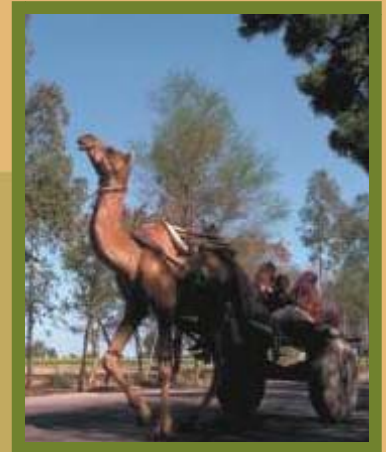


Executive Summary



Executive Summary

D*espite being considered one of India's lagging states, Rajasthan made impressive progress during the 1980s and 1990s.* The economy diversified significantly, and the growth rate accelerated to become the second highest among the major Indian states. School enrollment, literacy, and life expectancy increased markedly, while gender inequity decreased. The poverty headcount declined by more than half. In fact, by the end of the 1990s, Rajasthan's poverty rate was lower than that in several richer states—presenting somewhat of a puzzle. Rajasthan seemed poised to close the development gap that has existed for a long time between itself and the Indian average.

New challenges have emerged since 1999, however, threatening the progress in economic growth, social development, and poverty reduction. Per capita growth rates have nearly halved in the last five years compared to the previous two decades. Recurring drought, a growing crisis in ground water supply, falling investment rates, and fiscal stress that lowered public investment in infrastructure in the second half of the 1990s, have all contributed to lowering growth rates and increasing economic volatility. Given that large numbers of people live just above the poverty line, there is danger that poverty rates will increase. Further, if Rajasthan cannot restore its growth path, it risks being caught in a low-level development trap, with India's rising investment inflows—both domestic and foreign—bypassing it for the faster growing states. In that case, the development gap could widen again.

Recognizing these serious challenges, the Government of Rajasthan (GoR) has started implementing policy reforms to address them. The Chief Minister, in office since December 2003 with

the support of a clear parliamentary majority, has articulated an overarching vision framed as "Six Ideals". This vision includes: (i) eliminating hunger and malnutrition; (ii) taking care of disadvantaged groups; (iii) emphasizing human resource development; (iv) creating social and economic infrastructure; (v) ensuring good governance; (vi) and improving the fiscal position. The government has also been building partnerships with the private sector and civil society, most clearly manifested in the Economic Policy and Reforms Council (EPRC) set up last year. Finally, the government is also seeking an expanded engagement with external partners, such as the European Union and the World Bank, in meeting these challenges.

This World Bank Report has been prepared at the request of the GoR to help identify policy options to address these challenges. The report also contributes to the dialogue between the government, private sector, and civil society on Rajasthan's development prospects and priorities during the EPRC's meetings in 2004 and 2005. Finally, the Report seeks to inform stakeholders about policy issues confronting the state and the assistance strategy that can best serve its interest.

Background

Rajasthan has a diverse geography and social structure. With an area of about 350,000 square kilometers, it is India's largest state. Its population of 56.5 million and Gross State Domestic Product (GSDP) of US\$ 23 billion place Rajasthan eighth among the Indian states in terms of both indicators. The state is overwhelmingly rural, with more than three-quarters of the population still living in rural areas. It has one of the highest proportions of Scheduled Caste (SC) and

Scheduled Tribe (ST) population among Indian states—at 17.2 percent and 12.6 percent respectively.¹ The Aravalli range runs from the south-west of Rajasthan to the north-east, dividing the state into two distinct geographical regions. To the west lies the Thar Desert, covering over 60 percent of the state's land area, leaving Rajasthan acutely deficient in water supply. The state accounts for 10 percent of India's total land area, but has only 1 percent of the country's water resources. Agriculture continues to be largely dependent on rainfall, leaving the state highly vulnerable to drought-induced volatility.

Rajasthan inherited a feudal history and had a late start in development. Formed by the union of 19 princely states and three chiefships in 1956, nearly a decade after India's independence, Rajasthan faced a substantial development gap compared to other major Indian states. For instance, in 1960, Rajasthan generated only a quarter of the electricity of states such as Tamil Nadu, Maharashtra or West Bengal. School enrollment rates were half the all-India average.² The state's population growth rates have been consistently higher than the national average. With slower growth rates compared to the rest of India during the 1960s and 1970s, Rajasthan fell even further behind.

Progress during the 1980s and 1990s

Overcoming difficult initial conditions and two decades of slow growth, Rajasthan's development accelerated from the mid-1980s. The GSDP growth rate rose to 6.2 percent during 1980-2000, one of the highest in the country—largely propelled by investment, labor productivity growth, and diversification of the economy. With increasing diversity came reduced volatility. Even though agricultural performance was poor in the 1990s, rapid growth in industry and services sustained the momentum from the 1980s. School enrollment, literacy, and life expectancy increased markedly and gender inequity decreased. Poverty declined sharply,

and, at 15.9 percent, was lower than that in some of the richer states in the late 1990s. This was largely due to relatively equal income distribution and clustering of households just above the poverty line.

New Challenges to Growth, Poverty Reduction, and Human Development

However, economic growth has faltered markedly since 1999. Three droughts in the past five years, rapidly depleting groundwater levels and aquifers, and falling investment rates have all contributed to decelerating growth rates. Growth has also become more volatile and its decline pervasive—extending even to non-agricultural sectors that drove growth during the past two decades. It is likely that poor agricultural performance in the 1990s had spillover effects to other sectors through depressed demand. While a recovery of growth is under way, economic performance remains erratic. For instance, after a rebound in 2003-04, per capita growth fell again in 2004-05.

The slowdown in growth threatens Rajasthan's prospects of achieving the Millennium Development Goals (MDGs). Even with the progress of the past decades, Rajasthan presents a mixed picture in terms of achieving the MDGs. The state appears on track in its goals of achieving poverty reduction and environmental sustainability, but only under the assumption that growth rates and other conditions remain favorable.³ In education, it is likely that full primary enrollment will be achieved before 2015. The state is close to attaining gender equality in lower primary enrollment, even though it has some way to go to bridge the gender gap at higher levels of education. In health, the goal of reducing infant and child mortality will not be achieved without a "big push" effort. The state is off track in terms of providing access to reproductive health services for all. Given that progress in human development goals is closely tied to income levels, Rajasthan's faltering growth could thus greatly lower the prospect of attaining the MDGs.

¹ Figures from 2001 Census. Comparable national figures are 16.2 percent for SCs and 8.2 percent for STs.

² Government of India Planning Commission, Plan Documents.

³ The monitorable goal for ensuring environmental sustainability is in terms of halving the proportion of population without access to safe water.

The GoR has started taking steps to meet these challenges. Tax reforms leading to robust revenue growth and better expenditure management are creating more fiscal space for public investments and development expenditures. A new scheme for feeder renovation holds promise for sharply reducing power losses and helping the sector attain financial sustainability. Plans are underway to improve agricultural productivity, encourage diversification into higher yielding crops, and improve water resource management. New partnerships are being forged with the private sector to improve the investment climate and service delivery. E-governance programs such as *Lok Mitra* and *Jan Mitra* provide a wide array of government services in urban areas, and are about to be extended to rural areas. State-level public actions to promote human development and social protection focus on poor and disadvantaged groups like SC/STs and women.

The Pending Agenda: Building on Rajasthan's Strengths to Meet the Challenges

Rajasthan has important advantages and strengths that can help meet the outstanding challenges. The state civil service enjoys a reputation for competence. There is a tradition of responsiveness to civil society activism, and an institutional framework for accountability. Consistent with this tradition, Rajasthan's present and past governments have been engaged in addressing development issues. A rich cultural and historical heritage makes Rajasthan one of India's most attractive tourist destinations and conference venues. An abundance of small minerals offers the promise to provide new sources of growth and attract investment. Important sectors such as textiles, gems, cement, jewelry and handicrafts, are well established in the state. A long tradition of entrepreneurship, community and non-government organization (NGO) activism, and resilience of the people is emerging in vibrant off-farm economic activity. This is clearly manifested in the rapid growth of a modern dairy sector, for example. A young, better-educated population, waiting to enter the labor force, can raise growth and productivity rates. The main national highway system crosses Jaipur, increasing proximity to fast-growing

neighboring states such as Delhi, Gujarat and Maharashtra. This brings the "good neighborhood effect" to Rajasthan—in terms of linking it to the manufacturing and information technology (IT) hubs growing in and around these states.

Despite these advantages and strengths, Rajasthan still has an unfinished development agenda, and the task ahead will be to implement a well-prioritized medium term reform program. This report draws on the analysis of Rajasthan's constraints and strengths to present policy options centering on four areas: (i) reviving growth; (ii) creating fiscal space for development; (iii) strengthening public service delivery; and (iv) improving human development and social protection programs.

Reviving Growth

If Rajasthan is to close its development gap with the national averages, its economy has to grow at a sustained rate of 7-8 percent annually, well above the trend of 4-5 percent in recent years. Simple growth accounting suggests that, in order to achieve this aggregate growth rate, agriculture needs to grow at about 4 percent per year in keeping with the trend in the 1980s, while the non-agricultural sector should grow at about 8-9 percent. To achieve this, it will be necessary to increase investment—both private and public—from its current level of about 13 percent of GSDP to above 20 percent of GSDP, along with some growth in productivity. How can Rajasthan achieve these goals?

Agricultural and Allied Sectors

Agricultural diversification, supported by liberalizing agricultural marketing and modernizing research and extension, will be critical to reviving agricultural growth. Given Rajasthan's growing water scarcity and erratic rainfall, traditional cereal-based agriculture no longer offers significant growth opportunities. Instead, the focus will need to be on diversifying into high-value—but less water-dependent—crops and allied activities such as animal husbandry. It is encouraging to note that a trend towards diversification has already emerged with the share of cereals in agricultural output value dropping to a

third in recent years. This trend needs to be supported by creating marketing channels and promoting private sector investment in agriculture through contract and commercial farming. The key reforms needed include: (i) amending the Agricultural Produce Regulated Markets Act so that producers have the option to directly market their produce to commercial buyers who may then be encouraged to enter into contract farming; and (ii) improving the composition of public expenditure in agriculture by focusing on research and dissemination of high-value crop technology and animal husbandry.

In order to address Rajasthan's growing water crisis, policies could focus on moving from groundwater to surface water irrigation, and on reducing the current high waste in water use. Although agriculture accounts for 83 percent of water consumption at present, future projections to 2025 indicate that domestic and industrial demand will increase about three to four times by volume—creating added pressure on this scarce resource. At present, unsustainable groundwater use has already led to significant depletion of aquifers. Under-pricing of electricity for irrigation reduces the incentive for the efficient use of water and leads to the overexploitation of groundwater resources. Deteriorating surface irrigation infrastructure due to inadequate maintenance and poor cost recovery leads to more than one half of surface water being wasted. Key reform actions include: (i) implementing an integrated approach to water resources management by making the newly established State Water Resource Planning Department (SWRPD) functional as soon as possible; (ii) improving the composition of public expenditure to balance the needs for rehabilitation of existing systems versus the completion of existing schemes in irrigation; (iii) actively promoting community-based water user groups who, given a share in cost recovery revenues, will have incentives to raise revenues and use them for rehabilitation; and (iv) increasing water charges to reflect the scarcity of water and discourage wastage in water use.

Industry and Services Sectors

Since non-agricultural sectors account for three-quarters of GSDP, restoring and accelerating growth

in these sectors to at least their trend rate of the 1990s will be crucial. During the 2000s, major sub-sectors such as construction and manufacturing, and especially textiles, have witnessed a slowdown—with growth rates falling back to the 1970s trend. Although two sectors where Rajasthan has a comparative advantage—mining and tourism—show signs of better performance, they are still below potential. Another dynamic area is the dairy industry in the rural off-farm, informal sector. Reviving growth in all these sectors will need a considerable increase in private investment.

Given its geographical and other disadvantages, Rajasthan can expect to increase private investment rates significantly only if it offers a better investment climate than competing states. The factors that need to be addressed comprise: (i) reducing the number of steps required to set up businesses in the formal sector; (ii) decreasing the long time taken to enforce contracts, transfer property, or declare insolvency; (iii) lowering the high rates of labor-related firm inspections compared to other states, and relaxing the strict rules governing the hiring and retrenching of labor under the Industrial Disputes Act (IDA); and (iv) adopting more flexible labor laws with clarity in contract labor laws. It is also important to promote partnership with the private sector. Another area where Rajasthan lags behind is credit availability, with per capita credit to industry in Rajasthan being around 40 percent lower than the national average. Reforms need to focus on increasing access to credit while maintaining the relatively good financial health of Rajasthan's credit institutions.

Infrastructure: Power, Roads and Urban Development

Critical policy decisions are required to improve Rajasthan's infrastructure situation, one of the most important constraints to growth. Although Rajasthan has made significant progress in recent years in terms of increasing access, lack of reliable supply of power at reasonable cost and well-maintained roads to facilitate trade and marketing remain key constraints. The power sector faces a financial crisis—particularly due to aggregate network losses and low rates for agricultural users.

In order to make the sector financially sustainable, pricing issues will need to be addressed through a multi-pronged approach of improving operational and commercial efficiency and reducing power purchase costs. The scaling up of the feeder renovation program shows promise of lowering the large distribution losses. In the interim, the GoR could ensure that losses incurred by power utilities, caused by government policies to subsidize retail prices, are fully financed through the budget. In the roads sector, there are issues of capacity constraints and adequate maintenance—although after the Twelfth Finance Commission (TFC) award, the current requirement for maintenance would be met for the coming five years. While a Roads Fund has been created, it will be important to identify a sustainable source of funds for maintenance expenditures, and expand the role of the private sector in engineering, construction, and maintenance services.

Public private partnership (PPP) in providing infrastructure needs to be strengthened further. Since estimates place Rajasthan's annual infrastructure investment requirements at four times the government's present capital outlay, private sector participation is essential.⁴ Private investment, sought through PPPs, is a route to both attract additional sources of capital and improve efficiencies in the construction, operation and maintenance of infrastructure facilities. Rajasthan was, in fact, one of the first states to enact a Build Operate Transfer (BOT) policy in 1994, a reform that was enhanced with the enactment of the Road Development Act in 2002 and subsequent amendments in 2004. The state has also set aside a project preparation fund and set up a Power Development Corporation as a joint venture with the private sector for project development. However, critical issues that remain outstanding include: (i) developing planning and evaluation capacities to ensure that PPPs that go forward represent priority projects for the state and are best done through the PPP route rather than through traditional public procurement; (ii) strengthening capacities to monitor the fiscal costs of

PPPs, through support including real estate development rights, tax breaks, and contingent liabilities; and (iii) ensuring that PPPs earn their returns from user fees, as far as practical recognizing affordability issues for some consumers. On this last point, it is important that competition in the award of the PPP be used to minimize the cost incurred by the state under PPP contracts. It is also essential to develop political consensus through an overall policy framework, which sets out the rationale for PPPs and emphasizes that their use will depend on their offering efficiencies and a better deal for consumers and taxpayers.

Inadequate urban development, which can hamper Rajasthan's growth, needs to be addressed. Since non-agricultural sectors will drive most of Rajasthan's future growth, this growth will mainly show up in the development of cities and towns. Although Jaipur and some of the major cities have been growing rapidly, Rajasthan remains largely rural, with a low urbanization rate (23.4 percent). Thus, support to urban development assumes a high priority. The government budget for this year has made amends for a long neglect of urban issues by increasing the allocation for urban development. Focus will now be required in three areas: (i) reducing the multiplicity of municipal institutions that leads to a lack of coherence in city development; (ii) strengthening weak institutional and legal frameworks that lead to difficulties in implementing municipal responsibilities as specified in the 74th Constitutional Amendment; and (iii) providing greater financial resources to cities so that they can invest in and maintain infrastructure.

Creating Fiscal Space for Development and Using It Effectively

After several years of acute fiscal stress, a trend towards fiscal adjustment has emerged in the past two years. Rajasthan's current fiscal adjustment strategy focuses primarily on reducing revenue deficits and increasing capital expenditures. Fiscal performance has improved markedly, helped by

⁴ Government of Rajasthan, "Overcoming Investment Climate Constraints," Presentation, 2004.

buoyant revenues and containment of revenue expenditures. In particular, the GoR's own tax revenues have grown rapidly at almost 15 percent annually over the last two years due to sustained administrative reforms and some recovery from drought. Debt restructuring has also helped to contain current expenditures.

However, Rajasthan's fiscal position still continues to be fragile. Despite improvement in the fiscal position over the last two years, major challenges lie ahead. For instance, the overall fiscal deficit is almost 6 percent of GSDP, the debt stock is close to 53 percent of GSDP, and interest payments use up 29 percent of all revenues.⁵ Pension payments have also doubled since 1999, while annual power sector losses that create both explicit (on-budget) and implicit (off-budget and contingent) liabilities are close to 2 percent of GSDP. Hence, a substantial agenda of reform still lies ahead.

Fiscal Prospects in the Medium Term

The main priority now will be to sustain the fiscal adjustment trend by effectively implementing the Fiscal Responsibility and Budget Management Act (FRBMA) recently passed by the Rajasthan Assembly. The TFC Award, which has slightly increased Rajasthan's share in the revenue pool, and, more importantly, provides strong incentives for reducing deficits, will help the adjustment process. However, the Act can be bolstered in its implementation by more attention to three areas: (i) enhancing fiscal transparency by providing public access to information on budget implementation within the year; (ii) strengthening guarantee management by imposing clearer rules and caps; and (iii) announcing a Medium Term Fiscal Program (MTFP) that commits the government to a clear fiscal adjustment path.

The credibility of fiscal policy will be greatly enhanced if the government prepares and publicly commits itself to a Medium Term Fiscal Plan, and to

the important policy decisions that underlie it. Key among these decisions will be continued tax policy and administration reforms—including introduction of the Value Added Tax (VAT)—and increases in non-tax revenue, restructuring debts by successfully meeting FRBMA annual performance targets, managing off-budget liabilities arising from public enterprise losses, and deepening pension reforms. Critically, salary increases will need to be contained to a normal creep of about 2.5 percent per annum. An essential underlying requirement will be to maintain high economic growth rates through effective policies so that revenues can be generated.

Sustaining Revenue Growth

Sustaining the robust growth of Rajasthan's own revenues will be an essential element of any Medium Term Fiscal Plan. Although significant tax administration reforms and economic recovery have helped increase revenue growth, there is still an unfinished agenda of tax reform. This includes: (i) introduction of the VAT with suitable administrative reforms to ensure that its potential benefits are realized; (ii) improvement of property registration services linked to stamp duties; and (iii) reform in municipal taxes—primarily property, land and building taxes—and their gradual devolution to urban governments. In addition, the impressive administrative reforms already undertaken by the Commercial Tax Department (CTD) can be carried forward.

It will be important to introduce the VAT without much delay. Although the GoR has deferred introduction because no agreement has been yet reached on abolishing the Central Sales Tax (CST), there are several reasons why a VAT can help the state.⁶ First, the tax system will be simplified from the current complex system of 11 slabs. Second, it will lead to an improvement in the business climate for Rajasthan by eliminating taxes on inputs and enhancing the competitive position of Rajasthan's enterprises. Third, by deferring adoption of the VAT,

⁵ This is according to latest estimates.

⁶ The CST is a non-creditable tax imposed on interstate trade by origin states.

Rajasthan may lose out on the revenue guarantee offered by the Government of India (GoI) to VAT states as a backstop for rate rationalization and rate reductions. Finally, by joining the participating states, Rajasthan would have a more effective voice in ensuring that the CST is abolished or transformed in such a way as to prevent export of taxes.

Cost recovery provides important opportunities to increase non-tax revenues, promote more efficient use of scarce resources, and strengthen municipal governments. Auctioning mineral leases in lot sizes for periods long enough to attract many bidders can be a major source of non-tax revenue growth.⁷ Second, a water-rate structure reflecting scarcity value is urgently needed not only to achieve cost recovery, but also to foster more efficient and sustainable water use.⁸ Third, other areas where unexplored potential exists to raise additional resources through user charges include higher education and specialized care in urban hospitals.

Improving Public Expenditure Composition

With larger fiscal space and additional resources to spend, ensuring the quality of public expenditure has assumed greater importance. The composition of expenditure has improved in recent years with higher and more focused capital expenditures, increased spending on operations and maintenance (O&M), and a better balance between social and economic sectors in government spending. Further, aside from the subsidies to the power sector, Rajasthan's other subsidies appear reasonably well directed. The crucial issues that still remain to be addressed include: (i) increasing the effectiveness of capital expenditures; (ii) ensuring resources for O&M; (iii) and containing the civil service wage bill.

It will be particularly important to ensure that the rapidly increasing capital expenditures have high returns, and are not thinly spread over too many programs. Within capital expenditures, the share of

social services has been rising with an increased emphasis on water supply and sanitation and less on economic services such as irrigation and flood control. This appears to represent an explicit strategy to lessen the previous high concentration on major irrigation investments with long gestation periods, and focus instead on less capital-intensive minor watershed projects. The state will further need to strengthen investment approval and evaluation processes to ensure that investments are well-directed towards key sectors, on completing high-priority programs, and on meeting O&M requirements, unlike in the past. There are considerable gaps between road and irrigation maintenance requirements and expenditures that remain to be addressed. There is also the need for improving school and health facilities.⁹

Containing expenditures on salaries will also be crucial for fiscal adjustment. Rajasthan's salary to revenue expenditures (excluding interest payments and pensions) ratio, at 48 percent, is higher than most other major Indian states and much above the norm recommended by the TFC. Rajasthan can tackle the problem of the high wage bill in a number of ways, such as: (i) reducing the number of employees; (ii) reducing the average per employee salary; (iii) increasing the level of revenue receipts without increasing the revenue deficit; and (iv) by devolving services and employment to local governments who may be able to supply these services more cost effectively. While it may be difficult to reduce the average per employee salary, there remains scope for improving revenue receipts and reducing the number of employees in Rajasthan through well-designed voluntary retirement schemes.

Increasing Public Expenditure Effectiveness

Using public expenditures effectively will be as important as mobilizing and allocating public resources well. Overall, Rajasthan's Public Financial Management and Accountability (PFMA) Systems

⁷ This takes into account the recent liberalization by the GoI to permit foreign participation in mineral exploration and development.

⁸ See Chapter 2.

⁹ Chapter 4 indicates that lack of maintenance of schools and toilets is seen to be a major cause of poor educational service delivery in Rajasthan.

compare favorably with other states in areas such as: (i) well-defined rules on budget preparation; (ii) an active and an authoritative Public Accounts Committee (PAC) and a Public Undertakings Committee; (iii) advanced Treasury Computerization; and (iv) presentation of monthly accounts as well as the Annual Financial Statement (budget documents) including the Appropriation Accounts and the Finance Accounts within 12 months of the close of the financial year. In recent years, improvements have also taken place in budget implementation and enforcement of external audit findings.

The scope for improving effectiveness in public expenditure lies mainly in four areas. First, greater stress could be placed on performance in budgeting—a point which has been accepted by the GoR in principle. Clearly identifying government and departmental objectives and indicators to measure progress, and align capital and revenue expenditures in line with those objectives would be a good step towards achieving better results. Regular, within-year monitoring of budget implementation and progress in achieving targets and making the results public would also increase incentives for departments to use their budgets effectively. Second, there is scope to improve the present out-moded single entry cash management system through more streamlined release procedures as well as by including actual and contingent liabilities in reporting accounts. In the medium term, the government can consider moving to a modified-accrual accounting system in line with the GoI's guidelines. Third, oversight on public spending can be strengthened by opening the PAC discussions to the public and journalists, introducing system based audits, encouraging the Comptroller and Auditor General (CAG) to provide a professional auditor's opinion on the fairness of the overall annual financial statements, and reducing delays in tabling audit reports. Finally, the efficiency and transparency of public procurement can be enhanced by amending procurement procedures to standardize bidding documents and create a supervisory body.

Improving Governance and Public Service Delivery

Despite strengths in some traditional areas of government, service delivery mechanisms in Rajasthan are weak, contributing to poor human development outcomes. This is clearly evident, for example, in last year's citizen's survey that assesses service provisioning in five areas, and places Rajasthan fifteenth among India's 16 major states in user perceptions of service delivery—just behind Orissa and West Bengal and ahead only of Bihar.¹⁰ There is a clear need for measures to improve service delivery if Rajasthan is to tackle poverty effectively and meet the MDGs.

Towards a More Effective Civil Service

The GoR needs to take steps to improve the skills and composition of the civil service, reduce transfers and increase tenure, and make service providers more accountable for better public service delivery. Composition rather than size is the key constraint to the effectiveness of the civil service. The composition of the civil service is particularly skewed towards the lower tiers, with less than 6 percent having managerial responsibilities. There are problems related to the concentration of civil servants in better-developed districts, and frequent transfers. It will be important to follow the recommendations of the Shiv Charan Mathur Committee on Administrative Reform (2002). Some of the major recommendations are: (i) restricting most transfers to particular periods; (ii) guaranteeing a minimum stability of tenure of three years for all officers; (iii) making posts of teachers and medical staff non-transferable; (iv) creating separate urban and rural cadres, with better incentives for rural cadres and disincentives for urban cadres; and (v) delegating powers to allow for decentralized management of cadres/services and a total ban on interference from higher authorities. Upgrading the overall human resource management system is another priority, since problems of absenteeism, transfers, and civil service performance and productivity are all linked to the ability of human

¹⁰ See Paul, et. al. (2004).

resource management systems to manage, discipline, and motivate civil servants.

Reinvigorating Local Governments

It is crucial to reinvigorate decentralization and local governments in Rajasthan, perhaps more than in many other states. The state's large area and distances, its geographically distinct regions, its dispersed, ethnically diverse, and primarily rural population, and its long tradition of community and NGO activism all create conditions for effective decentralization. Although political decentralization has made considerable progress in Rajasthan (with more than 9000 panchayat, block and zila governments in place), the potential benefits from decentralization still remain largely unrealized.

Fiscal decentralization needs to be strengthened and an effective local government civil service cadre introduced to realize the full potential of local governments. Removing the overlapping jurisdictions between state agencies and local governments would be an important first step for this as it would raise incentives for local governments to use their existing tax bases. Further, grants-in-aid to local governments could be increased and made untied and devolved on the basis of a well-balanced formula. Remaining conditional grants could be more broadly banded to the devolved functions and not to highly disaggregated line items. In the case of the civil services, Rajasthan's last budget announced that the government would introduce an exclusive administrative cadre to serve in local government institutions: the Rajasthan Vikas Services (RVS). A proposal on the constitution of the RVS is in the process of cabinet approval. While implementing this measure would be an important step forward, care would be needed to ensure that the RVS staff are recruited on merit and made more accountable to elected local government representatives rather than the state government's bureaucracy.

Strengthening Institutions for Accountability and Transparency

The Right to Information (RTI) Act of 2000 was a major step forward in improving governance and

transparency, but evidence suggests that the Act was less effective in practice than its potential. In 2005, the GoI has introduced an RTI Act which is wider in scope and ambit. Following central legislation, the state Act has been repealed. The challenge before the state is to implement the new RTI Act effectively. In order to do so, the government could: (i) encourage departments and agencies to disseminate suo motu or on their own initiative, timely and relevant information on their operations; (ii) set up adequate reporting systems within departments to monitor progress on right to information; and (iii) provide positive incentives to officials to become more open to the public.

Rajasthan's record on adopting anti-corruption measures presents a mixed picture. The institutional framework for tackling corruption is relatively strong, with an Anti-Corruption Bureau (ACB) in place. It has a good reputation and is perceived to be reasonably independent of political interference. Although the ACB has well-defined procedures and is active in prosecuting corruption cases, it is comparatively less successful in winning convictions. Thus the ACB's institutional capacity needs to be strengthened to help prepare good cases, facilitate speedy disposal, and avoid the buildup of backlogs. Going beyond the ACB, it will also be important to build up public awareness against fraud, waste, abuse, and corruption.

Rajasthan's progress in e-governance provides a sound basis for augmenting public service delivery. The state has issued an overarching policy document for e-governance, focusing its activities on supporting public services, and enhancing transparency and accountability in rural and urban services. Two initiatives—the *Lok Mitra* and *Jan Mitra*—have been particularly successful in providing a variety of services in urban areas, such as computerized land registration and records, treasury services, and procurement. There are plans to extend services to rural areas.

Promoting Human Development and Social Protection

While Rajasthan has made substantial progress in expanding education, challenges remain in enhancing

its quality and extending services to disadvantaged groups. In particular, the primary sub-sector is relatively well-funded, and has a clear vision. This is partly due to national policies and programs like the Sarva Shiksha Abhiyan (SSA), effective partnerships with external agencies, and state commitment and public action. Outstanding challenges remain for the sector—in terms of overlapping management structures and responsibilities arising from multiple interventions with separate implementation agencies, inadequate human resources in the form of teacher vacancies, inefficiencies in the post-elementary sub-sector, and inequities by gender, region, and social groups. This calls for measures such as: (i) re-engineering of the business process including more effective personnel policy and better management information systems; (ii) devising locally-specific policies to reduce dropouts; (iii) focusing on the teaching and learning process to raise student achievement and strengthening the District Institutes of Education and Training (DIETs); and (iv) and developing more effective partnership with the private sector for expansion and better quality of secondary education. Policies targeted at disadvantaged groups should also be strengthened for the attainment of MDGs.

The health sector is a cause for serious concern, even though there have been some improvements in recent years. Important health indicators, such as maternal mortality rates, are worse than the national average. Furthermore, some child health indicators have deteriorated during the 1990s, seriously jeopardizing the state's chances of achieving MDGs in this area without focused policy action. The prevalence of HIV-AIDS appears as a threat, even though Rajasthan's performance is better than most Southern and North-Eastern states. The state should focus on better resource allocation within the sector, based on disaggregated outcome data at the district level and below. The human resource situation also needs to be addressed, in terms of improving location, tackling absenteeism, and the lack of skilled personnel. Involving the local government institutions can help to increase health care awareness among communities, strengthen checks and balances, and ensure accountability of health service personnel. A greater involvement of

communities is also found to be effective outreach agents for change. Special attention is needed for child health interventions. An emerging priority for the government is to step up its existing interventions to fight HIV-AIDS by focusing on increasing awareness through targeted information, education, and communication (IEC) campaigns, strengthening surveillance through improved monitoring and data, and increasing access to voluntary testing, counseling and treatment at facilities. Policies targeted to lagging social groups and regions should be strengthened further.

Given the recurrence of droughts, social protection has assumed greater significance in Rajasthan. In addition to over 8.6 million poor people, a large number of vulnerable people live just above the poverty line. Both groups are highly prone to drought and falling incomes. Rajasthan has the typical array of anti-poverty and welfare programs seen in all Indian states. There are a number of areas where Rajasthan's performance has been relatively good—for instance, in the coverage of disadvantaged SC/ST groups and active participation of communities through panchayats in certain schemes. At the same time, analysis suggests significant scope for better implementation, increased coverage, and improved targeting of some schemes—both at the household and district levels.

Rajasthan's weak monitoring and evaluation (M&E) systems need considerable improvement to help achieve the state's human development and social protection goals. Without good M&E systems, it becomes difficult to track progress in human development, implement effective targeting, and understand the efficiency of state programs. While data on several indicators of social development are available, many are based on outdated surveys, and current data on indicators like maternal mortality and HIV-AIDS incidence is not yet available—making it difficult to evaluate progress against MDGs. Evaluation of many key programs has not been undertaken, and there is scope to improve targeting and program implementation through better understanding of impacts or expenditure flows. Ultimately, a strong M&E system would help policymakers to increase

the effectiveness of public spending, and contribute to rationalization of financial and human resource allocation. In this area, the government could: (i) strengthen M&E institutions in the Planning Department through capacity-building and provision of better technology; and (ii) identify selected programs for evaluating impact and find lessons that could influence future program design or mid-course corrections of existing interventions.

The Road Ahead: Medium Term Prospects

After two decades of significant progress during the 1980s and 1990s, Rajasthan's development prospects are now under threat from several directions. Growth has faltered significantly. A growing crisis in water supply and erratic rainfall calls for fundamental changes in agriculture and water management policies. Falling private investment rates—at a time when investment needs to be increased—requires urgent attention to improving the investment climate. Inadequate public investment in the late 1990s and poor maintenance have led to a large shortfall in infrastructure. Weak public service delivery mechanisms impede further progress in human development, a key requirement for long term growth.

Rajasthan's medium term prospects will depend on how effectively the government implements a reform

strategy to address these challenges and achieve the government's "Six Ideals". Rajasthan has valuable strengths for the government to draw upon to develop such a strategy: rich cultural heritage, substantial mineral resources, the presence of major industries in the state, a young and educated labor force, proximity to fast growing states such as Delhi, Gujarat and Maharashtra, and a tradition of entrepreneurship and civil society activism. Most important, a proactive government has started implementing reforms to address these challenges. The task ahead for the government will be to sustain the reforms it has launched as well as those initiated by the previous government.

Drawing on its analysis of Rajasthan's constraints, strengths, and ongoing government initiatives, this report recommends a medium term reform strategy built around four areas: (i) reviving growth; (ii) creating fiscal space for development; (iii) strengthening civil service, local governments and public accountability; and (iv) sector specific interventions for human development and social protection. A public awareness campaign to highlight the benefits of the reform program and the trade-offs involved to the people will be of great value to build support for the program. While the rest of the report provides detailed recommendations in these areas, key policy recommendations are presented in the following Box.

Short Term Policy Reform Options Suggested Time Frame: FY 2006-07

Short Term Policy Options for Restoring Growth

- ◆ Amending the Agricultural Produce and Regulated Markets Act to allow private sector organizations to set up produce markets and allow direct sales by farmers in these markets alongside Mandis.
- ◆ Clarifying and formalizing revenue sharing arrangements between Water Users' Associations (WUAs) and the Irrigation Department that allows the WUAs to retain part of revenues; rationalizing water tariffs upwards from the current Rs. 190 towards achieving full recovery of O&M cost and encouraging more efficient and sustainable water use; making the State Water Resources Planning Department (SWRPD) operational by providing staff and budgets.
- ◆ Setting up an implementation body, with public and private sector representatives, to follow up on the Economic and Policy Reform Council's (EPRC) recommendations.
- ◆ Developing and implementing sector-specific time-bound action plans in consultation with industry representatives for tourism, gems and minerals, and textiles, with special emphasis on easing entry and approvals for business; setting up a public-private Tourism Board to oversee policies and implementation in the sector.

Short Term Policy Reform Options (Contd.)

- ◆ Amending Clause 5B of Industrial Disputes Act (IDA) and the Contract Labor (Abolition) Act to increase labor market flexibility; reducing factory inspections on labor issues to only a limited number of days to be carried out jointly with other inspections.
- ◆ Announcing an overall Public Private Partnership (PPP) policy framework that sets the rationale for pursuing PPPs, and clarifying that PPPs will only be pursued where they prove to be efficient and provide a better deal for consumers and taxpayers.
- ◆ Adopting and implementing a revised electricity sector Financial Restructuring Plan; supporting implementation of tariff orders by the Rajasthan Electricity Regulatory Commission (RERC); supporting transmission and distribution companies' efforts to reduce network losses.
- ◆ Introducing a road maintenance prioritization plan based on traffic and road conditions; increasing routine maintenance to 30 percent of state and rural road; increasing funding for maintenance to 100 percent of requirements; making the Roads Board operational with proper staffing and budgeting.

Short Term Policy Options for Creating Fiscal Space for Development and Using It Effectively

- ◆ Publicly committing to a Medium Term Fiscal Program (MTFP) to meet the Fiscal Responsibility and Budget Management Act (FRMBA) targets, and to its underlying policies; reporting on quarterly and mid-year progress on budget and plan target implementation.
- ◆ Improving debt and pension management; setting clear guidelines to cap guarantees; undertaking a risk weighted classification of guarantees; making public sector undertaking accounts current; producing medium term projections of pension spending and estimates of the outstanding pension liability based on data on active workers and current pensioner stock under current rules and reasonable assumptions with regard to future civil service strength and salary adjustments.
- ◆ Introducing the Value Added Tax (VAT); establishing a physically unified large taxpayer's unit; simplifying property registration, property taxes and other stamp duties; devolving municipal taxes and fees to municipal bodies.
- ◆ Improving the present accounting system in the areas of contingent and pension liabilities, quasi-fiscal activities pertaining to public sector undertakings, tax expenditures, and information on geographical spread of expenses to ensure accuracy and completeness.
- ◆ Strengthening legislative oversight by opening Public Account Committee (PAC) sessions to the public and media.

Short Term Policy Options for Improving Governance and Public Service Delivery

- ◆ Deciding on and implementing key recommendations of the Shiv Charan Mathur Commission on Administrative Reforms, particularly regarding stability of tenure, transfers and local government appointments.
- ◆ Strengthening the Right to Information (RTI) Act by: (i) encouraging departments and agencies to disseminate on their own initiative, timely and relevant operational and financial information including quarterly departmental accounts and response to external audit and observations of the legislative oversight committees; (ii) clarifying to the public and departments and agencies what information can be provided freely, and what information is non-classified and what is classified; and (iii) providing positive incentives to officials for becoming more open to the public.

Short Term Policy Options for Strengthening Human Development and Social Protection Strategies

- ◆ Piloting targeted scholarship and stipend program for girls in secondary education to reduce gender inequity.
- ◆ Improving Education Management Information Systems to ensure accuracy in child tracking and educational indicators, and conduct valid and reliable student assessments to measure outcomes.
- ◆ Improving mother and child health indicators with a focused program on expanding skilled care at birth by auxiliary nurse midwives (ANM); greater home-based new born care by trained Anganwadi workers; and improving referral services for sick children; increasing the health budget and improving intra-sectoral and inter-district allocation.
- ◆ Building capacity of the Poverty Monitoring Cell and Evaluation Department through training; identifying particular interventions, schemes, and policies for evaluation using external experts as required; improving spatial resource allocation in health and education with targeting based on disaggregated outcome data at the district level and below.

Medium Term Policy Reform Options Suggested Time Frame: FY 2007-08 to FY 2008-09

Medium Term Policy Options for Restoring Growth

- ◆ Developing a regionally differentiated strategy for marginal dryland areas, moderate to high potential areas, and high potential irrigated areas to foster increased productivity and agricultural diversification, taking into account diverse conditions, including rainfall availability, agro-ecological potential (e.g. high vs. low fertility), and accessibility of irrigation; promoting drought-resistant crop varieties, appropriate soil and water conservation measures, and technical advice on alternative cropping systems or non-farm income generating activities to mitigate agriculture income risks in areas where irrigation is not feasible.
- ◆ Increasing expenditures in research and extension on non-cereal high-value crops, animal husbandry, and forestry, including through PPPs.
- ◆ Identifying the key factors that constrain access to finance (particularly for rural households, micro enterprises, and small and medium enterprises) and developing and implementing an action plan to improve the delivery of credit and other financial services to these under-served segments.
- ◆ Strengthening the PPP cell in government with planning and evaluation capacities to prioritize PPPs, monitor their fiscal costs of PPPs, and ensuring that they earn their returns from user fees, as far as practical while recognizing affordability issues for some consumers; introducing greater competition in the award of PPPs to minimize the cost incurred by the state under PPP contracts.
- ◆ Implementing the Financial Restructuring Plan for the Power Sector; scaling up the feeder renovation scheme to bring down transmission and distribution losses to 30 percent by FY 2007-08.

Medium Policy Options for Creating Fiscal Space for Development and Using It Effectively

- ◆ Implementing the FRBMA targets and the MTFP; introducing and implementing Medium Term Expenditure Framework for agriculture, irrigation, roads, education, and health.
- ◆ Developing and implementing proposals for entitlement reform of the defined benefits scheme in order to ensure long-run actuarial soundness of the system based on pension liability estimates; developing and costing out proposals to revise the rules (benefit formula, eligibility conditions etc.) of the civil service pension to eliminate existing inequities and control medium term expenditures.
- ◆ Improving budget presentation and transparency by presenting economic classification alongside functional classification; introducing greater performance orientation in budgets by targeting well-defined indicators for each department and following implementation; gradually moving towards an accrual accounting system.
- ◆ Introducing a procurement reform law under which standard legal rules are framed, making it mandatory for the departments to follow these rules rather than issuing their own rules and regulations; setting up a central agency, following good international practices, to produce and revise public procurement norms, policies, procedures and a procurement manual, and to enforce these in public procurement by all departments; developing standard bidding documents for procurement of goods and works for all departments.

◀ XV ▶

Medium Term Policy Options for Improving Governance and Public Service Delivery

- ◆ Implementing the Shiv Charan Mathur Committee's Recommendations, accepted by the government.
- ◆ Establishing a comprehensive and computerized Human Resource Database aligned with the payroll.
- ◆ Undertaking functional reviews at the level of the Secretariat and Districts to restructure staffing profile, expand managerial capacity and re-engineer business processes.
- ◆ Strengthening local governments by establishing a local government civil service, the Rajasthan Vikas Services (RVS), recruited by the State Public Service Commission accountable to local governments; strengthening capacity of the State Finance Commission to expand awards to local governments.
- ◆ Strengthening the anti-corruption function by expanding its preventive and public awareness roles and establishing special courts to try anti-corruption cases; making the Lok Ayukta's Office fully functional.

Medium Term Policy Options for Strengthening Human Development and Social Protection Strategies

- ◆ Developing and implementing an education sector strategy to achieve the dual goals of expanding access and improving quality in a cost-effective manner; addressing links between different levels; reviewing public and private expenditures to assess whether the resources have been used efficiently; having a high-quality student assessment system in place to track academic achievement.
- ◆ Developing a comprehensive health sector strategy that better integrates family welfare, reproductive and child health, disease control programs and nutrition programs; strengthening governance and institutional management capacity at all levels of the public health system; forging partnerships with the private sector and communities; and addressing resource constraints, especially for the secondary sector.
- ◆ Improving monitoring of public works programs, with particular attention to quality, economic impact of and client satisfaction with assets created, coverage rates at village and households levels, seasonality of employment demand and program supply, and participation of communities in planning and monitoring—in particular, with the introduction of the Employment Guarantee Scheme (EGS), a full baseline survey can be conducted in selected district(s) to allow for future evaluation of impacts; completing EGS evaluation and approval of more complete M&E indicators for all public works programs (including reporting of actual person days of employment created and quality of asset indicators).
- ◆ Introducing new social security plans for workers in the unorganized sector; expanding coverage of existing programs and improving targeting; reviewing the below poverty line (BPL) system and performance indicators.
- ◆ Piloting and evaluating public distribution system (PDS) reforms, including use of food vouchers in obtaining PDS, measures to improve the financial viability of Fair Price Shops (FPS), and increasing the role of communities in program monitoring (and delivery through cooperative ownership of FPS); improving the BPL targeting process through: (i) computerization and timely public availability of BPL census results; (ii) strengthening Panchayati Raj Institutions (PRI) and community roles in BPL verification and monitoring; and (iii) reviewing BPL criteria to assess suitability to local conditions and needs for adjustment and/or increased flexibility.
- ◆ Formulating and implementing on an ongoing basis, a public awareness-raising strategy with respect to public services being provided by the state and entitlements under anti-poverty programs, including a strategy for inclusion of communities, PRIs, NGOs and other stakeholders in information dissemination.
- ◆ Building on the Poverty Monitoring and Human Development database to set up integrated data system including data from line ministries; institutionalizing evaluations and enhancing policy feedback mechanism from these studies.