

# Background and Recent Developments

## The Country Context

While the country context for the FY02-04 strategy period was marked by the political stability of a 24-party federal coalition, it has also been notable for economic policy, particularly reform initiatives, being pursued at an uneven pace. A few important underlying trends have impacted on India's reform progress, and progress towards meeting the MDGs, in recent years.

The first of these trends has been the urban elite's growing confidence about India's place on the world stage. This confidence has been fueled by several factors: the growth in the last decade of a vibrant middle-class with spending power; high recent economic growth and India's strong external position; the IT boom in which India is emerging as a global leader; the achievements of the Indian diaspora; improved relations with all major world powers; and the readiness of a new generation of industrialists and entrepreneurs to compete globally. With its influence magnified by an expanding print and electronic media, this class of urban elite has become the key driver of India's liberalizing agenda.

A second trend, related to the first, is the slow but growing assertiveness of less privileged sections of Indian society. Through the 1990s, this was seen in the rise of political parties largely representing the less privileged and regional aspirations and their influence on the federal polity. Multiple-party governments at the Center and some of the major states based on minimum common agendas and pragmatic power-sharing have resulted in greater durability of coalition governments. This democratic assertion and sharing of political power has had the

positive effect of increasing empowerment of historically weaker sections, but the quality of governance and the delivery of services remain uneven.

Finally, increasingly politically-articulated aspirations for jobs, infrastructure and health, education and sanitation services, have highlighted the necessity of institutional and policy reform, decentralization, and employment-friendly growth policies. The forthcoming CAS period will see an intensification of the struggle to match these needs with short-term political demands. In particular, creating incentives to improve service delivery to the poor will remain a challenge.

This new Bank Group CAS coincides with a fresh governing cycle at the Center and in major states. In elections held in April/May 2004, the government at the Center and in the states of Andhra Pradesh (AP) and Karnataka were voted out. In an earlier set of state elections in late-2003, governments were also voted out in the states of Rajasthan, MP and Chhattisgarh. The new government at the Center, which is a coalition led by the Congress party (which initiated the process of economic reforms and liberalization in the early 1990s) is now supported by leftist parties. The ruling alliance has agreed on a Common Minimum Program as its policy agenda, which retains the broadly liberal economic policy thrust of the last decade but with a strengthened emphasis on social programs and benefits to low income groups, especially in rural areas.

With the completion of elections, the new governments at the Center and these states face the challenge of protecting vulnerable sections and investing in infrastructure and rural development, while facing up to the prime necessity of fiscal and power reform and creating conditions that would encourage private investors and employment-oriented growth. During the forthcoming strategy period, states will be faced with decisions on contentious issues such as rationalizing power and water subsidies, partnering with the private sector to deliver basic services, and giving further impetus to decentralization. Many of these decisions will be hotly contested, which should place development issues into the center of the political agenda.

## Recent Social Progress and Outlook

By many measures, India has made good progress in reducing poverty and improving the welfare of its citizens in recent years. The Bank's 2003 Development Policy Review - "India: Sustaining Reform, Reducing Poverty" (DPR) provides a detailed discussion. Official estimates show a decline in poverty from 36 percent in the early 1990s to 26.1 percent in 1999-2000, but attempts to adjust the household survey underlying the 1999-2000 figures to make it comparable with earlier surveys result in a smaller degree of poverty reduction; how much smaller is a matter of considerable debate and estimates vary widely<sup>3</sup>.

In addition to the reduction in poverty incidence, education indicators have improved markedly. For the first time since independence, the absolute number of illiterate citizens in India declined between 1991 and 2001. Literacy rates rose particularly for women. Enrollment rates of primary-aged children also increased, and the gap between enrollment ratios for boys and girls declined.

However, against these achievements, progress in improving health indicators in India has been mixed. Reductions in the infant



*The Indian Elementary Education Project aims to reduce the number of children who are out of school by at least 9 million, narrow gender and social gaps and improve quality of education.*

<sup>3</sup> One set of alternative estimates, developed by Angus Deaton of Princeton University (see "Adjusted Poverty Estimates in 1999-2000", 2001) estimates a poverty incidence of 28.6% in 2000. This is the estimate used in the World Development Indicators, but other plausible estimates show higher poverty in 2000, and the issue of how much poverty fell in the 1990s remains unresolved. By using the internationally comparable standard of the proportion of people living on less than \$1 a day, the poverty rate for India was 39% in 1999/2000.

**Table 1. Progress on Social Indicators, 1980-2000**

Indicator	Reported date		
	1980s	1990s	2000
<b>Poverty</b>			
Poverty incidence (%)	44.5	36.0	26.1
<b>Demographics</b>			
Population (millions)	685	846	1,027
Population growth (%)	2.2	1.9	1.6
Overall sex ratio, ages 0-6 (females per 1,000 males)	978	955	927
<b>Education</b>			
Overall literacy rate: 7+ years (%)	44	52	65
Female literacy rate as percent of male literacy (5)	53	61	71
Net enrollment rate (NER): grades 1-5 (%)	47	51	77
Female NER as a percent of male: grades 1-5 (%)	70	80	81
<b>Health</b>			
Life expectancy at birth (year)	56	60	61
Infant mortality rate, 0-12 months (per 1000 live births)	115	79	68
Under-five mortality rate (per 100,000 live births)	152	94	95
Malnourished children, ages 0-3 (%)	n.a.	53	47
Maternal mortality rate (per 100,000)	n.a.	424	540
Prevalence of HIV (million people)	n.a.	3.5	4.0
<b>Environmental Sustainability</b>			
Access to improved water source (%)	n.a.	68	78
Households with toilet facility (%)	n.a.	30	36
Forest area (% of total land area)	n.a.	21.4	21.6

**Notes:** Poverty estimates are for 1983, 1993/94 and 1999/2000. They are official estimates, which are not comparable between 1993/94 and 1999/2000 due to changes in the 1999/00 survey. For further discussion, see page 8. Demographics and literacy rates are for 1981, 1991, and 2001. Enrollment rates are for 1981, 1991, and 2000. Health and sanitation data are for 1992/93 and 1998/99. HIV prevalence is for 1998 and 2001. Improved water resources defined as access to piped drinking water and hand pumps.

Table taken primarily from the India DPR. Data Sources: Poverty-India, Planning Commission based on National Statistical Survey; Deaton 2002. Demographics-India, Office of the Registrar General 1981, 1991, 2001. Education-National Statistical Survey; India, Office of the Registrar General 1981, 1991, 2001; India, Department of Education. Health-India, Office of the Registrar General 1981, 1991, 2001; National Family Health Survey, Sample Registration System (for a discussion of maternal mortality data, see page 8). HIV-National AIDS Control Organization. Sanitation-India, Office of the Registrar General 1981, 1991 2001; and National Family Health Survey.

mortality rate (IMR) slowed during the previous decade and higher IMRs have persisted among disadvantaged groups such as the SC/ST population (Box 1 provides additional context to this problem). Progress in addressing malnutrition has been minimal. Based on existing data, the maternal mortality rate has worsened; however there are problems with the data for this indicator in some of the largest

states that raise questions regarding data at the national level. It appears that, at the very least, the maternal mortality rate has not improved significantly. Other worrisome trends are an accelerating rate of infection by HIV/AIDS and deterioration in the overall sex ratio for children under four. These trends have continued despite an increase in public expenditures on health in the 1990s - and partly because public

## Box 1: Why do infants and young children die in India?

India has achieved remarkable progress in reducing infant and child (under 5) mortality in the past 25 years, nearly halving the nation-wide IMR from 1975 to 2000. However, much of this success took place in the 1980s, while there was a sharp slowdown in improving this critical indicator in the 1990s - the average reduction in IMR per year slowed from 3.5 percent in 1981-1990 to 1.8 percent in 1991-2000. At the same time, many other countries in South and East Asia, including neighboring Sri Lanka and Bangladesh, have managed to maintain an IMR reduction of 3 percent or more annually. Even more worrisome, India's under-5 mortality rate hardly improved in the 1990s, remaining more than 2.5 times higher than in China.

In order for India to achieve a reduction in IMR from 68 infant deaths per 1000 live births in 2000 to 45 by 2007 and to 28 by 2012, as targeted in the Tenth Plan, the annual decline should jump to nearly 5 percent, which is a very tough challenge. Inter-state disparities imply that the challenge is even tougher than the national data suggests, since the poorer, lagging states will have to achieve much greater reductions.

What are the main factors contributing to infant and child mortality in India? According to India's National Family Health Surveys (NFHS), for every 68 infant deaths, 43 of these happen during the neonatal period (first 28 days). Since a large number of these deaths take place at home, global studies indicate that improving home based behaviors related to breast-feeding, oral rehydration and newborn temperature management, can have a strong impact on child survival. Increasing the 'birth spacing', or interval before the next child in the family can also impact child survival. This is an important issue for India, where permanent methods of family planning are predominantly used.

Recent studies also highlight the importance of focusing on a range of socio-economic parameters and cultural issues in addition to better health care. Girls are at a greater risk of dying before the ages of 1 and 5 than boys, reflecting better care for boys. Correcting for this gender inequality in child-care would improve overall survival rates. One of the most significant positive effects, emerging consistently from various studies, is a literate mother, reinforcing the utmost importance of girls' education. Household wealth also clearly matters, and so - and independently from wealth - do basic infrastructure services that help to keep the household and community environments clean. Different studies suggest strong links between reductions in infant/child mortality and increased sanitation coverage, improved water supply and the use of cooking fuels and practices that produce less smoke. Given that acute respiratory illness, which is associated with solid fuel smoke by a series of studies, and diarrhea, which is linked to the lack of sanitation and hygiene, are the two top "killers" of children under 5 in India, this is hardly surprising. Access to electricity has also been shown to correlate with reductions in infant and child mortality in several studies, although corroborating epidemiological evidence is lacking. Substantial differences in the impact of these infrastructure variables have been observed between urban and rural areas, as well as between better-off and poorer states.

**Sources:** M. Claeson, et al. 1999, Reducing Child Mortality in India, World Bank; L. Wang and B. Klaauw, 2004, Child Mortality in Rural India, World Bank; World Bank 2004, Attaining the MDGs in India; G. Hughes, et al, 2001, Environmental Health in India, World Bank; WHO 2002, World Health Report 2002; NFHS 1998-99.

expenditures on health remain low by international standards.

Furthermore, the aggregate indicators mask widening divergence in GSDP per capita and other indicators of well being between the richer and poorer states. While

poverty declined in both, the rate of progress has been greater in the richer states. In 1999/2000, 76 percent of India's poor lived in states with per capita GSDP lower than the all-India average (Table 2). Generally, the poorest states also lagged behind in social indicators, although the ranking is different

**Table 2. Concentration of Poverty in India**

% of total number of poor	1983	1987/88	1993/94	1999/00
Poorer states*	71	70	71	76
Richer states**	27	28	26	22
Others	3	2	3	3
	100	100	100	100

\* includes AP, Assam, Bihar, Kerala, MP, Orissa, Rajasthan, UP, and West Bengal.

\*\* includes Gujarat, Haryana, Karnataka, Maharashtra, Punjab, and Tamil Nadu In this table, the classification of poorer and richer states is based on GSDP per capita rather than poverty headcount.

**Source:** India DPR: Staff calculations, based on Planning Commission

than that by per capita GSDP. For example, Assam has the highest percent of population that is calorie-deficient, reflecting extreme hunger poverty; Orissa, MP and UP have the highest infant and child mortality rates; and UP shows the lowest primary school enrollment rate. Access to reliable water supply and electricity, which is important to both economic and human development, is also very uneven across states, as well as significantly lower in rural areas where the vast majority of India's poor live.

Performance on environmental issues, particularly related to environmental health, also reflects some growing disparities. While urban air pollution in Delhi and other metro-

cities has stabilized and/or shown some decline - largely thanks to mounting pressure to act from environmental activists and NGOs representing the urban elite - efforts to reduce indoor air pollution from use of traditional biomass fuels have suffered from inconsistent policies and lack of recognition of the issue. For the poor, it is often this indoor air pollution that constitutes a larger risk to health, disproportionately affects women and young children and contributes to high infant/child mortality rates. In other areas of environmental sustainability, the story is mixed. For instance, deforestation appears to have been reversed on a national scale, which is a considerable achievement. At the same time consumption of fuel wood has increased, suggesting continued pressures on forests. The worsening availability and quality of water, particularly through ground water depletion, has emerged as the major concern threatening livelihoods and development prospects in many areas.

The issue of whether India will be able to reach its MDG targets by 2015 remains a focus of much research and debate. The recently completed Bank report "Attaining the Millennium Development Goals in India"<sup>4</sup> has focused on the major human development-related MDGs (e.g., child and infant mortality,



*Indoor air pollution results in 400,000 annual deaths of women and children in India*

<sup>4</sup> World Bank, 2004. "Attaining the Millennium Development Goals in India". South Asia Region Human Development Unit.

child malnutrition, schooling enrollment and completion, gender disparities in schooling and hunger poverty), disaggregated by sub-national units in India. In its analysis of the progress and prospects for achieving the MDGs at the state level, the report asserts that India cannot hope to attain the MDGs without significant improvement in the poorest states, which will account for an even larger share of the country's population in 2015. The study concludes that achieving these goals will be very challenging in the poorest states - particularly for the goal of 100 percent net primary enrollment and 100 percent primary completion of education. A useful illustration of the increased rate of progress that will be needed on average across India is provided in Figure 1.

Taken from the World Bank Group India CAS Progress Report, December 2002; Source: NSS 50th and 55th Round, Schedule 10 for enrollment estimates; NFHS-1 (1992/93) and NFHS-2 (1998/99) for IMRs and attended birth estimates. The

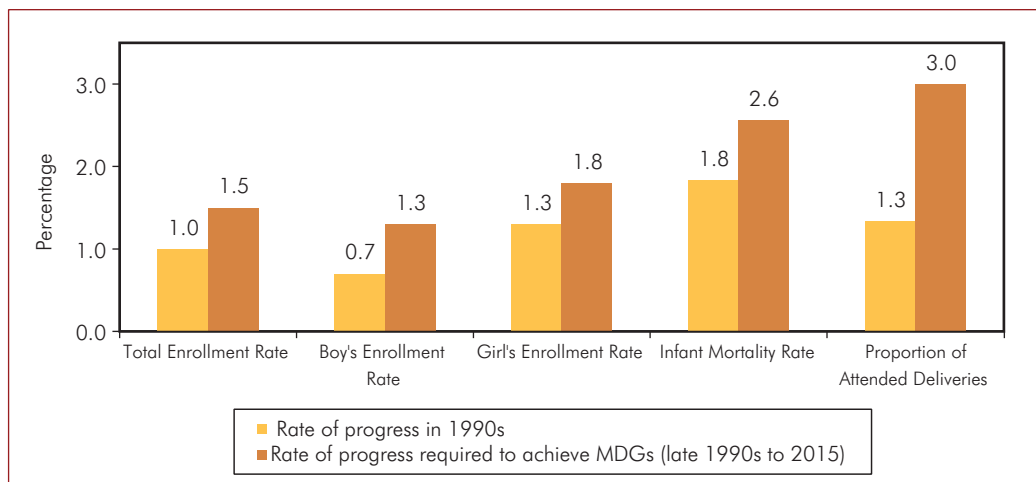
rate of poverty decline in the 1990s in India is a subject of considerable debate (see page 8).

## Economic Developments and Outlook

India's ambitious program of economic reforms, underway since 1991, can be credited for the overall good progress in increasing incomes and improving living standards. After the setback associated with the 1991 balance-of-payments crisis, economic growth, supported by wide-ranging reforms to open and deregulate the economy, picked up significantly. Reforms included abolition of all quantitative restrictions on non-consumer goods, reduction in tariffs, unification of the exchange rates, adoption of more liberal rules for foreign direct investment, and the introduction of current account convertibility.

Even though the pace of reform has been uneven since the mid-1990s, cumulative changes so far have been substantial. Many sectors have opened up to

**Figure 1: The Challenge of Meeting the MDGs  
(selected indicators, annual percentage point change)**



Taken from the World Bank Group India CAS Progress Report, December 2002;

**Source:** NSS 50th and 55th Round, Schedule 10 for enrollment estimates; NFHS-1 (1992/93) and NFHS-2 (1998/99) for IMRs and attended birth estimates. The rate of poverty decline in the 1990s in India is a subject of considerable debate (see page 8).

private activity, trade policy and the exchange rate regime have been further liberalized, and the reform of capital markets has started, leading to an improved investment climate. Some positive reform developments have taken place recently: after several years of at best slow decline, tariffs were significantly reduced in January 2004 - the average un-weighted tariff was cut from 33 percent to 22 percent; there are initial signs of fiscal adjustment at the Center and in some states; and important reform legislation has been passed by both central and several state governments in recent years, including in the areas of power sector reform, fiscal responsibility, and debt recovery.

Growth was rapid in the mid-1990s: the Eighth Plan Period (1992/93-1996/97) showed an annual average of 6.7 percent growth. Overall growth then dropped during the Ninth Plan Period (1997/98-2001/02) to 5.5 percent due to a significant slow-down in industrial growth. Growth slowed further in 2002/03 to an estimated 4 percent due in large part to the impact of poor rains on agricultural output. But 2002/03 also saw the beginning of an industrial recovery and increased investment in infrastructure. Growth performance in 2003/04 was excellent, with an estimated growth rate of around 8 percent following a good monsoon and a rebound from the 2002 drought, continued strong service sector performance and further recovery in the industrial sector.

However, the fiscal stance since the mid-1990s has not been conducive to long-run growth and poverty reduction. The general government (Center and states) fiscal deficit has averaged around 10 percent in recent years. These high fiscal deficits have been accompanied by poor composition of expenditure with wages, pension, interest and subsidy crowding out capital spending and

maintenance, and leading to slow real growth in social sector spending.

The fiscal deficits have also been largely financed by borrowings, with a strategic shift towards long-term rupee debt after the 1991 crisis. General government debt rose from 58 percent of GDP at end-March 1986 to 85 percent of GDP by end-March 2003. Including the debt of public enterprises, total public debt is now 95 percent of GDP, with contingent liabilities from loss-making public enterprises adding another 12 percent of GDP. Despite the apparent ease with which the fiscal deficit is being financed, a large part of household savings is being used to finance the gap between public sector investment and savings. However, the risk of crisis in India today is mitigated by public control of much of the banking sector, as well as by the strong external position. Rising external reserves and low levels of short-term external debt give the country a very comfortable cushion to counter any speculative attack. The risk is further reduced by limited capital account convertibility, and a flexible exchange rate.

Moreover, at the Center, there are early signs that the fiscal and revenue deficits may be falling below their peak of 2001/02, and that central debt is stabilizing. Preliminary estimates indicate a Central Government fiscal deficit of 4.8 percent of GDP for 2003/04 - significantly lower than the budgeted number of 5.6 percent of GDP. The passage of the Fiscal Responsibility and Budget Management Act, which mandates elimination of the current account deficit of the central government by March 31, 2008, is also an encouraging development. Nevertheless, further efforts will be needed to address fiscal imbalances at the Center and especially in the states, which account for about 40 percent of the general government fiscal deficit, where, while some states have

made good progress, there is so far little by way of aggregate fiscal adjustment. The low interest rate regime observed today may also not remain forever and as long as debt remains high the sustainability of the fiscal stance is extremely vulnerable to an increase in interest rates. Major fiscal reforms are needed to reduce central and state fiscal deficits, to reorient public spending towards public investment and non-wage operations and maintenance, to improve the quality and efficiency of government spending, and to increase revenue mobilization (simplifying tax structures, eliminating exemptions, bringing services into the tax net, implementing a VAT).

Medium-term prospects for growth depend critically on the pace of structural reform as well as fiscal consolidation. An aggressive reform effort by the government will be required to encourage the private investment needed to achieve higher sustained growth. Key areas for growth

promoting structural reforms are the power sector, agriculture and factor markets, especially labor and land (for details on the required reforms, see the discussion of Gol's poverty reduction strategy in the next section).

The DPR developed two growth scenarios: a *slow reform scenario* in which growth would slow to 5 percent, and a *fast reform scenario* in which growth would progressively accelerate to 8 percent<sup>5</sup>. Currently, India appears to be in between these two scenarios. Medium-term growth prospects have definitely improved over the last year with faster industrial and services growth already in evidence, and with considerable reform progress in the last year or so. While India is currently on an underlying growth path of around 6 percent, it is clearly possible for Gol and the states to set growth on a higher path and achieve 8 percent in the coming years, provided reforms are further broadened and accelerated.

<sup>5</sup> World Bank, 2003. "India: Sustaining Reform, Reducing Poverty". South Asia Region Poverty Reduction and Economic Management Unit.