justice. Analytical work carried out in the Planning Commission suggests that the initial conditions in absolute terms are at least as important as growth in explaining changes in poverty. In other words, the same growth rate will yield a lower impact on poverty reduction in poorer states than in the richer. In addition, the composition of growth is important. It has been found that agricultural productivity and public expenditure on social development have stronger poverty reducing effects than other components of growth. Thus, it appears that income poverty and human poverty are not disconnected, and that focus on the latter can indeed lead to improvements in the former as well.

8. Another issue, which needs to be highlighted is that, an excessive focus on poverty reduction, measured in the sense of the proportion of people below the poverty line, may in fact lead to iniquitous results. The objective of planning is to improve the lot of the poorest of the poor, and it is more than likely that the most deprived may not rise above the poverty line within the given time frame. Nevertheless, amelioration of their lot must be a central component of public policy. Therefore, poverty alleviation has just as much a role to play as poverty reduction when the human condition is the objective.

9. These various strands of thought have been integrated into the growth and poverty reduction strategy of the 10th Plan. There are four main components to this strategy:

(i) First, agricultural development is viewed as a core element of the Plan since growth in this sector is likely to lead to the widest spread of benefits especially to the rural poor. The first generation of reforms concentrated on reforms in the industrial economy and reforms in the agricultural sector were neglected. This lacuna is sought to be changed in the 10th Plan.

(ii) Second, the growth strategy of the 10th Plan aims to ensure rapid growth of those sectors which are most likely to create high quality employment opportunities. Particular attention is paid to the policy environment influencing a wide range of sectors which have a large employment potential. These include sectors such as construction, tourism, transport, SSI, modern retailing, IT-enabled services and a range of other new services which need to be promoted through supportive policies.

(iii) Third, to supplement the impact of growth with specific programs aimed at special target groups, which may not benefit sufficiently from the normal growth process. Such programs have long been part of Indian development strategy and they will have to continue in the 10th Plan. However, it is important to ensure that they are effective in achieving their objectives.

(iv) Fourth, reducing inter-regional disparities through greater focus on growth in backward states and regions.

Agriculture and Rural Development

10. The policy approach to agriculture, particularly in the 1990s, has been to secure increased production through subsidies in inputs such as power, water and fertilizer, and by increasing the minimum support price rather than through building new capital assets in irrigation, power and rural infrastructure. This strategy has run into serious difficulties. Deteriorating state finances have meant that subsidies have "crowded-out" public agricultural investment in roads and irrigation and expenditure on technological upgrading. Apart from the inability to create new assets, the lack of resources has eroded expenditure on maintenance of canals and roads. The financial unviability of the State Electricity Boards has made it difficult to expand power supply in uncovered rural areas and contributed to the low quality of rural power. These problems are particularly severe in the poorer states.

11. The equity, efficiency, and sustainability of this approach are questionable. The subsidies have grown in size and are now financially unsustainable. Some of the subsidies, e.g. the fertilizer subsidy, are really subsidies to cover the high cost of the fertilizer industry. Other subsidies, e.g. under-pricing of power and irrigation do not improve income distribution in rural areas and may also be environmentally harmful. Excess use of subsidized fertilizer has created an imbalance between N, P and K, whereas excess use of water has produced water logging in many areas.

12. It is necessary to evolve a new approach to agricultural policy based on a careful assessment of current constraints and possibilities. A sober and careful assessment of resources indicates that both

land and water will be crucial constraints on the efforts to expand production in agriculture. India is already in a situation where the extent of forest cover has declined alarmingly. Although in recent years there has been some improvement, it is a long way from our eventual target. In such a situation there is no possibility of increase in the cultivated area in the country, and indeed perhaps an eventual decline as urban demand and environmental imperatives lead to conversion of some agricultural land. There is therefore no alternative but to focus on raising the productivity of the land and water resources in a manner which is sustainable over the longer term.

13. The first, and possibly the most important, area of focus must be to raise the cropping intensity of existing agricultural land. Climatically India is fortunate in that it is possible to have multiple crops practically all over the country. The critical problem here is water. However, water resources are also under severe strain. Despite large investments in irrigation in the past, only about 40% of the agricultural area is irrigated. The progress on this front has slowed down considerably in recent years, particularly in terms of major and medium irrigation projects.

14. Public investment in irrigation has fallen significantly over successive Plan periods. This is largely due to resource constraints faced by governments both at the Center and the states. However, resources are not the only problem. Potential irrigation projects are located in areas which are either more difficult or environmentally more sensitive, which makes it difficult to implement irrigation projects. The 10th Plan, therefore, aims at a major revival of public investment in irrigation capacity and especially on water management. Greater attention is also paid to rain water harvesting and increasing the irrigation potential through scientific watershed development. There is also considerable scope to improve the efficiency of the existing irrigation infrastructure through better and more participative management practices.

15. The second priority is the development of other rural infrastructure that supports not only agriculture, but all rural economic activities. A number of recent studies have indicated that the rate of growth of rural incomes and reduction in rural poverty are strongly influenced by the provision of rural road connectivity. Other forms of rural infrastructure are also important, but the impact of rural roads in widening the opportunities and alternatives available to the poor has a dominant effect.

16. The third area that needs attention is the development and dissemination of agricultural technologies. Over the years India has developed an extensive system of agricultural research centers and extension services. There is reason to believe, however, that the quality of the agricultural research effort has weakened while the extension system has virtually collapsed. Strengthening of the agricultural research and development system and a significant improvement in the sophistication of the technology dissemination methodologies are essential to achieving rapid and sustained growth in agricultural productivity. A radical overhaul of the extension service is also needed.

17. Finally, the true potential of Indian agriculture can be realized only when there is diversification of agricultural products, both geographically and over time. The food and nutritional requirements of the people for leading healthy lives demands a wider range of food products than are presently consumed on the average. Most of the non-food grain food products are, however, perishable in nature. In order to encourage this diversification through minimization of wastage will require considerable focus on post-harvest technologies and marketing infrastructure. It would also require a reconsideration of the various rules and regulations that govern agricultural trade, which frequently act against the interests of the farmers and distort their incentive structure.

18. Forests are natural assets and provide a variety of benefits to the economy. Recorded forest area is about 23% of the geographical area of the country but 41% is degraded, and hence unable to play an important role in environmental sustainability and in meeting the forest produce needs of the people, industry and other sectors.

19. The problems and constraints in forestry development include lack of awareness about multiple roles and benefits of forests; no linkage between management and livelihood security of the people; low level of technology; inadequate research and extension, weak planning capability, wastage in harvesting and processing, market imperfections, overemphasis on government involvement and control, low level of people’s participation and NGOs involvement, lack of private sector participation, unwanted restrictions on felling transport and marketing of forest produce grown by the people, lack of inter-sectoral coordination and weakness and conflicting roles of public forest administration. These issues are addressed in the 10th Plan.

Policy Issues in Raising Non-Agricultural Growth

20. The 10th Plan focuses on creating a policy environment in which the private sector can become efficient and competitive. The specific policy issues that deserve special attention in the context of development of the non-agricultural sectors are discussed below.

21. The first policy issue relates to the need to extend industrial liberalization, which has been extensively implemented at the Central level, to the state level also. Industry circles frequently complain that the administration of regulation at the state level is extremely cumbersome and subjects entrepreneurs to frequent harassment. The transactions cost imposed by this system, including costs on account of corruption spawned by excessive regulation, are very large. What is more, they are especially burdensome for small-scale units. Radical changes are proposed in these areas.

22. Small scale industry has a vital role to play in the process of industrialization by providing a vehicle for entrepreneurship to flourish. Small-scale industries are also vehicles for achieving a broader regional spread of industry. Since SSIs are generally more employment intensive per unit of capital than large-scale industry they are also a source of much needed employment. Khadi and village industries also have an important role to play, especially in promoting non-farm employment in rural areas. The 10th Plan tries to ensure that policies towards the small-scale sector are supportive. Liberalization of controls at the state level can help in this process.

23. Equally important is the need to ensure that adequate credit is made available to SSI units. A proactive policy encouraging banks to meet the needs of SSI, while maintaining all necessary banking diligence in credit appraisal is very necessary. Procedures for credit approval and disbursement in the public sector banks need to be modernized to ensure quick response. It is also proposed that the Development Finance Institutions (DFIs) should not be wound up, but their operations should be reoriented from financing large projects to providing support to small and medium enterprises.

24. Construction is another area of focus, especially for its role in providing work opportunities to the poor. Historically this sector has not played the role it should have in India for a variety of reasons, and the 10th Plan aims at correcting this position. The potential of this sector is manifested in the poor endowments of infrastructure and housing that exists in the country. Therefore, a central

component of the Plan is in increasing infrastructural investments and providing a policy framework which is conducive to housing development. The main issues in the latter relate to the land-use regulations and municipal functioning, which retard the healthy growth of this activity.

Social Infrastructure

25. Performance in the field of education is one of the most disappointing aspects of India's developmental strategy. Out of approximately 200 million children in the age group 6–14 years, only 120 million are in schools and net attendance at the primary level is only 66% of enrolment. This is completely unacceptable, and the 10th Plan aims at a radical transformation in this situation. Education for all is one of the primary objectives of the 10th Plan. Assertion of the dignity of labor and vocationalization of curricula are essential to ensure that a dysjunction does not take place between the educational system and the work place, and this is sought to be integrated into the educational structure.

26. Mere establishment of schools and hiring of teachers will not lead to an improvement in education if teachers remain absent as happens in many parts of the country, especially in rural areas. It is therefore essential that control over schools and teachers should be transferred to local bodies which have a direct interest in teacher performance. States should be encouraged to implement the 73rd and 74th Amendments of the Constitution, which facilitate the transfer of management of primary and upper primary schools to Panchayats/ local bodies. Planning, supervision and management of education would have to be through local bodies at district, block and village levels. Efforts should also be made for social mobilization of local communities for adult literacy campaigns and for promotion of primary education.

27. Improvement in the health status of the population has been one of the major thrust areas in social development programs of the country. This is to be achieved through improving the access to and utilization of Health, Family Welfare and Nutrition Services with special focus on under-served and under-privileged segments of population. Technological improvements and increased access to health care have resulted in a steep fall in mortality, but the disease burden due to communicable diseases, non-communicable diseases and nutritional problems continues to be high. In spite of the fact that norms for creation of infrastructure and manpower are similar

throughout the country, there remain substantial variations between States and districts within a state in availability and utilization of health care services and health indices of the population.

28. There is a continued commitment to provide essential primary health care, emergency life saving services, services under the National disease control programs and the National Family Welfare program free of cost to individuals based on their needs and not on their ability to pay. At the same time, suitable strategies will have to be evolved, tested and implemented for levying, collecting and utilizing funds obtained for health care services from people above the poverty line.

29. One of the major factors responsible for poor performance in hospitals is the absence of personnel of all categories who are posted there. It is essential that there is appropriate delegation of powers to Panchayati Raj Institutions (PRIs) so that there is local accountability of the public health care providers, and problems relating to poor performance can be sorted out locally.

Reorienting Anti-Poverty Programs

30. As has been mentioned, poverty alleviation is considered to be of continuing relevance at this stage of India's development. There is sufficient empirical evidence that shows that these programs have helped in reducing the depth and severity of poverty in the country, even if they may not have contributed substantially to poverty reduction. Furthermore, the social mobilization that has been engendered by these programs have benefits which cannot be quantified by standard economic measures. It is, however, necessary to reorient the poverty alleviation programs in a manner that they contribute more efficiently to the creation of rural assets, both private and community.

31. The 10th Plan visualizes the wage employment program as a valuable method of not only creating rural infrastructure, but also for converting the excess stock of food grains into an investible resource. Unfortunately, the institutional structures that could undertake this function have eroded over the years, and there is an urgent need to reinvent them along appropriate lines. In particular, the state Public Works and Irrigation Departments need to be revamped in order to provide the institutional mechanism for using local labor for creating local assets.

32. The reorientation of the self-employment program to a group lending format is seen as the most valuable way of not only creating livelihood opportunities, but also for social mobilization, especially of women. Women's self-help groups have proved themselves to be very effective in improving standards of accountability of various public agencies and in bringing about substantial social transformation.

Reducing Inter-regional Disparities

33. The Indian Central Plans have traditionally focused on setting only national targets. However, recent experience suggests that the performance of different states varies considerably, and cognizance has to be taken of this issue. For example, although the economy as a whole has accelerated, the growth rates of different states have diverged and some of the poorest states have actually seen a deceleration in growth. It is important to recognize that the sharp increase in the growth rate that is being contemplated for the 10th Plan is possible only if there is a significant improvement in the growth rates of the slow growing states. Indeed if the higher growth target is sought to be achieved with a continuation of the low growth rates observed in some of the most populous states, it would necessarily imply a very large increase in inter-state inequality with serious consequences for regional balance and national harmony.

34. In order to emphasize the importance of ensuring balanced development for all states, the 10th Plan includes a state-wise breakdown of the broad developmental targets, including targets for growth rates and social development. These state specific targets take into account the potentialities and constraints present in each state and the scope for improvement in performance given these constraints. This has required careful consideration of the sectoral pattern of growth and its regional dispersion, and also focuses attention on the nature of reforms that will have to be implemented at the state level to achieve the growth targets set for the states.

Governance Reforms

35. Successful implementation of development programs requires adequate funds, appropriate policy framework, formulation of suitable Plan schemes, and effective delivery machinery. However, past experience suggests that availability of funds is no panacea for tackling the problems of poverty, backwardness and low human development in India. Funds may be necessary, but they are not a sufficient condition; the determining factor seems to be the capability

of the funding Ministries/State Governments to formulate viable schemes and at the delivery system to implement these schemes on the ground. There are serious deficiencies in both respects and they can be regarded broadly as due to poor governance. These weaknesses can no longer be side-stepped as merely macro-level field problems. They need to be faced squarely and redressed at the planning stage itself. Reform of governance therefore is one of the centerpieces of the 10th Plan.

36. While the functions of the state in India have steadily increased, capacity to deliver has declined over the years due to administrative cynicism, rising indiscipline, and a growing belief widely shared among the political and bureaucratic elite that state is an arena where public office is to be used for private ends. In almost all states people perceive bureaucracy as wooden, disinterested in public welfare, and corrupt. The issue of reform in governance has acquired critical dimensions in poorer states in the light of low economic growth and fiscal crisis. Weak governance, manifesting itself in poor service delivery, excessive regulation, and uncoordinated and wasteful public expenditure, is seen as one of the key factors impinging on growth and development.

37. In the area of civil service reform, the Government faces three critical challenges. It must enhance the productivity of the civil service and make certain that each employee is performing socially relevant tasks. It must ensure the long-term affordability of the civil service, and it must enforce procedures for rewarding and promoting merit, disciplining malfunction and misconduct, to strengthen accountability and performance quality. It has become necessary to reshape the bureaucracy so that it perform its core public functions and develop new ways of ensuring that critical economic and social services are provided directly or indirectly. A new work culture will have to be evolved at all levels of the staff. Innovation and performance should be encouraged and rewarded and steps should be taken to ensure effective devolution and control of the elected bodies over the functionaries.