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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	Q1 FY2005	3,825	8.1
● GDP in Agriculture	Rs. Billion	Q1 FY2005	751	1.9
● GDP in Industry	Rs. Billion	Q1 FY2005	1,064	9.7
● GDP in Services	Rs. Billion	Q1 FY2005	2,011	9.8
Industrial Production – General (1993-94=100)	Index	April- July 2005	212.1	9.3
Industrial Production – Manufacturing (1993-94=100)	Index	April- July 2005	224.3	10.4
Wholesale Price – All Commodities (1993-94=100)	Index	24 September 2005	196.5	4.0
● Primary Articles	Index	24 September 2005	193.3	1.6
● Manufactured Articles	Index	24 September 2005	171.2	2.0
Consumer Price (Industrial Worker) (1982-83=100)	Index	July 2005	538	4.1
Broad Money (M3)	Rs. Billion	30 September 2005	24,693	16.8
RBI's Credit to Commercial Sector	Rs. Billion	7 October 2005	14.00	-26.6
RBI's Credit to General Government	Rs. Billion	7 October 2005	-254	-234.2
Consolidated Fiscal Deficit / GDP	Per cent	FY2004	7.9	-
Domestic Public Debt	Rs. Billion	FY2003	21,252	13.6
Exports	$ Billion	Q1 FY 2005	21.8	22.0
Imports	$ Billion	Q1 FY 2005	37.6	63.2
Trade Balance / GDP	$ Billion	Q1 FY 2005	-.15.8	-
Current Account Balance / GDP	$ Billion	Q1 FY 2005	-6.2	-
International Reserves	$ Billion	16 September 2005	138	22.1
External Debt	$ Billion	31 March 2005	123.3	10.4
External Debt to GDP Ratio	Per cent	31 March 2005	17.8	-
Debt Service Ratio	Per cent	end-March 2004	18.3	-
Foreign Exchange Rate, Spot	(Rs./$)	23 September 2005	43.93	-4.6
Nominal Effective Exchange Rate (1985 =100)	Index	January-March 2005	35.8	0.8
Real Effective Exchange Rate (1985=100)	Index	January-March 2005	78.0	5.9

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

Contents

1. Growth Performance

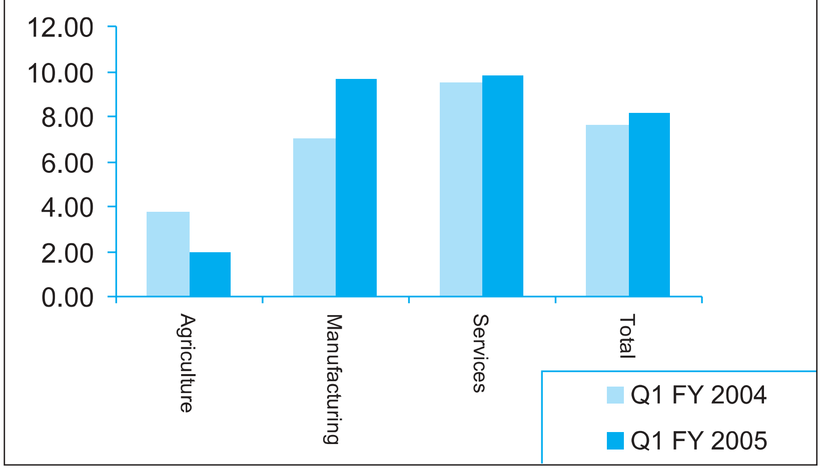
Strong growth momentum continues

1. Robust growth momentum continues in FY 2005. After growing by 6.9% in FY 2004, gross domestic product (GDP) grew by 8.1% in the first quarter of FY 2005. Both manufacturing and services registered higher growth when compared with the growth rates in the first quarter of FY 2004 (figure 1). However, agricultural growth declined from 4% to only 2%.

Agriculture performance remains subdued

2. Performance of agriculture remains a cause for concern, especially keeping in view that two-thirds of India's population still depends on this sector for their livelihood. Agricultural yield has been declining, and improving the performance of this sector appears to be the most difficult challenge of the present Government. Several new initiatives are being proposed. One such initiative, proposed by the Prime Minister, is identification of regions and crops in which a breakthrough could be achieved, and putting in place institutional and organizational changes required to facilitate this. He also proposed that agriculture must shift the focus from the traditional grain-based strategy towards diversi-

Figure 1: First Quarter (FY 2005) Growth Rates



fication, more specifically towards horticulture, poultry and livestock to keep pace with changing consumer preferences and to provide higher returns to farmers.

3. Two important areas that need immediate attention are: (i) reversal of the declining trend in investment in agriculture – public as well as private; and (ii) reorientation of agricultural marketing system. To overcome these two constraints, it has been suggested by the Prime Minister to pool the resources under the Bharat Nirman scheme for rural infrastructure and the National Rural Employment Guarantee Scheme with the resources of the Ministry of Agriculture and Water Resources to add substantially to the asset base of agriculture. Amendment of the Agriculture Produce Marketing Committee Act to allow for contract and free marketing, organized retailing, and competitive trading is likely to be an important step towards reforming the entire gamut of agricultural marketing.

Manufacturing growth remains strong

4. Robust growth in manufacturing is corroborated by the continued high growth in industrial output in the first four months of FY2005 with the cumulative growth in the general index of industrial production (IIP) during April-July 2005 (over the corresponding period for 2004) being 9.3%. Manufacturing also recorded double digit growth rates of 10.4%. The buoyancy in industrial production is also exhibited by a rise in business confidence. The NCAER business confidence index is at its highest level since December 1995.

Encouraging growth in the capital goods sector

5. As per use-based classification, growth in April-July 2005 was the highest for consumer goods at 16.9%, followed by capital goods at 13.6% (consumer durables and consumer non-durables recorded growth of 13.9% and 18.0% respectively), basic goods at 6.7% and finally intermediate goods at 2.9%. The double-digit growth in capital and consumer goods signifies increase in investment activity and rising consumer demand. 14 of the 17 two-digit industry groups have shown positive growth during April-July 2005 as compared to the corresponding period of the previous year, with 7 groups exhibiting double digit growth, as shown in table 1 below. It is expected that leather production would maintain its growth momentum. This expectation stems from the Rs16 billion investment that the Government (Rs3 billion capital subsidy for plant and machinery) and industry are planning to make, along with the reduced competition from the People's Republic of China (PRC) due to

Table 1: Sectoral Performance: Manufacturing (% growth)

Increasing Output				Declining Output			
Sector	2003-04	2004-05	2005-06@	Sector	2003-04	2004-05	2005-06@
Textile Products	-3.8	19.2	25.5	Man-made Fibers etc.	6.2	3.6	-1.1
Jute and Mesta	-4.2	3.7	1.6	Wood & Wood Products	6.8	-8.4	-0.9
Machinery (except Transport Equipment)	15.2	19.7	10.9				
Basic Metal	9.1	5.4	15.3				
Leather Manufactures	-4.3	6.9	7.9				
Transport Equipments	17.0	4.0	10.9				
Chemicals & Allied Products	8.2	14.4	14.1				
Other Industries	6.5	17.8	15.9				
Paper & Paper Products	15.9	9.8	7.3				
Food Products	-0.2	-0.7	7.1				
Cotton Textiles	-3.3	7.4	9.9				
Non-metallic Mineral Products	3.7	1.5	4.3				
Beverage, Tobacco etc.	9.4	10.8	17.7				
Rubber, Plastic etc.	4.5	2.4	3.9				
Overall Manufacturing	7.2	9.0	10.4				

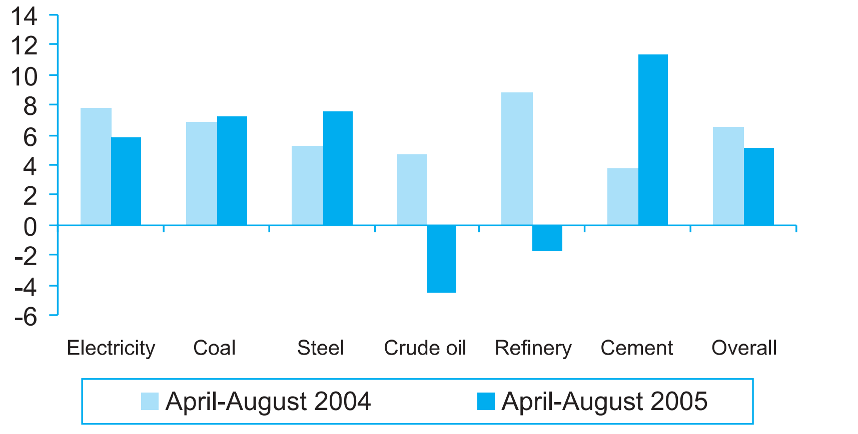
Note: @ April-July 2005-06
Source: Compiled from www.mospi.nic.in./stat pr.htm

a rise in the wage level as well as exchange rate appreciation. The food products sector recorded a turn around. This sector has grown at 7.1% during April- July 2005 after negative growth rates in the past two years.

Upturn in the infrastructure sector

6. Infrastructure sector registered an upturn in August with 5.7% growth, as against only 1.8% in July 2005 despite a sharp decline in production of crude oil, and petroleum refinery products. Six infrastructure industries together grew by 5.1% during April-August, as against 6.5% growth during the same period last year (figure 2).

Figure 2: Core Sector Growth (%)



II. Inflation, Money and Financial Market Developments

Inflation relatively low but high inflationary threat persists

7. The first quarter of FY 2005 began with a high Wholesale Price Index (WPI) based overall inflation rate of 5.9% in April 2005, followed by 5.5% in May. Inflation, however, fell to 4.3% in June 2005, and further declined to only 3.2% by the first week of September. Inflation rose thereafter and finally settled at 4% by the last week of September. The fuel group inflation registered a sharp rise of 11.7%. Prices of petroleum products were revised in June and again in September to accommodate rising international prices. This is likely to impact inflation adversely in the coming months as higher prices of petroleum products will lead to higher input costs.

8. Two issues are very important in the context of pricing of oil products in India. First, the pricing mechanism is not consistently applied because the market is overwhelmingly dominated by state-owned Oil Marketing Companies (OMCs). In the absence of competition among various companies, market-determined prices became synonymous with import-parity prices. Even the import-parity pricing system for petrol and diesel could not be applied with continued hike in crude prices. Although the OMCs were granted freedom to fix retail selling prices of petrol and diesel on a fortnightly basis, in view of the political sensitivity, price revisions always lag increases in international prices by several months.

High tax incidence in petroleum products

9. Second, taxation of domestic consumption of petroleum products is an important source of revenue both for the Federal Government and State Governments. Consequently, the incidence of tax in domestic prices of petroleum products is quite high with a substantial component of this comprising sales tax levies by the States. For example, the share of excise and sales tax in the retail sales price (RSP) of petrol and diesel is 53% and 28% respectively in Delhi. Thus, there is scope for reduction in the price of petroleum products, provided the Government is willing to accept lower revenues.

High money supply growth led by bank credit

10. The annual growth in money supply was 16.8% as of 30 September 2005 (figure 3). There is a discernible change in the sources of the rise in money supply. Bank credit to the commercial sector emerged as the main engine of growth as against foreign exchange asset with the banks in the previous year. Credit to industry, housing and real estate continues to record impressive growth.

11. Recent data show that credit growth also picked up for metal and metal products, engineering, power and roads and ports. As a result, investment on government securities declined. Despite this, the statutory liquidity ratio of commercial banks at 37.4% of net demand and time liabilities in early August 2005 remained higher than the stipulated level of 25%. However, high non-food credit growth may not be sustainable for two reasons. First, high oil prices may dampen industrial activity. Secondly, infrastructure industries may not keep pace with the growth in manufacturing industries.

Protracted upward movement in equity market index

12. The secondary equity markets rallied strongly during September 2005. Both BSE's Sensex and NSE's Nifty reached an all time high of 8487 points and 2567 points respectively (figure 4). This is partly attributed to the strong investments by foreign institutional investors (FIIs). However, the secondary equity market has witnessed some volatility recently. The protracted upward movement of secondary equity market indices has prompted RBI to advice banks to track the end use of loans taken by companies

Figure 3: Sources of Money Supply

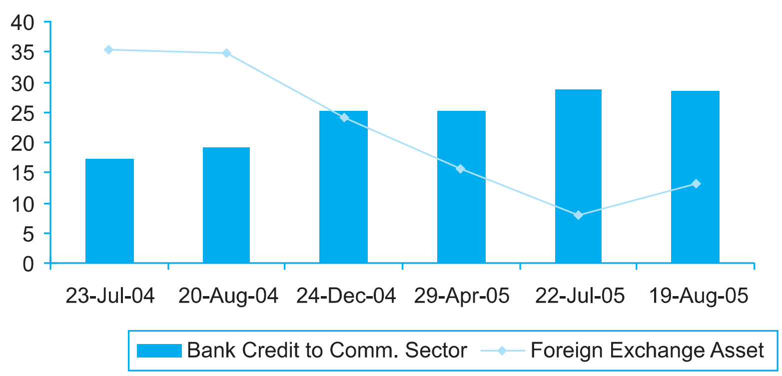
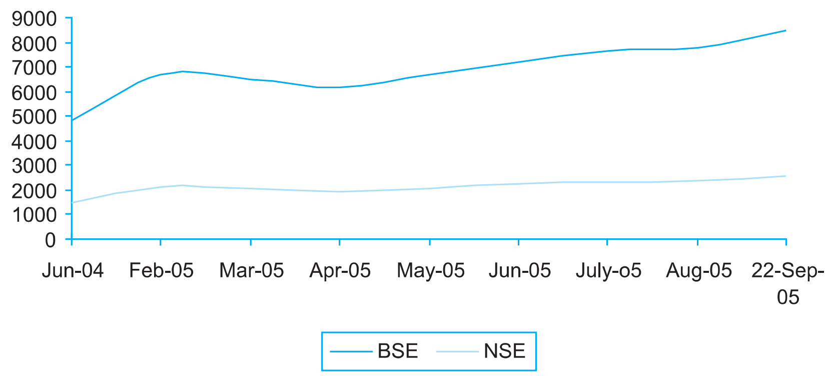


Figure 4: BSE and NSE Equity Markets Index



III. Fiscal Developments

Fiscal situation under control

13. The first quarter of the current financial year was characterized by an increase in tax buoyancy (except in Union Excise Duties), moderation in pace of expenditure and consequent moderation in the deficit levels.

14. Tax revenue of the federal Government, net of States' share, increased by 25.5% during April-July 2005 as against a 20.1% increase in the corresponding period last year. Non-tax revenue registered a 4% rise during the same period. This growth was in line with the 3.5% increase envisaged in the budget.

15. During April-July 2005, total expenditure of the federal government rose by 10.4% as compared with a 4.1% increase recorded in the same period of 2004. Revenue expenditure increased by 19.3% while capital expenditure declined by 41%. The decline in capital expenditure was primarily attributed to a sharp drop in loans and advances following the acceptance of the recommendations of the Twelfth Finance Commission (TFC). TFC has recommended that the plan size of each

State needs to take into account the sustainable level of debt and the capacity to borrow in the market. It has been proposed that the system of imposing a 70:30 ratio between loans and grants for extending plan assistance to non special category States (10:90 for special category States) should be abolished. The federal Government should only extend pure grants to the States, and leave it to the States to decide how much they wish to borrow.

Some stress on revenue front

16. On the revenue front, however, the federal Government will feel some stress in the coming months. Increase in the international prices of petroleum products and consequent losses incurred by the Oil Marketing Companies (OMCs) can affect adversely both tax and non-tax revenues of the Federal Government. OMCs are not in a position to pay any dividend this year. This will affect the federal Government's non-tax revenue. Moreover, this will also affect tax payments by OMCs. Besides, these challenges, finding resources for funding the employment guarantee programs and neutralizing the decline in non-debt receipts due to debt relief to States under the award of the 12th Finance Commission will pose additional burden on the finances of the federal Government.

IV. Balance of Payments

Trade deficit and current account deficit widen

17. First quarter balance of payments data are now available for FY2005. Exports grew by 22% over the first quarter of FY 2004. However, imports registered a massive growth rate of 63.2% leading to a trade deficit of $15.8 billion. Oil imports rose by 31% and are equivalent to 30% of total imports (figure 5).

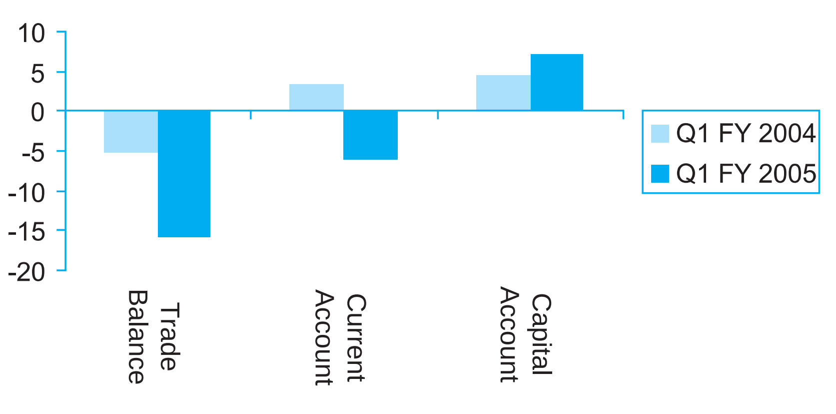
18. The merchandise trade deficit of $15.8 billion was significantly offset by robust inflows from invisibles, which included earnings from services such as software exports and transfers from non-resident

Indians. Despite this, current account recorded a deficit of $6.2 billion as against a surplus of $3.4 billion in the first quarter of FY 2004.

19. On the capital account, the country received a net capital inflow of $7 billion during the first quarter of FY 2005. The surplus on the capital account is mainly on account of foreign investment ($$1.9 billion), commercial borrowing (($0.9 billion), banking capital ($1.2 billion), and other capital ($3.2 billion). Net foreign direct investment was $1.1 billion.

20. The recently published World Investment Report shows a strong growth in FDI inflows to developing countries. Inflows to developing countries surged by 40%, to $233 billion in 2004. This is attributed to many factors including (i) intense competitive pressures in many industries leading to firms exploring new ways of improving their competitiveness; (ii) higher prices for many commodities further stimulating FDI to countries that are rich in natural resources; and (iii) an upturn in cross-border merger and acquisition activity.

Figure 5: Balance of Payments ($ Billion)



21. Asia and Oceania were the top destinations of FDI flows to developing regions. They attracted $148 billion of FDI in 2004, of which India's share is only 4.7% ($7 billion). IMF in its report on Global Financial Stability says that FDI has been hindered in India by a difficult investment climate as well as by caps on FDI in certain sectors. Moreover, the growing inadequacy of India's infrastructure constitutes a major obstacle to private investment.

Special Feature

Mid Term Appraisal of the Tenth Five Year Plan*

* This section is based on a background note prepared by Dr. Pronab Sen, Advisor, Planning Commission.

Mid Term Appraisal of the Tenth Five Year Plan

1. The Tenth Five Year Plan, covering the period from 2002 to 2007, was formally approved and adopted in December 2002. Nearly two and a half years have passed since then, and an assessment was made on the degree of success that has been achieved in meeting the objectives of the Plan, the changes that are necessitated by the prevailing economic scenario and the tasks that lie ahead. The Mid Term Appraisal of the Tenth Five Year Plan (MTA) has been prepared by the Planning Commission and has been broadly accepted by the National Development Council (NDC). This note will briefly summarize the findings of MTA.

Growth Performance

2. The Tenth Plan established an ambitious target of 8.1% growth, based mainly upon the large excess capacities that existed in a number of sectors, especially in manufacturing. Consequently, the investment requirement for the Plan (28.4% of GDP) was significantly lower than what would have been required on a trend basis (33% of GDP). The strategy adopted was that enhanced public investment, especially in infrastructure, would lead industrial recovery in the first two years of the Plan, with private investments taking over as the growth driver once capacity utilization had improved sufficiently and the investment climate was made more congenial. Even with optimistic projections about the next two years, the average growth during the Tenth Plan period is not likely to cross the 7% mark. The cause of this shortfall is lower than anticipated growth of agriculture. Moreover, inadequate public investment during the first three years of the Plan, and slow growth in private investment are also responsible for not achieving the targeted growth rate. The Indian economy has simply not been able to productively absorb the available investible resources.

Agriculture and Related Sectors

3. More disturbing than missing the growth target is the deteriorating performance of the agriculture sector. Trend growth rate in agriculture is unlikely to exceed 1.5% during the first three years of the Plan. The periodic failure of the monsoons in the last few years is certainly a contributory factor, but it should not obscure the fact that there has been a loss in momentum in the agricultural sector, especially in efforts at drought-proofing. One of the most telling findings of the MTA is that despite inadequate investment in agriculture, there has been an emergence of excess capacities in this sector since 1997-98. The MTA, therefore, argues that there is a need to shift focus away from an 'investment only' approach to addressing a wider set of constraints.

4. Availability and management of water is the most important constraint on agricultural productivity and this area has been neglected because of paucity of resources especially with the State Governments, and also a diffusion of responsibility over several different departments in the Central Government. The priorities laid down in the MTA are:

- Rehabilitation of the existing irrigation systems;
- Ground water development in areas where there is unutilized potential through back-ended subsidy schemes;
- Artificial recharge of ground water in areas suffering from aquifer depletion; and
- Inclusion of command area development works as part of major/medium projects.

5. The policy of severely under-pricing water from canal systems has two well known adverse effects. It encourages excessive water use, especially in upstream areas, often leading to water logging and salinity, which damages soil productivity. It also weakens the finances of irrigation departments which are unable to maintain existing systems and to complete ongoing projects. Water pricing is a sensitive issue but to leave it unattended for this reason will only perpetuate present problems. The following policy correctives have been suggested:

i) States should be encouraged to set up Water Regulators for periodically revising water tariffs as is being done by Maharashtra and Gujarat. Water regulators could set differential water tariffs for high water consuming crops, linked with ground water status, and also recommend a lower scale of subsidy on power tariffs for agriculture in water depleted areas to discourage excessive withdrawal of ground water.

ii) The States could also set up Water Users' Associations (WUAs) to manage distribution of water and also empower them to collect the tariff, and retain a part of it for system maintenance.

6. More than half of India's cultivable area is rain-fed and much of it is under severe water stress. Programmes for the treatment of wastelands and degraded lands, including steps at water conservation are extremely important for these areas. At present, these programs are being implemented by several departments, with similar objectives but different operational guidelines and, also different cost norms, which is not conducive to operational efficiency. The present system needs to be reviewed so that all watershed projects in a particular agro-climatic zone are implemented by a single department/agency within a common framework.

7. Agricultural diversification needs to be supported by the evolution of market institutions which are different from those needed for non-perishable cereal crops. It requires a much stronger linkage of the farmer (and therefore his production decisions) with the buyer who can reflect the specific needs of the market, which vary greatly depending on whether the product is destined for domestic retail or for exports or as an input into agro-processing industry. Contract farming will enable corporate buyers to organize groups of farmers to produce under contract, with the buyer organizing the supply of seeds and related inputs, and also providing a measure of extension support. Contract farming needs to be supported by changes in the Agricultural Produce Marketing Committee Acts in the States, which require that agricultural produce can only be bought in regulated markets. There is resistance to bringing about these changes because of entrenched interests that control existing *mandis* and their associated funds, but the changes must be made in the interest of the farmer.

8. Agricultural growth cannot be revived without rejuvenating support systems in extension, credit and the delivery systems of inputs such as seeds, fertilizers, veterinary services. Delivery systems regarding seeds, fertilizers and pesticides require revamping by strengthening not only the existing public infrastructure but also facilitating the growth of private alternatives. The regulatory framework for these inputs also needs to be strengthened urgently to avoid the sale of spurious material without putting too great a constraint on enterprise. It should be recognized, further, that success in this area depends critically upon the development of essential infrastructure in rural areas including especially development of transport linkages, rural electrification and, in the case of exports, suitable handling facilities at airports.

Social Development

9. Equally worrisome is the fact that the social sector targets are also not likely to be achieved. Social sector indicators in education and health show that while there is progress over time, India is lagging far behind the East Asian countries in these areas, not only compared to the levels in these countries today, but even in comparison with the levels achieved by these countries twenty-five years ago, when they first began to grow rapidly. The social indicators also show disturbing gender gaps, large rural-urban differences and wide variation across States. A basic shift in priorities signaled by the National Common Minimum Programme (NCMP) of the present Government was the need to give greater importance to social sector expenditures as part of the effort to promote development with social justice. The Tenth Plan specifies monitorable targets for certain indicators of social development in health, education and gender equality. These targets are not identical to the Millennium Development Goals (MDGs), but it is believed that if these targets are met, then the other MDGs are also likely to be achieved. The main challenge lies in the institutional structures through which public intervention in these areas operates.

10. Although the Sarva Shiksha Abhiyan (SSA) has picked up momentum in the current year, the target of achieving hundred per cent enrolment is likely to slip by at least two years. However, there are other dimensions such as teaching quality and teacher absenteeism which remain areas of concern. Subsequently, even greater attention will have to be paid to ensure that drop outs do not take place in the primary schools. The Mid-day Meal Scheme, which is the main intervention for improving retention, has been universalized and it is imperative that the institutional mechanism for implementing it effectively across the country is put in place as soon as possible. In particular, there is need to place special emphasis on the education of the girl child. Greater involvement of local communities and Panchayati Raj Institutions, and also NGOs will help address the problems of both poor teaching quality and teacher absenteeism. Close monitoring and evaluation is necessary to provide feedback designed to improve the functioning of the scheme. Extension of the SSA Mission up to class X, or setting up a new Mission for secondary education on the lines of the SSA is needed for a major expansion of secondary education. Since the private sector has a substantial share in secondary schools at present, the proposed expansion in secondary schooling will have to recognize the scope for promoting public private partnership in this sector.

11. The state of university education needs a comprehensive review. There are deep seated problems of poor and varying standards, inadequate facilities, outdated syllabi and rigid recruitment and promotion procedures which provide little incentive to teachers to remain abreast of the subject, or to the best students to choose academic life as a career. An issue which needs to be addressed urgently relates to the fees structure. Fees in the majority of universities and colleges are currently pitched at unsustainably low levels and more than half the number of students coming to this level actually pay lower fees than they did in private secondary schools. An increase in university fees should be combined with aggressive means based scholarship and loan programs by public sector banks.

12. On the health front, matters are even worse. The pace of progress in improving health indicators is painfully slow, and the rural to urban divide and the gender gap do not appear to be reducing in any significant manner. The infant mortality rate is reducing very slowly, and in some States it is worse than even in sub-Saharan Africa. The maternal mortality rate has shown virtually no movement in the past decade or more. India's consolidated public expenditure on health has been declining and is currently around 0.9% of GDP. It will need to be increased to around 2% of GDP by the end of the 11th Plan.

13. The National Rural Health Mission, being launched in 2005 is a new major initiative seeking to restructure the health delivery system in rural areas by integrating the different disease control programs and creating a single district health committee which would work on a pooled budget for central funds and co-ordinate these different activities while also seeking active involvement of Panchayati Raj Institutions (PRIs). The initiative is being supported by an enhanced level of funding in 2005-06 but further large increases (around 30% per year) will be needed in subsequent years to achieve the stated objectives.

14. It is well recognized that safe drinking water and sanitation are two critical "non-health" determinants of the health status of a population. Although 95% of rural habitations have been fully covered with potable drinking water facilities by March 2004, access to sanitation remains extremely inadequate. Even today, nearly 70% people across the country have no option other than open air defecation, and this directly contributes to high incidence of water borne and parasitic diseases. Accordingly, sanitation facilities need to be provided to all dwelling units. This would be best pursued in mission mode through a National Sanitation Mission and could be dovetailed with the four year, six point agenda introduced as Bharat Nirman in the Budget 2005. Such an intervention will require sensitivity to local conditions and cannot be effectively carried out without the full and enthusiastic involvement of the States from the design stage itself.

15. The issue of gender bias goes beyond merely the education and health attainments. The Union Budget for 2005-06 has initiated the first step in gender budgeting by incorporating a separate statement highlighting gender sensitivities of budgetary allocations under 10 Demands for Grants of Ministries/Departments. However, gender budgeting by itself will not ensure that the stated outlays for women translate into outcomes in terms of a reduction in gender gaps in education and literacy, health, employment, etc. There is a need to improve the quality of implementation and enhance the efficiency and accountability of the delivery mechanism in all women-specific and women-related programs.

16. The MTA commitment to universalize the Integrated Child Development Scheme (ICDS) requires the scheme to be restructured to include provision of day care/crèche facilities and pre-school education. Day-care support services are an essential requirement for working mothers. To ensure nutrition for children during their critical development from 6 months to 2 years, they need to be fed frequently, and with appropriate care, several times during the day. The ICDS program does not provide this critical component of day-care for working mothers. Its absence has an indirect impact on the education of the girl child, since they are often made to stay back to take care of younger siblings. The 93rd Constitutional amendment in effect accorded elementary education the status of a fundamental right, but left out pre-school education. The exclusion of the latter deprives children in the age group 3 to 5 years of pre-school education, contributing to greater school dropout rates and other problems for them later on. District-level strategies need to be designed for the pre-school education of children.

Infrastructure Development: Power

17. MTA clearly recognizes that infrastructure is a major weak spot and if corrective steps are not taken, will prevent the economy from transiting to higher rates of growth. Despite several steps at reform over the years, the situation in the power sector is worrisome, primarily because of the following reasons: (i) internationally uncompetitive and poor quality of power; (ii) more than 40% aggregate technical and commercial losses; (iii) financially sick State Electricity Boards (SEBs); (iv) 56% of households are not electrified; (v) growing share of CPSUs relative to state sector and private sector with a guaranteed post tax return leading to a non-competitive and unsustainable structure; and (vi) very low pace of reforms in the distribution segment.

18. The Accelerated Power Development and Reform Program (APDRP) is aimed at supporting distribution reforms in the States through investments and incentives to achieve the desired outcomes. Two issues are worth mentioning in this context. First, the total investment in APDRP projects over three years has only been Rs58 billion. Thus, despite recognizing the critical importance of the distribution sector to the efficiency of the power sector, actual investments in the distribution sector remain low. Second, the actual investment is in fact well below the total funding made available for APDRP projects. Privatization of distribution could be a potential answer to tackling the issue relating to distribution reforms and distribution losses. However, recent experiences in some States clearly reveal that this may not be a guaranteed solution. Therefore, a review of APDRP is essential.

19. The power sector in India is internationally uncompetitive. The Electricity Act 2003 intended to provide the basic framework for encouraging reforms and introducing competition in this sector. This is an extremely important document since it will establish the basic framework within which investors will work. The Act requires that the Government of India (GOI) issue a tariff policy. The Act requires open access to be introduced for all users of 1 MW and above, no later than January 2009, for which purpose the State Electricity Regulatory Commissions (SERs) have to issue regulations by June 2005. The Electricity Act also provides that electricity supply (generation, transmission and distribution) is completely delicensed for notified rural areas. States need to urgently notify rural areas where this could lead to the emergence of independent rural suppliers of electricity. However, the required consensus around these policies and implementing regulations is still weak.

Infrastructure Development: Railways and Roads

20. Improvement in the quality of transport infrastructure is an essential pre-requisite for high economic growth. The Tenth Five-Year Plan, therefore, seeks to ensure the growth of the transport sector in a manner that all regions of the country can participate in the process of economic development, paying special attention to integrating remote regions into the economic mainstream. Other focus areas are: augmenting the capacity, quality and productivity of the transport infrastructure and services through technology upgradation and modernization; overcoming the problem of resource constraints through higher generation of internal resources and increased participation by the private sector; improving overall economic efficiency by bringing in competition into the sector; higher emphasis on safety, energy efficiency, environmental conservation and social impact; and developing an optimal inter-modal mix.

21. The achievements in the transport sector are mixed in the first three years of the Tenth Plan. The growth of rail and port traffic, for example, indicate that the Plan targets are likely to be achieved or even exceeded in some cases. The railways have recorded some improvement in financial performance, but the generation of internal and extra budgetary resources (IEBR) is not in line with the Plan targets. In the case of the roads sector, the four-laning and six-laning of the Golden Quadrilateral (GQ) is behind schedule, but work relating to strengthening of weak pavements and improving the good quality of roads is ahead of target.

22. MTA has also highlighted major issues for the transport sector. For example, the issues for railways include: (i) increased share in freight traffic; (ii) an investment strategy; (iii) rebalancing of tariffs; (iv) technology upgradation and modernization; (v) safety; (vi) organizational restructuring; and (vii) resource generation through non-conventional sources.

23. It was recognized in MTA that funds have been the main constraint in implementing the National Highway Development Program (NHDP). Thus, working out Public-Private Partnership (PPP) arrangements to the maximum extent possible is inevitable for augmenting resources and for improving efficiency in implementation of projects.

24. The National Highway Authority of India (NHAI) is responsible for implementing the various phases of NHDP. This is a large task entailing management of an enormous portfolio of projects, some of which are in the form of construction contracts and others in the form of BOT projects. Capacity constraints at NHAI also emerged as a serious bottleneck. Therefore, it is proposed in MTA that NHAI needs to be restructured by inducting multi-disciplinary skills into the organization and enabling it to access specialized skills when needed. The NHAI Board should also be restructured with induction of professional expertise at the Board level.

25. Unlike NHDP, the rural roads initiative of the Prime Minister (PMGSY) has not taken off as per expectations. The mismatch between the target date of completion and the availability of funds remains unresolved, which is undermining the viability of the scheme. The federal Government is considering widening of funding sources and leveraging of funds. On their part, the States need to address the issues relating to capacity development at the State level, maintenance funding, management and integration of rural roads with higher category roads. An appropriate role for district (panchayats) in the management of rural roads also needs to be developed.

Infrastructure Development: Urban

26. The poor quality of urban infrastructure in the major cities has been increasingly recognized in recent years. Urban infrastructure problems are likely to intensify as cities expand and the urban population grows. Besides, in an environment in which States are increasingly interested in attracting foreign direct investment, quality of urban infrastructure will be a key factor in influencing investment decision.

27. The Tenth Plan had laid stress on improving the functional and financial autonomy of urban local bodies (ULBs), strengthening of their finances through smooth implementation of State Finance Commissions (SFC) awards, rationalization of the property taxation system, and levy of user charges. The Plan advocated broad-based urban sector reform measures and emphasized that PPP should be brought on the urban agenda in order to improve the efficiency and delivery of services. Although some states have made earnest efforts in this regard, the progress in these thrust areas is below expectations.

28. The principal reason for the low quality of urban services is that the ULBs are not financially viable. They cannot maintain the quality of services without large subsidies. Their inability to impose reasonable user-charges, itself a reflection of political constraints, is the major obstacle to their becoming financially viable.

29. A key assumption in designing the urban reforms is that the urban infrastructure should be financially self sustaining, subject to the provision of a reasonable amount of viability gap funding. The MTA proposes a new Urban Renewal Mission, which takes the basic approach that States willing to undertake urban sector reforms will be provided with assistance that would help finance critical urban infrastructure. The key characteristics of the proposed Urban Renewal Mission include among other things:

- The funding pattern would be 35:15:50 (between Federal, States/ULBs and financial institutions) for mega cities (population more than 4 million), 50:20:30 for cities with million plus but less than four million population and 80:10:10 for other cities.
- The grant assistance (both Federal and States) would act as seed money to leverage additional resources from financial institutions/capital market. In addition, various PPP models with viability gap funding would also be explored to further supplement the resources. The scheme would be implemented through a designated State level nodal agency.
- The menu of urban reforms will include both mandatory and optional items of reforms.

Labor and Employment

30. The shortfall in the growth target, especially on account of agriculture sector's performance, has wide ranging implications for other important economic variables as well. It is well known that growth of employment and poverty reduction are both intimately linked to growth performance, especially in agriculture. The MTA projections, using sectoral growth rates and estimated employment elasticities, suggest that the unemployment rate for the economy as a whole, based on the current daily status of employment would have increased from 8.87% in the base year 2001-02 to 9.11% in 2004-05. The data on employment in the organized sector presents an even more disturbing picture showing a decline in absolute employment between 2001 and 2003 in both the public sector and the private sectors. This suggests that while employment may be increasing in the unorganized sector in response to growth, there is actually a contraction in employment in the organized sector, which is the preferred sector for employment by new entrants to the labour force.

31. For this purpose, the NCMP and the MTA propose to launch the National Rural Employment Guarantee Program. The objective of this program is to ensure that at least 100 days of manual employment is provided to each rural poor family. This will provide a measure of support at the low end of the employment spectrum i.e. casual manual labour in rural areas, but it cannot address the problems of the educated unemployed who are typically looking for employment of a higher quality.

32. Despite lack of jobs, there is evidence that the educational system is not generating a sufficient supply of trained people, especially those trained in skills that are in demand. Thus, industrial Training Institutes (ITIs), which are under the State Governments, require extensive upgradation and modernization of the syllabus to cover trades with contemporary relevance of which there are a large number. A beginning has been made with the proposal to upgrade 100 ITIs, but much more experimentation is needed, with a larger role for public private partnership.

33. It is a common complaint that Indian labor laws are less flexible than in other developing countries with whom India has to compete, and this impedes the ability to exploit the full potential for tapping into the global market for labour intensive manufactured products. The National Common Minimum Programme rules out automatic hire and fire but it acknowledges that the need for changes in labor laws needs to be discussed. The Report of the Second Labour Commission which has made a number of suggestions would provide additional flexibility while also protecting interests can provide the starting point for such a dialogue.

Governance

34. The MTA recognizes that many intended interventions will not be successful without appropriate decentralization, and that there is a need to empower Panchayati Raj Institutions

(PRIs) in consonance with the spirit of the Constitutional provisions by transferring functions, financial resources and administrative staff. Since a large volume of resources is transferred for implementing the Centrally Sponsored Schemes (CSS), which typically deal with subjects that should be handled at the local level, State Governments need to transfer financial resources and also equip PRIs with administrative support to fulfill the objectives of the CSSs. To encourage a greater role for PRIs, consideration should be given to introducing a linkage whereby releases under CSSs are made to the States only if the States transfer functions, functionaries and financial resources to the PRIs. This could be done at least in the case of the CSSs that fall within the ambit of the Eleventh Schedule of the Constitution which lists functions assigned to PRIs.

Resource Constraints

35. The availability of resources in the public sector to meet targeted levels of Plan expenditure is a major area of weakness. Neither the federal Government nor the States have been able to mobilize the resources needed to keep outlays in line with Tenth Plan projections and this has led to significant under funding in many sectors. The Central Sector Plan was projected to be 6.4% of GDP in the Tenth Plan against which the achievement in the first four years is only 5.4%. The States plan was expected to be 4.69% of GDP against which the likely achievement in the first four years will not exceed 3.64%. Taking the federal Government and the States together, Plan outlays will be lower than expected by 2 percentage points of GDP. This shortfall is despite the fact that both the Federal Government and the States have relied much more on borrowed resources than was intended, leading to a rise in public debt. The consolidated public debt of the Federal Government and States taken together is about 80% of GDP, which is among the highest in emerging market economies.

36. There is one specific dimension in which the economic environment has changed significantly and which will affect the way that the development strategy is implemented in the future. First, the Fiscal Responsibility and Budget Management (FRBM) Act has been passed by the Federal Government, which mandates a reduction of the revenue deficit to zero by 2008-09. This has consequences on the Federal Government's ability to support State expenditures. Second, the Report of the Twelfth Finance Commission, which has been accepted by the Central government, has brought about a major alteration in Federal-State economic relations and the manner in which States will have to manage their affairs by recommending *inter alia* a debt-relief package contingent on passage of FRBM-type legislation combined with a complete cessation of central government lending to States. There are apprehensions regarding the impact of these changes on the finances of state Governments, but it is expected that in the long run it will increase the flexibility of state Governments and lead to more healthy relationship between the federal Government and the States.

37. These constraints on fiscal activity have implications which need to be noted. Meeting the objectives of the Plan will involve substantial public expenditure in social sectors and in rural infrastructure. These resources will not become available unless the growth rate of the economy is stepped up further and maintained at a high level. Since the Government's priorities and expenditure patterns will have to gradually shift towards social and rural infrastructure, such growth will not take place without substantial increase in private investment, not only in commercial activities but also in areas where it had limited involvement in the past, such as physical infrastructure.

38. The special purpose vehicle (SPV) for financing infrastructure announced in the Budget for 2005-06 needs to be operationalized at the earliest. This can provide valuable support for potentially viable infrastructure projects which may not be financed if left entirely to market sources. States must take the lead in developing infrastructure projects which would qualify for SPV funding. Furthermore, in view of the resource constraints facing the State Governments, it is necessary to exploit fully the opportunity for sale of minority equity stakes in state public sector enterprises. Systematic pursuit of this option could yield very substantial resource mobilization in the years ahead.

39. The shift in the government priorities will not happen by itself, and deliberate measures will have to be taken by the Government to ensure that economic progress of the country is not affected by lack of investments in production sectors. These interventions would have to be at two levels. First, the policy and procedural environment needs to be made considerably more welcoming towards private investment than it is at present. Second, the government will have to incentivise the private sector to enter unfamiliar activities through well design public private partnership models. The vast scope that exists in involving private initiatives in the economy including the social sectors has been clearly brought out in the MTA document. It has also indicated the policy changes that would be necessary.