

India Development Policy Review:

Inclusive Growth and Service delivery: Building on India's Success

Overview

The two most pressing challenges for public action in India are:

- Institutional reform to enhance the capability of public sector institutions to ensure the effective delivery of core services.
- Sustaining rapid growth and making the process of economic growth more inclusive—across sectors, across regions, and bringing the benefits of higher incomes and living standards to more people.

Packed into those two sentences is an enormous agenda. This Report motivates these two themes and then unpacks these dense sentences into action. We cannot, nor would we wish to, present detailed prescriptions on the literally hundreds of policies that affect these outcomes. Rather, our much more modest goal for each of the themes is to provide some evidence about the current *issues* and *context*, propose an *analytic framework* and *common principles* for examining existing options, and point to promising directions for *pragmatic solutions* (with examples).

A theme common to both improving service delivery and expanding the inclusiveness of economic growth is *empowerment and opportunity*. In service delivery, India is in the midst of a sea-change in expectations as all parts of the society are increasing their demands as citizens on the state. The accountability of government and service providers for outcomes and outputs is meeting the rapidly emerging gap between the access to services and citizen satisfaction with those services. Similarly, in the economic sphere policies are moving away from the notion that the government's role is to protect people from markets, towards the notion that government can play a role in empowering people to participate in markets on fair terms.

I. Motivation of the themes of service delivery and inclusive growth

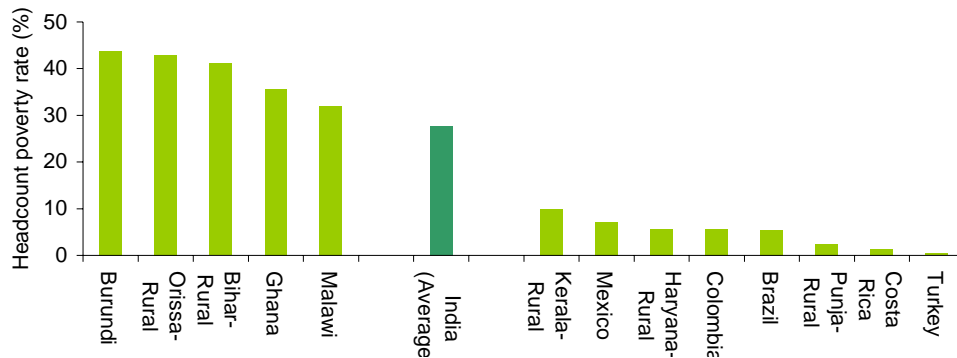
Of all the many issues facing India, why does the World Bank's Development Policy Review focus on these two themes?

India is the best of the world, it is the worst of the world—and the gaps are growing. We start from the premise that the goal of development is to improve human well-being in a sustainable way, with particular emphasis on the less well-off. The discussions of development and poverty reduction have been enormously enriched by the contributions of Amartya Sen, which emphasize that development is about much more than increasing material well-being, but also includes expansions in capabilities and in both positive and negative freedoms. A more consistent attention must be given to assessing development progress not simply as a measure of an aggregate of economic activity but as an assessment of the inclusiveness of economic growth, with emphasis not only on the distribution of gains but also on the security, vulnerability, empowerment, and sense of full participation that people may enjoy in social civic life. It is worrisome that in both

economic progress and in service delivery the gaps between the best and worst are growing. India often has among the world's best and worst across a range of indicators. India is an emerging global super-power, joining the elite club of acknowledged nuclear powers; and India has child malnutrition rates among the highest in the world. Parts of India are indeed shining, but, as the election results of 2004 revealed, the greater intensity of the light heightens the contrast with the shadows where the shine has not reached.

The headcount poverty rate in rural Orissa (43 percent) and rural Bihar (41 percent) is higher than similarly measured poverty rates of African countries like Malawi or Ghana. By the same standard poverty in rural Haryana is only 5.7 percent—less than upper middle income countries like Colombia and Brazil and rural Punjab is only 2.4 percent—approaching the rates of Costa Rica (famed for its social successes). The gap between rural Punjab and Turkey, which is knocking on Europe's door, is only 2 percentage points—20 times smaller than the gap between Punjab and Orissa.

Figure 1: Poverty rates in rural areas of Indian states span the range from worse than Malawi (in Orissa, Bihar) to better than Mexico (in Haryana, Punjab)

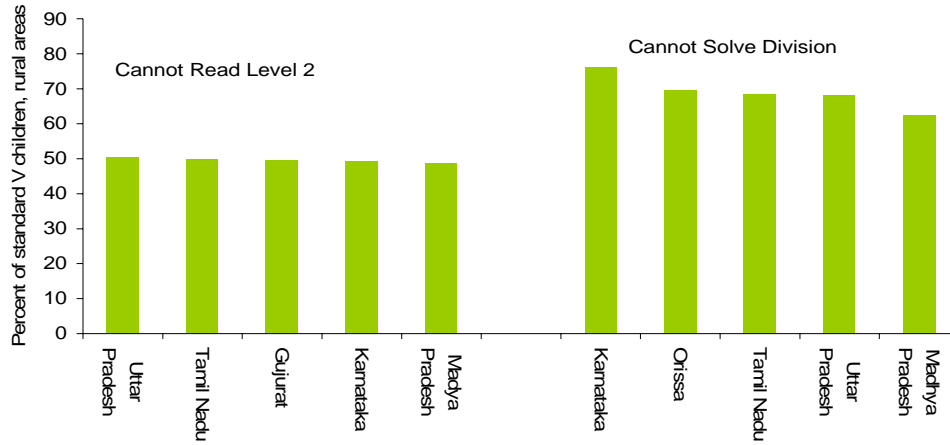


Source: Author's calculations using World Bank data

Parts of urban India are competing successfully not just in low-skill services like call centers but in high skill services like consulting, software engineering and biomedical research. Indian firms are pushing the cutting edge of technology and business in many fields—an Indian pharmaceutical company recently acquired a German firm to expand their business in Europe. But over half of the labor force works in agriculture, often in conditions and with results that were surpassed centuries ago and agriculture is growing slowly.

The top students from the Indian Institutes of Technology are not just globally competitive, in many ways they set the global standard. The recent graduates of Indian Institutes of Management and the new private Indian School of Business are so in demand that the very top starting salaries are approaching 1 crore (approx \$225,000). Yet, the recent assessment of learning achievement in rural India, the first Annual Status of Education Report (ASER) found that in the worst five states more than half of children in class V could not read at the levels expected of class II children and more than two-thirds could not do simple division.

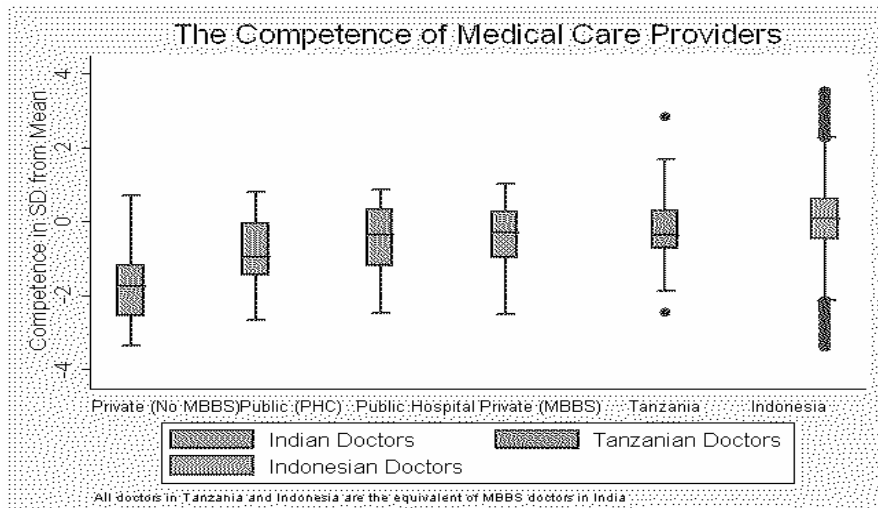
Figure 2: In a recent independent assessment of learning achievement in rural India, in the worst five states around half of standard V students could not read at a class II level while more than two-thirds could not do division



Source: Pratham 2005.

While there is increasing “medical tourism,” where people travel to India for high-quality, low-cost medical treatments—the typical Primary Health Center (PHC) doctor in Delhi is less competent than doctors in Tanzania. A detailed survey of the knowledge of medical practitioners for treating five common conditions in Delhi found that the typical quality doctor in a public primary health center has a *more than 50-50* chance of recommending a *harmful* treatment. In these facilities medical practice has yet to reach the “do no harm” standard.

Figure 3: Public PHC doctors in New Delhi score less well on their competence than doctors in Tanzania or Indonesia

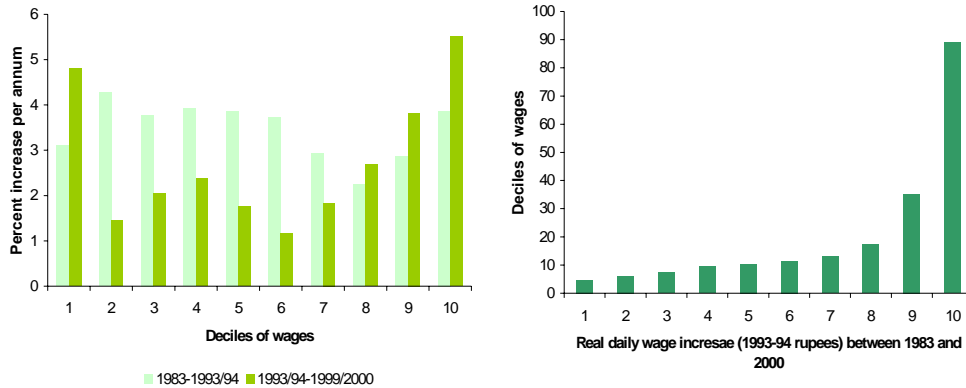


Source: Das, Gertler, and Leonard (2005)

Examples of the best and worst cut across sector after sector. India’s Supreme Court is world renowned, but local courts are backlogged and ineffective and local police are frequently a miasma of corruption and brutality. Delhi’s new metro is a 21st century marvel while rural roads in many states are in poor repair and often impassable.

These gaps are also playing out economically. Interestingly, in proportionate terms the most rapid growth of wages in the 1990s was at both the bottom and the top end of the wage distribution. The percentage growth of wages has been very fast at the very bottom (the 10th percentile) and at the top (8th, 9th, and 10th deciles) but has been quite slow in the middle. This implies that that absolute wage gains have been concentrated at the top—while the daily wage has increased by about 5 rupees per day (in 1993/94 rupees) for the bottom decile and about 10 rupees per day for the median (typical) worker wages have increased by 90 rupees a day for the workers in the top 10 percent of wage earners.

Figure 4: In proportionate terms the very bottom and top of the wage distribution have gained the most—but the absolute wage gains are much larger at the very top



Source: Narain (2005).

The economy is booming, but the capacity of the public sector for effective implementation is not keeping pace—and implementation is everything. India’s growth performance has been spectacular. After some weakening, GDP growth recovered to an estimated 8.5% growth in 2004/05 and in 2005/06. The signs of the economic boom in the modern sector are everywhere. India adds thousands of new cell phone subscribers *every day*, automobile and motorbike ownership is taking off, and cities are vibrant. The reforms of the early 1990s that moved India towards a more competitive economy—both domestically and globally—continued the rapid growth that is allowing India to emerge as a global superpower. While even a decade ago India fretted over head to head competition with the rest of the world, now the rest of the world frets over India’s rise. The current generation of political leaders has seen India move from negotiating with the USA over food aid to negotiating with the USA India’s entrance to the previously closed club of nuclear powers.

India’s sterling economic performance has been accompanied by a curious inversion. In past decades people would fret about economic performance, but marvel at India’s institutional strengths in the public sector—a vibrant democracy, an extraordinarily talented top-tier bureaucracy (the “steel frame” of the Indian Administrative Service), and a set of organizations that could provide law and order, revenue collection, and a modicum of services in a sprawling poor country. Today, these concerns are almost inverted: it is easy to be optimistic about India’s economic prospects, but there is growing concern that the basic institutions, organizations, and structures for public sector action are failing—especially for those at the bottom. Statements of the need for institutional reform come from inside and outside of government, from the left and right of the political spectrum, and from the top to the bottom.

Box 1: Concerns about institutional deterioration and the need for urgent reform to improve service delivery are being raised across the spectrum....politicians, ex-civil servants, academics

I am convinced that the government, at every level, is today not adequately equipped and attuned to deal with this challenge and meet the aspirations of the people. To be able to do so, we require the reform of government and of public institutions ... No objective in this development agenda can be met if we do not reform the instrument in our hand with which we have to work, namely the government and public institutions. Clearly, this will be my main concern and challenge in the days to come.

Prime Minister Manmohan Singh, June 24, 2004.

It is a striking fact that economic renewal and positive growth impulses are now occurring largely outside the public sector.... In the governmental or public sector, on the other hand, we have seen a marked deterioration at all levels- not only in terms of output, profits and public savings, but also in the provision of vital public services in the fields of education, health and transport.

Bimal Jalan, former head of Reserve Bank of India.

While the functions of the state in India have steadily increased, capacity to deliver has declined over the years due to administrative cynicism, rising indiscipline, and a growing belief widely shared among the political and bureaucratic elite that the state is an arena where public office is to be used for private ends.

Naresh C. Saxena, former Chief Secretary Uttar Pradesh.

The performance of India's public institutions has become a matter of serious concern both for the quality of the country's democracy and the well being of its people.

Devesh Kapur and Pratap Bhanu Mehta, University of Texas and Center for Policy Research

Sources: Jalan (2004); Saxena (2005); Kapur and Mehta (2005).

It is important to note that the theme of the report is *institutional reform* for more effective provision of core services. The intent of the report is not to “place more emphasis” on certain sectors (much less advocacy of “spending more money” with business as usual). In large part the GOI has placed the right emphasis and has launched and committed to funding a variety of initiatives and committed to budget increases in crucial service delivery deficit areas: *Bharat Nirman* to address rural infrastructure, the National Rural Health Mission, the Jawaharlal Nehru National Urban Renewal Mission, the *Sarva Shiksha Abhiyan* to address primary education, and the National Rural Employment Guarantee Act to address rural employment and poverty. GOI is not “ignoring” key problems or sectors. While the specifics of the design of some specific policies and schemes will be discussed, it is also not the case that a major theme of the report is that policies are, in general, badly designed. The concern of this report is that of the Prime Minister, that “the instrument in our hand with which we have to work, namely the government and public institutions” is increasingly less capable of delivering on any program or policy. Without deep institutional reforms that strengthen capacity and accountabilities at all levels—politicians, policy-makers, organizational administrators and managers, front-line providers—the best of budget allocations, the best designed scheme, will be incapable of making the difference in deficits in service delivery.

Institutional reform, as abstract as that may sound, is a theme of this report because the hard facts at the ground level say that *implementation is everything*. Effective implementation requires more than choosing the “right” areas for emphasis and more than just more resources to chosen

sectors and even more than technically well designed policies and schemes. India’s development experience is replete with well-designed schemes—some of which worked. Effective implementation requires that interaction between citizens, the state, and providers create the right political, social, and organizational pressures so there is a drive for results—a focus on better outcomes and outputs.

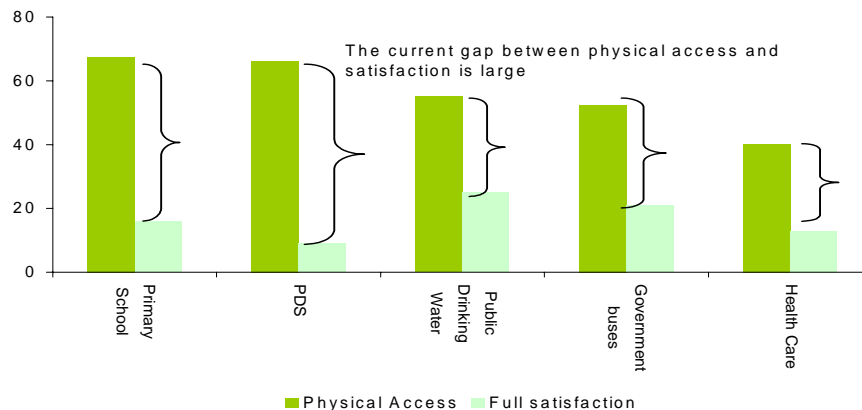
II. Reforming Public Institutions to Ensure Effective Delivery of Core Services

There are many causes for dismay in the current state of service delivery in India--corruption, absenteeism, low quality, excessive costs—but one should keep perspective that many of the current challenges are not the challenges of failure, but rather challenges that emerge from current achievements. The Public Affairs Centre has surveyed people around India about their experiences with publicly provided services. What emerges as a key concept is the “access-satisfaction” gap.

What does a typical citizen encounter when he/she seeks services from public sector producers? A recently published nationwide survey of citizen access, use, and satisfaction with public services illustrates the gap between the *access* created by investments in asset creation and citizen *satisfaction* with the quality and reliability of services (Paul and others 2004). While 72 percent of households used the Public Distribution System (PDS) less than one in ten were fully satisfied with the quantity, quality, or fairness of the system. While in this survey 78 percent of households reported using government (or government-aided) schools, only 16 percent reported being “fully satisfied” with the behavior of their child’s teacher (figure 5). Across states the fraction reporting themselves as satisfied with their government school was shockingly low: only 1 percent of parents fully satisfied in Punjab, 3 percent in Orissa, 5 percent in Haryana, and 6 percent in Rajasthan.

Figure 5: The gap between physical access to services and the quality of services produced leads to an access/satisfaction gap

Percentage of population having access to public services and expressing satisfaction with those services



Source: Paul et al (2004)

This focus on the access/satisfaction gap reveals that India is not struggling with the problems of a complete failure of the state—but of incomplete successes, mixes of failure and success, of achievements that create new challenges:

- The *achievement* of rising incomes means that citizens are demanding more, and higher quality, services and have more income to seek those from the private sector if public sector provision is inadequate. This revolution of rising expectations creates the *challenge* that governments are under pressure to deliver services like never before.
- The *achievement* from the cumulative investments in asset creation has brought the goal of physical access (to a road, to a clinic, to a school, to a market) within reach but creates the *challenge* of asset operation to deliver services. For instance, the education program of Sarva Shiksha Abhiyan is being implemented and the target of universal enrollment of children in primary schooling is close to *achievement* but this creates the *challenge* of adequate quality and learning.
- The *achievement* of sustaining a flourishing electoral democracy and its expansion to include newly powerful social groups creates the *challenge* that newly powerful groups are tempted to use politics for “jobs, contracts and subsidies” to provide patronage to narrow groups and private benefits to insiders rather than improved service delivery as the means of satisfying broad constituencies.
- There has been a revolution in aspirations and expectations as the increased connectivity of rural and urban India and the increased fluidity both economically and socially means the aspirations of all are mounting but this *achievement* creates the *challenge* that people are no longer satisfied with poor performance or content to be ignored.

How can India continue to build on its achievements and not only provide fair access for all citizens to core services but also to meet the challenges of improving citizen satisfaction by providing reliable and appropriate quality services? The answer has four elements:

- Meeting these challenges requires *systemic reform*, not merely expansion of “business as usual.”
- These reforms must improve the *relationships of accountability* between citizens, the state, and the organizations which provide services (whether these are part of the government or not).
- There are a set of common strategic *principles* that are the foundation of successful reforms.
- While reforms may share common principles there is no “one size fits all” solution that can be *adopted*, rather reforms must be *adapted* to the specific circumstances of the sector and state (as Indian states vary widely in capacity for implementation and in the direction they may choose). We discuss how three broad types of reform *may* reflect the common principles: *internal reforms*, *decentralization/devolution*, *public private partnerships*.

Systemic reform, not more of the same

The existing primary school system is crying out for radical reform.

Amartya Sen, Nobel Prize Laureate in Economics, 2002

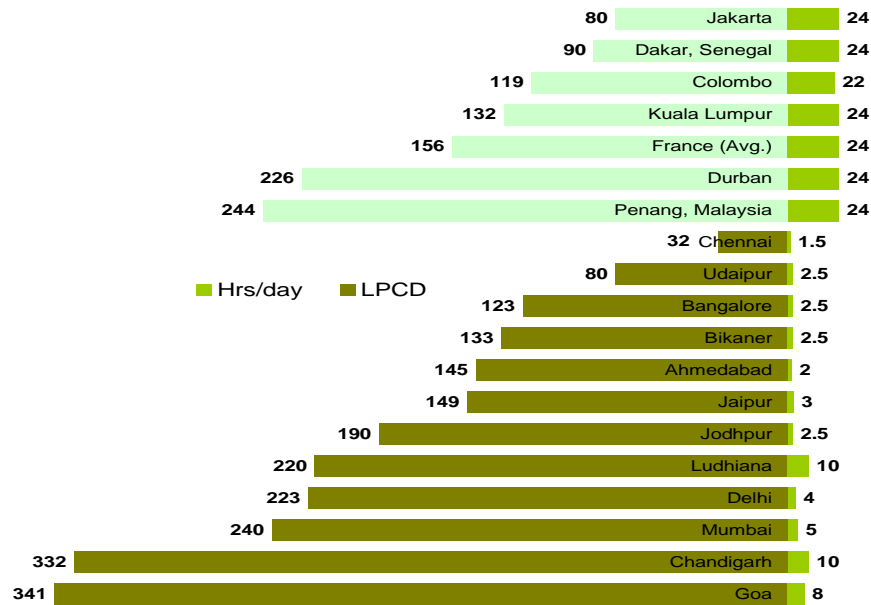
There is a growing consensus of those inside and outside of government at every level that improved implementation will require more than policy tinkering or stronger internal management. The nature of this reform is phrased in various ways: “moving from inputs to

outputs and outcomes” or “from asset creation to asset operation” or by the slogan: “don’t fix the pipes, fix the institutions that fix the pipes.”

Figure 6 illustrates the gap for urban water supply. No Indian city provides 24 hour water supply, which brings important benefits to consumers in reliability and purity of water delivered and technologically to the maintenance of the infrastructure. Is the reason that there “isn’t enough water?” No. Cities in Africa and Asia maintain 24 hour water with much lower volumes (liters per capita per day). Delhi uses more water per person than the municipal average in France. Is the problem a lack of “pipes”? No. Indian cities have created extensive assets for water delivery. Is it just a “managerial” problem? No. The problem is deeper. It is an *institutional* problem, it is not an organizational problem that can be fixed by changes within the agency responsible for water supply (though often internal reformers can make substantial improvements). The problem is in how the agency is embedded in the relationships between politics and the citizens who are the consumers.

Figure 6: While many major cities in developing countries maintain nearly 24-hour water supply, most Indian cities have service only a few hours a day.

Average hours per day and quantity of water service in selected Indian and comparator cities



Source: Ministry of Urban Development and Water and Sanitation Program benchmarking study, ADB utilities book, verified with relevant utilities

The emphasis on systemic reform is not to say that more resources will not be needed. But better utilization of resources is also needed. Examples abound from all types of expenditures and in all sectors. Increased wage payments without more “value for money” have not worked—the premium of a public sector worker over a statistically equivalent worker in the private formal sector increased from 48 percent to 68 percent from 1993 to 1999—did services improve equivalently? In education a recent study found ways of remedying children’s deficiencies in reading that were 50 times more effective than reducing class size. A recent study of rural water supply found that some states were five and six times more effective in creating water connections than other states. In the current system many resources simply “disappear”—a tracking study of food in the Supplementary Nutrition Program in Orissa found that a large share

of the food did not reach beneficiaries. Commitment to more spending on this or that priority makes no sense without an equally passionate commitment to better spending. But better spending doesn't just happen.

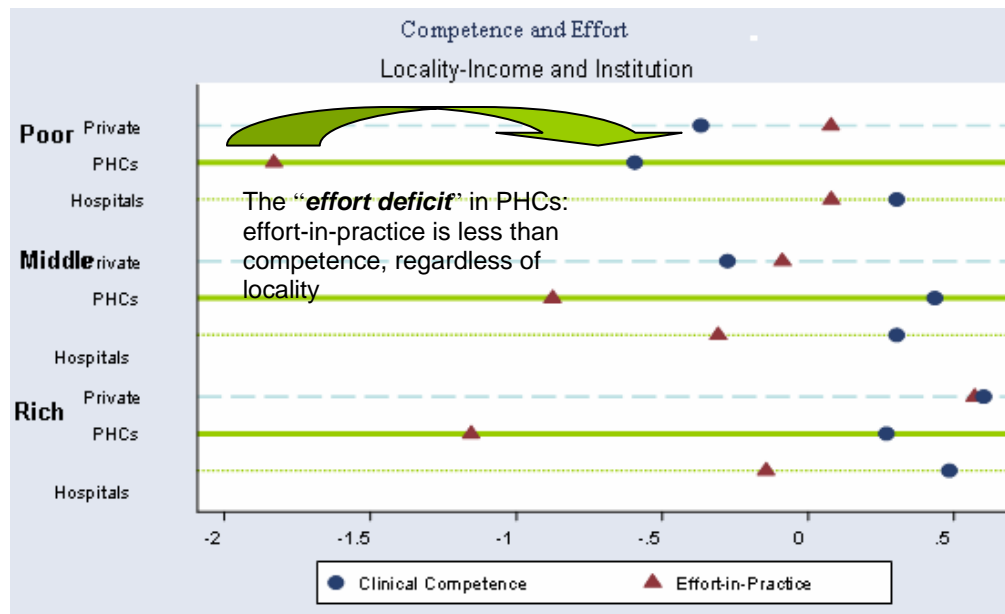
Why accountability as a central theme of systemic reform?

If the Indian state has a weakness, it is this: most of the institutions and rules—courts, bureaucracies, police—are so riddled with perverse incentives structures that accountability is almost impossible.

Pratap Bhanu Mehta, *The Burden of Democracy*, 2003.

The motivation of a focus on accountability is perhaps best illustrated with examples. A recent study of medical practitioners in Delhi measured the competence of providers by presenting them with a variety of hypothetical, but well prepared, vignettes. Following up those assessments of competence the researchers also observed their actual clinical practice. What was striking about the results was the enormous “effort deficit” of practitioners in PHCs (all MBBS doctors). In the middle income neighborhoods the competence of the public doctors exceeded that of the private practitioners (who include less than fully qualified practitioners). But in practice the PHC doctors did only a small fraction of what they revealed as their competence in a hypothetical situation—while the private practitioners actually did a bit more.¹ The observation of clinical competence assessed time spent with patients, number of diagnostic questions asked, and number of physical exams (e.g. taking a temperature, blood pressure). For the typical PHC the answer is: *two*, *one*, and *zero*—the doctor spent *two* minutes, asked on average *one* question, and typically carried out *no* physical exams.

Figure 7: The “effort deficit”—the gaps between what medical practitioners knew to do and what they actually did—is present in all public facilities, and enormous in PHCs in Delhi

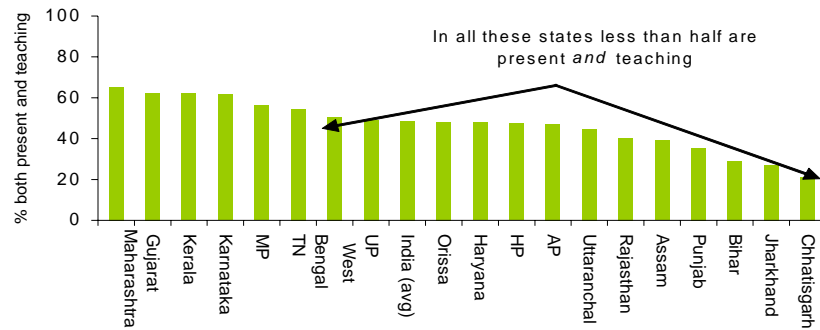


Source: Das and Hammer (2004)

¹ In fact, the story is even more complicated as private doctors tended to over-prescribe treatments in order to satisfy clients and generate revenue, even when they knew the treatments would not be effective.

Based on the results of large scale surveys of health workers and teachers in the states of India the absence of public sector employees has recently received enormous attention and has increased the attention to accountability. But “accountability” does not mean “blame the provider”—there are enormous numbers of

Figure 8: In a nationwide survey using unannounced visits the nationwide average was that less than half of teachers were both present and engaged in classroom activity



Source: Kremer and others 2004.

dedicated civil servants working against the odds to do their duties. If one worker shirks then perhaps the problem might be with the worker, but when 48 percent of health care workers are not present, or when only half of teachers are present and engaged in teaching when visited during the school day (figure 8) then the problem is not with the individuals but with the system. The focus on absenteeism does not mean that absenteeism is the disease; absenteeism is a symptom of a system in which the internal and external lines of accountability have broken down.

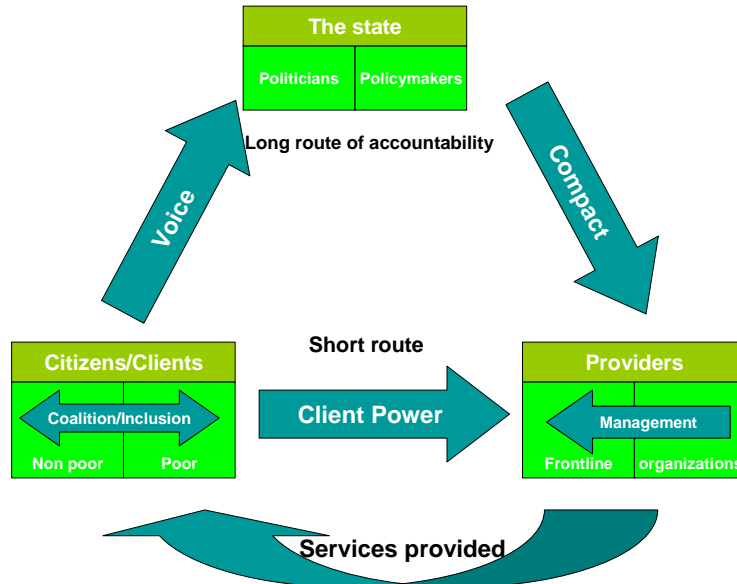
A recent global report on service delivery laid out a framework for analyzing accountability. The framework is *four by five*. That is, a system of accountability has four possible links of accountability (which are illustrated in figure 9):

- From *citizens to the state* called *voice* (or more commonly, politics).
- From the *state to organizational providers* (which could themselves be line agencies or wholly owned parastatals) called *compact*.
- From *organizational providers to front-line providers* called *management*.
- From citizens directly to providers (both organizational and front-line) called *client power*.

Each of these four relationships of accountability (voice, compact, management, and client power) has five constituent elements:

- *Delegation*, a clear statement of the desired outputs and outcomes,
- *Finance*, the provision of adequate sources of finance to reach the desired outputs and outcomes,
- *Information*, on the quality of performance,
- *Enforceability*, making the outcome for the agents dependent on how well they achieved the desired outputs and outcomes, and
- *Performance*, the agent chooses what actions to take based on incentives created through delegation, financing, information, and enforcement of the system.

Figure 9: Relationships of accountability between citizens and the state and between citizens and service providers are central to improving services



Source: World Bank 2003.

If tracking surveys show food from nutrition programs going missing before reaching the children, if surveys show massive corruption in policing, if there is an “effort deficit” of health care workers, if teachers are not teaching, if citizen surveys show massive dissatisfaction—these can tell us that accountability is weak, but cannot say where. A useful analogy is an electrical circuit. In order for current to flow within a circuit all of the wires and all of the connections have to be sound. A short or break in any one wire can cause the entire circuit to fail even if all other wires are sound. The essence of repair is to identify the “weak link”—as the saying goes, “just because the tire is flat does not mean the hole is on the bottom.” The weak link can be in any one of the four relationships or can be any of the five elements of those relationships.

The difficulty with systemic problems is that piecemeal reforms or “more of the same” might not work—expanding the power into a system when the wires are broken does not lead to greater output. Perhaps the weak link is internal management of organizations responsible (e.g. line agencies), perhaps the weak link is with the politics of service delivery itself, perhaps the weak link is that there is no information on performance, perhaps there is ample information but no one can act on that information—low enforceability.

Four weak links in the chain of accountability explain many of the currently observed symptoms:

- *Weak voice.* Accountability to the citizens and voters of the state (politicians and policy makers) is systemically weak because *delegation* is weak (voters do not have a clear idea of what it is the government can accomplish), *financing* is weak (there is little connection between financing (tax payments/user charges) and delegation or performance), *information* is weak (the typical citizen has little or no reliable, relevant, timely, benchmarked information on performance in service delivery), and *enforceability* is weak (because so many other factors outside of the politicians control affect electoral outcomes). A key question is what kinds of changes to the system would make it more attractive for a well-meaning politician or policymaker to engage in reforms that would improve services?

- *Weak citizen cohesion.* One tremendously important aspect in India in creating voice for effective services is the temptation for groups to organize only to improve their benefits from the state, not services more generally. The politics of caste and other identity politics often work so that the benefits of winning elections are not to improve services but to control access to provider jobs or contracts. With weak citizen cohesion and weak voice the state and its apparatus are treated not so much as a means of generating public goods or services, but rather as a means of generating private benefits for those who control the state. In particular, the power to grant contracts, choose beneficiaries, and fill government jobs conveys the potential for enormous benefits. When this power is exercised in the absence of any clear standards and external accountability to service delivery, the benefits of the public sector are for those in the sector.
- *Blurred compact.* A major feature of the institutional landscape is that two roles of the state are blurred: one is the state as a steward to ensure adequate services, and the other is the state as an organization that produces services. The result is that the exigencies (and temptations) of being a provider overshadow the responsibilities of being a steward. For instance, is the Ministry/Department of Health (at the center or state) responsible for improving health conditions in the population or merely the operator of one provider of some health services?
- *Weak client power.* Since neither organizational nor frontline providers depend directly on the served citizens (either as individuals or communities) for their financing and since the served citizens have little capacity to enforce their preferences, the citizens' information about provider performance plays little or no role in the prospects of the organization or frontline providers. As a result, "client power" plays almost no role in accountability.

Common principles of accountability enhancing reforms

I must caution that outlays do not necessarily mean outcomes. The people of the country are concerned with outcomes. The prime minister has repeatedly emphasized the need to improve the quality of implementation and enhance the efficiency and accountability of the delivery mechanism.

Minister of Finance *Budget Speech*, February 28, 2005

There are many successes across states, sectors and agencies that point towards viable new approaches for creating greater accountability of the state and of service providers to deliver. These approaches, while disparate in many ways and adapted to the contextual features of the sector and locations, nevertheless tend to have five features in common:

- Clearer *delegation*— this moves the system away from merely giving responsibility to organizations for compliance with internal processes in the use of inputs to responsibility for outputs and outcomes.
- Stricter *unbundling*—a distinct separation—of the roles of the government as the entity that sets goals, gives financing, enforces the "rules of the game" and the role of government as a direct producer or services. When the umpire is a player everyone knows who will win. This unbundling can happen within the public sector (by separating roles of regulator and producer), across tiers of government (by separating roles between state and (levels of) local governments), or between the public and private sectors (through various degrees of Public-Private Partnerships).

- More *autonomy* for providers (both organizational and frontline) to use flexible means to reach their goals without undue political interference in decisions.
- Greater *external accountability* through better information. The recently passed Right to Information Act potentially creates a sea-change in transparency. But to make information effective for the system requires more than just making existing information available—very often the key information on performance isn't even created—it requires that the information available be relevant, regular, and reliable.
- Better *enforceability* in the system—whether between citizens and their elected officials or directly on frontline providers—without that link many initiatives founder.

These five principles (*clear delegation, unbundling of roles, provider autonomy, external accountability, and enhanced enforceability*) do not dictate any single systemic solution. Rather they are ways to judge potential reforms: do they advance towards a coherent and cohesive system in which all of these are accomplished? For some services a public-private partnership (perhaps with financing flowing directly to the end-users) might be the best way. But if a PPP arrangement does not embody these principles (e.g. where there is not enforceability over a private sector monopolist) it may miss the chance to improve services.

The next sections discuss which of the elements many of the current reforms are geared to address and give some brief information about success cases in each.

Internal Reforms

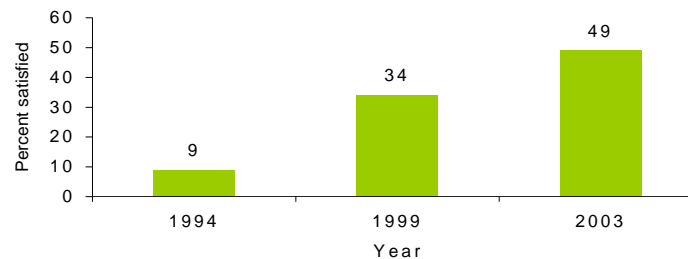
While the public sector faces systemic challenges, it also shows promise. A recent World Bank report *Reforming Public Services in India: Drawing Lessons from Success* examines 25 cases in which major reforms in service delivery occurred. There are many examples of institutional innovations in service delivery at the Center (such as the creation of the National Highway Authority of India) and in the states (e.g. *Bhoomi* for land records in Karnataka, Education Guarantee Scheme in Madhya Pradesh). Only a few of the lessons from that study can be summarized here.

Creating an enabling environment for reform. There are ways these successes can be promoted. As one example, many successes are driven by “reform champions” within the public sector as many cases of successful “internal” improvements in services happen when civil servants are given a clear political mandate for reform, adequate time, and autonomy. One of the most worrisome features of the current system is the shortening duration of top civil servants in their posts as it both detracts from their capability to carry through and reflects an undesirable politicization of the civil service.

Information for greater external accountability. There is now widespread recognition that if citizens are to create pressure for better services they need better information, and information that meets the three Rs: *reliable, relevant, and regular*. There are a variety of promising initiatives:

- The government has recently passed a Right to Information law, that creates enormous scope for citizens to know what is happening—but it is only a promise that will require support to become a vehicle for service improvements and not merely a means for political grandstanding.

Figure 10: Improvement in services in Bangalore following the introduction of the citizen report cards



Source: Paul 2006

- The use of survey information via “citizen report cards” that began in Bangalore shows the need for persistence—while “once off” efforts can generate agitation and fleeting press attention—it is only when people take it to heart as a regular indicator can it be used to drive reforms. Figure 10 shows the improvements observed in Bangalore following the disastrous showing of 9 percent satisfaction in 1994—numerous efforts in many agencies and branches of government were required but many feel the report card itself was an important driving force for improvements.
- There are also a variety of efforts to make information available from the bottom up through existing channels—such as the Gram Sabha or user committees in various sectors or such as the nongovernmental organization Pratham’s efforts to make information on learning performance available in villages and districts.

Using information technology to improve accountability. Merely putting the letter “e” in front of something doesn’t magically make it better and “e-governance” can be as much caught up in “jobs and contracts” as governance without an “e.” But there are examples of the use of the *occasion* of making functions of government “e” to undertake what would otherwise be organizationally and politically impossible fundamental business process changes—including eliminating functions and limiting the potentially abused discretion of government officials. A critical area in which e-governance can be helpful is procurement. Procurement is a key component for effective service delivery since budgets get translated into services in large part through the operation of the procurement system. Utilizing modern technology, in the form of e-procurement, can be a vital tool in improving procurement outcomes since it supports simplification, transparency, and internal and external monitoring and management when done as part of a business reengineering process.

Sustaining reforms. While internal reforms can often be initiated without systemic changes and hence are relatively more feasible (given the political commitment from the top) there is also a risk of backtracking once the top level commitment disappears or when a reform champion departs. Demonstrating benefits through rigorous evaluation (as is happening increasingly in India, in Andhra Pradesh on education initiatives, in Tamil Nadu in water reforms) helps sustain support. Institutionalizing reforms in legal changes can also underpin reform.

Decentralization—local governments

More than a decade ago India’s 73rd and 74th constitutional amendments launched an effort to improve local governance through devolving responsibilities to democratically elected bodies

heading autonomous units of local government. Political decentralization has moved ahead and India now has more than 3 million citizens serving in locally elected bodies. But in most states decentralization is “unbalanced” in that political decentralization has moved much further along than any effective devolution of responsibilities.

Decentralization is no panacea--services can get better or worse with decentralization: as with all other reforms, implementation is everything. Moving forward with a well-designed decentralization requires aligning the “three Fs”: funds, functions, and functionaries in ways that make it possible to have technically effective services with both “accounting” (the capability to spend money well by providing reliable processes for planning, budget control and reporting) and “accountability” (the ability of citizens and communities from the bottom up to hold elected officials and providers responsible for outputs and outcomes).

The activity mapping of the “three Fs” into concrete actions to be undertaken by the various tiers of government (centre, state, district, block, gram panchayat) is complex and needs to be done activity by activity and sector by sector. Two general tendencies do emerge.

First, decentralization creates an opportunity to *unbundle* responsibilities across tiers of government in order to create checks and balances in the interests of the tiers of government—so that one tier reports on the performance of another—in order to assist citizens in getting the information they need to create accountability for performance.

Second, decentralization, in creating new lines of responsibility also creates opportunities to strengthen the “demand side”—the mobilization of communities from the bottom up to demand better performance with better information and greater scope for voice and choice. This is an important part of the design of many of the new programs of the Centre and of the States. The employment scheme under the National Rural Employment Guarantee Act places important responsibilities on the PRI bodies—and envisions different roles for the districts, blocks, and GPs in monitoring different aspects of performance. The National Rural Health Mission creates new health workers under the control of the local bodies as a means of creating a cadre of workers whose primary line of accountability is at the local level. Many of the states have begun to use the local bodies to certify attendance of teachers and other states have moved even further to give local bodies more ability to influence the teachers. But, implementation is everything.

Public-Private Partnerships

Public-private partnerships (PPP) can play an increased role in the provision of services of all types, from telecommunications to health, from airport modernization to primary education. As with all other service delivery reforms merely involving the private sector (which could be either for-profit or not-for-profit (e.g. NGO)) cannot be expected to improve services unless it increases accountabilities.

Discussions of “privatization” are controversial as often “privatization” is usually taken to involve the reduction in government responsibility for a sector and a reliance on market outcomes or involves the divestiture of state assets. But public-private partnerships is just a broad umbrella for discussing ways in which engagement with non-state actors can help the government *fulfill* its obligations to supply core services, services which are being badly served now but with an excess political commitment to *providers* over actual *provision* of services. In fact, health care, education, water supply, irrigation have all been, to a considerable extent, *de facto* privatized, not by deliberate policy but systemic failures in practice.

Public-private partnerships then cover the variety of ways, from management contracts, to demand side transfers (such as provider portable health insurance), to changing industry regulation (telecommunications) to specific contracting (e.g. airport modernization, highway construction) in which the public sector can use the strengths of the private sector (particularly when choice is an effective tool for enforceability on providers) to accomplish public purposes. It is for their potential for gains in efficiency that PPPs are desirable—there should be no illusion that PPPs bring new resources to the table: while they might bring additional financing, in the end financing is just about bearing costs today versus costs in the future. Unless PPPs work to promote more cost effective services the mere availability of private financing for specific projects does not lessen the total resource burden of creating infrastructure—and ultimately these costs will be borne by the citizens of India either as taxpayers or as users.

One advantage of PPPs is that they by their very nature force an open decision about *delegation* (what is the public sector going to pay for and why?) and also force clear *unbundling* in separating out the roles of provider and regulator. In addition, provider *autonomy* is easy to accomplish with a PPP. Why then are they not a panacea?

First, using private providers (including NGOs) works best when citizens can exercise choice across providers to create *enforceability*, when citizen private and public interests coincide, and when the relevant *information* about the quality of provider performance is easily observable. This is why in India, as nearly everywhere in the world, telecommunications reform has gone further and faster and been perceived as more successful than say, provision of urban water supply. With water supply there is much less scope for direct choice and hence enforceability over providers is much more complex.

Second, using private providers (including NGOs) to fulfill public purposes is in nearly every context, and perhaps particularly so in India, a politically charged topic as it creates a three-way relationship between citizen and the state, the state and the providers and the citizen and the provider—and all dimensions of that relationship can be problematic (see Box 2). In many instances reforms that are desirable to make services viable (such as higher user charges) are caught up in political controversies such that even quite desirable contracts are impossible as they create too much risk for potential providers.

That said, there is massive scope for expansion of the use of PPPs in nearly every sector. India is in the position to build on successes in the transport and communications sectors. The role of PPP, as another way of promoting better services, is not limited to infrastructure. In health, in education, even in the implementation of poverty programs there are promising ways to use the empowerment generated by allowing people to make their own choices by channeling funds to people first rather than providers.

Box 2: Delhi Jal Board Reforms

The quality of water supply in most of India's major cities remains poor by international standards. The Delhi Jal Board, recently at the center of controversy over plans to contract out services on a pilot basis in some areas to the private sector, provides what can only be described as poor quality service. Despite a high availability of water, at 250 liters per capita per day, the Board can only distribute water for around 3-4 hours per day (or less). This level of performance puts it behind many water utilities that serve major cities in Africa (figure 5 above). More affluent consumers can still provide themselves a 24x7 service through overhead tanks and boreholes, the latter adding to the rapid depletion of the water table. In contrast, the poor do not have this option, and spend considerable amounts of time to meet their water needs. The coping costs for households in slums in terms of time wasted are nearly as large as the money costs in more affluent neighborhoods.

But however dire the current performance or large the potential benefits, reforms need both to have a transparent process and a strategy for addressing the concerns of the public. Transparency and consultation in identifying and implementing reforms are essential, both in ensuring that all stakeholders have confidence in the process and can make their voices heard, but also to ensure that the right service options are developed and price structures that reflect what consumers are looking for. Also, delay in responding to concerns about not just the substance but also the processes around the reform can lead to greater controversy and can damage the reputation of reforms.

Summary on service delivery

Our assessment of the status of service delivery is not pessimistic. One can have a realistic assessment about the magnitude of the challenges faced while being optimistic about the capability of India, its citizens, society, and government, to face and surmount these challenges. Tackling the new challenges requires taking confidence from past achievements but without complacency about the magnitude of the task ahead. The Government of India has put institutional reforms of the various agencies and service providers at the top of its agenda.

While a discussion of “institutional reform” and “principles of accountability” may seem abstract, it is the most concrete and pressing task facing the government. The success of all of the priority programs will depend on the ability to create effective accountability. Will the NREGA be effective at reducing poverty? If beneficiary lists are not accurate, if projects are not chosen by communities, then no. The design of NREGA has focused on allocation of functions to create accountability, now it depends on implementation. Will the NRHM help reduce mortality among children? Will *Bharat Nirman* expand rural infrastructure? Will SSA be able to move beyond enrollment targets to learning achievement? The answer: *implementation is everything*.

III. Sustaining Rapid and Inclusive Growth

Accelerations in economic growth have propelled India onto the global stage as an emerging economic superpower. After a slowing from 2000-2003 GDP growth has resumed its rapid clip and preliminary estimates are that GDP growth was again over 8 percent in 2004/05 and 2005/06. India's GDP per capita growth rate since 1991 puts her into the top ten of all countries in the world. We feel the primary medium term policy challenge for India is *not* to raise growth from 8% to 10%. Rather we feel the primary challenge is to *sustain* rapid growth while extending rapid growth and its benefits to more regions, sectors, and people. As figure 11 shows the countries in the top ten growth performers in one decade have tended to decelerate substantially in the following decade—the average has been for the leaders to slow by 2 to 3 percentage points per annum over their previous performance. If India were to follow the pattern of other countries a deceleration of this magnitude could take India from the pace of 6 percent growth (the average

from 1992/93 to 2002/03) to only 4 or even 3 percent. Rapid growth is not a “natural” state for an economy: economies in motion at 8 percent growth do not tend to remain at 8 percent growth. Keeping rapid growth growing requires continuous effort.

As with the previous theme of service delivery, there isn’t sufficient space to delve into the details of all of the policy decisions that affect economic

growth, rather we can only hope to lay out some of the pressing issues and general strategic directions. On the economic front there are two general principles that unify the discussion of the policy actions to sustain inclusive economic growth.

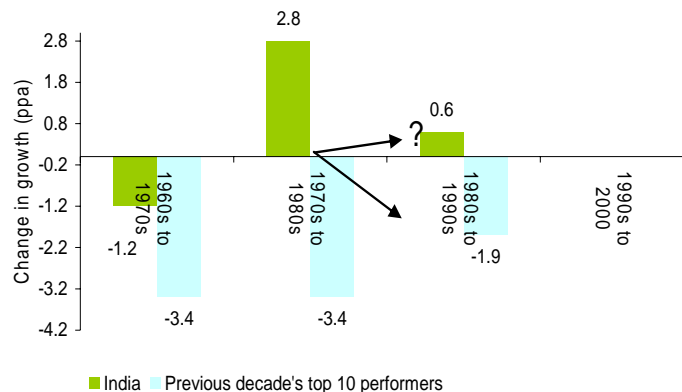
Attack the Binding Constraints. Economic policy making is an endeavor of enormous complexity because every step the government takes can have enormous repercussions, rippling out to affect millions of people. Decisions on what might seem to outsiders as minutiae can affect the profitability of thousands of enterprises. This implies that at any one time the overview of government policies and strategies will be complex and many things need to happen simultaneously. For instance, the Government’s Mid-Term Appraisal of the Tenth Five Year Plan runs to 513 pages and conveniently concludes with a list of 316 recommendations. The opening executive summary limits itself to only 59 key points. This is not a criticism, as policy making in a large and sophisticated economy and polity like India is in fact complex.

But our approach is motivated by a recent review of the lessons of economic growth in the 1990s around the world and by an approach outlined in Hausmann, Rodrik, and Velasco (2005). These make the point that policy analysis can often degenerate into a check-list of all the standard possible reforms that could have an impact on the economy--and the World Bank itself falls prey to this temptation. But while it would be good to do everything, no government has the ability (either technically or politically) to do everything at once. Therefore the goal of analysis should be to identify not just the constraints on economic growth—of which there are legion—but the *most binding constraints* on growth. While it is empirically difficult to quantify and rank the most binding constraints, examining the pattern of growth can provide clues to what important constraints to growth are likely to be.

These binding constraints on growth will not be constant nor static, but are going to be different from sector to sector (what is most constraining agriculture is unlikely to be the same as what is constraining expansion of high-tech services) and from state to state: the binding constraints in Tamil Nadu and Bihar are not just qualitatively but quantitatively different.

The importance of identifying binding constraints is that the capacity for formulation and implementation of policy reform is very limited—as is the political space for attention. Therefore agenda setting so that the right things are on the agenda can be as important as doing the right thing with what emerges on the agenda.

Figure 11: India needs to avoid the common pattern of growth deceleration following superior performance



Source: Author’s calculations.

Empowerment and Opportunity. The second broad theme on growth is that in order to achieve inclusive growth policy reforms should focus on empowerment and opportunity—enabling all Indian citizens to engage with the emerging economy on *fair* terms. We cannot stress enough the centrality of this theme, as though it is often in the background in many policy discussions, it is a complementary part of every reform. Expanding rural infrastructure is good, but without complementary investments in empowerment and opportunity will not be enough. Increased access to rural finance *can be* important, but only if embedded with other reforms to make the rural economy work for the poor.

The government has an important role to play in promoting equity in the economy, the question is how that can be done. In the past, the government has intervened heavily to restrict the operation of the market, at times ostensibly to protect the interests of “the poor” or specific groups. But it has been the sad experience that many programs of this type are launched but few succeed, as they often attempt to limit forces of expansion of productivity and tend in the long-run to reduce opportunity and innovation.

That said, the conclusion that the government can and should do nothing to promote a more equitable economy is wrong and is politically and socially untenable. What the government can do is improve the investment climate to create broad based growth, promote empowerment (by emphasizing human capabilities and facilitating efforts at self-help), and promote *fair* access to assets, input markets and outlets for outputs. This is not an invitation to return to past failed redistribution focused models but a scaling up of new approaches that are proving effective in practice.

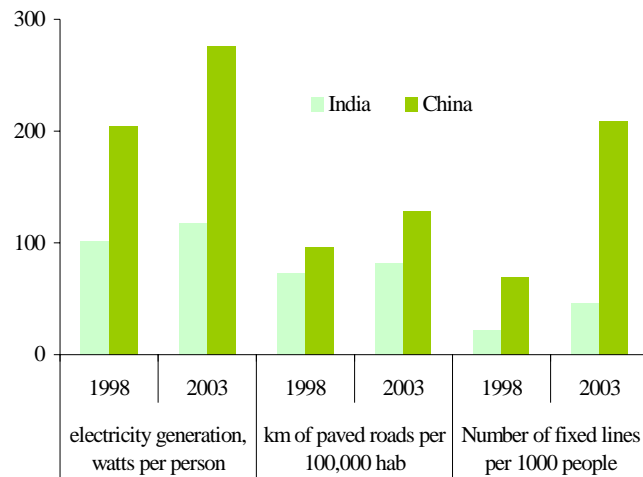
Avoiding Binding Constraints to Overall Growth: Infrastructure and Fiscal Balance

Economic Infrastructure. The massive demands now on power networks, transport, urban infrastructure, and ports are the result of India's success in promoting economic growth. The danger is that poor economic infrastructure now will put a brake on that overall growth. Infrastructure is also important to equalize growth—investments that raise productivity and farmer incomes in agriculture, infrastructure that help jobs move to people, as well as the infrastructure that is needed to connect rural India with the benefits of a growing economy (this role of rural infrastructure is addressed below in the discussion of lagging states).

The aphorism “In a desert one should find camels not hippopotamuses” is a guide to analyzing the pattern of economic growth. If rain is scarce, then one should find animals adapted to a scarcity of water, not those reliant on water. In an economic environment where, say, transport infrastructure is scarce, one should find “transport infrastructure camels”—those industries and firms that are thriving should be less than usually reliant on infrastructure. The enormously successful industries in both computer programming, consulting services, call centers, and the off-shoring (whether out-sourcing or in-sourcing) of a variety of back office or service functions are very much infrastructure camels—most of these industries can be almost completely cocooned from the overall infrastructure (except for getting workers to and fro, and interestingly, many of these firms do that as well rather than relying on existing public transport).

The obvious comparison is between the two global giants of China and India. China has developed a strong infrastructural basis and has had growth led by a spectacular expansion in manufacturing production and exports. Industry is only 27 percent of Indian GDP compared to 46 percent in China. Chinese manufactured exports were nearly 10 times larger than India's in 2004 with related differences in transport infrastructure—China had 12 times as much airfreight and almost 30 times as much port container traffic.

Figure 12: China has an enormous—and growing—advantage in infrastructure



But the shaping of economic structure by infrastructure constraints has its limitations. First, many of these infrastructure camels are educated labor hippos and the growth of these industries has relied on a previously underutilized pool of educated labor—but the price of *very* highly educated labor is escalating very fast (see figure 4 above). It is far from obvious whether these narrow industries can be a base for sustained growth. Second, for the inclusiveness of growth India clearly needs a growth pattern that is consistent with the increase in employment of large numbers of educated, but by global standards “semi-skilled” labor. These jobs are almost certainly going to be more infrastructural intensive than the current pattern.

Of course, this report is hardly breaking new ground in pointing out the weaknesses in infrastructure: the problems are widely recognized, not least by the government. It is clear that India has not invested sufficiently in expanding infrastructure assets.

Fiscal. India's consolidated (center and states) fiscal deficit has been persistently large for many years. While recent efforts to tackle the deficit at the Center and in the states have paid off in substantial progress, the deficit remains a concern.² There is always some risk of a macroeconomic crisis, which can easily undo extended growth episodes, as even the East Asian “Miracle” countries were brought to a halt by the crisis in the late 1990s. The “sustainable” level of debt depends on a larger variety of factors and even though India's debt ratios place it well above many countries which have had severe crises, India is not subject to short-term risks in external financing of the deficit. But interest payments are 6 percent of GDP and 35 percent of total revenue—in a period with historically low interest rates—and with high levels of deficit the debt dynamics can turn very ugly very fast. Sticking to the targets established in the Fiscal Responsibility and Budget Management Act will be important to keep India on track.

But the major reason to be concerned about the deficit is the effect a looming deficit has on the ability to direct the composition of expenditures. As discussed above, the United Progressive Alliance government elected in 2004 has been launching many potentially desirable initiatives in

² Although some have suggested that the large deficit has crowded out private investment, this argument is currently not persuasive because interest rates have not gone up and the commercial banks are holding significantly more government paper than they are required to. Nevertheless, in the absence of fiscal adjustment now, crowding out could become a binding constraint to growth in the future.

priority areas: rural infrastructure (Bharat Nirman), employment (National Rural Employment Guarantee Act), education (Sarva Shiksha Abhiyan), rural health (National Rural Health Mission), urban infrastructure (Jawaharlal Nehru National Urban Renewal Mission). But those new initiatives must be financed with some combination of higher taxes (or user charges), or cutting existing expenditures. The existing deficit leaves the government no *fiscal space* even for highly productive or high social priority new spending.

Even with optimism about progress on taxation, new spending will require governments at the Center and States to tackle the tough issues of restraining the wage bill and tackling the explosive issue of subsidies. While top civil servants are almost certainly underpaid relative to people performing jobs of similar complexity and responsibility in the private sector, the evidence suggests the bulk of the civil service has pay that far exceeds that of equivalent workers in the private sector. Another round of Pay Commission wage hikes would severely compromise the ability to finance priority sectoral expenditures and investments.

The Government (GOI Ministry of Finance, 2004) estimates that non-merit subsidies accounted for 58 percent of total subsidies in 2003/04. The National Common Minimum Program pledged “all subsidies will be sharply targeted at the poor and the truly needy,” but no concrete action has been taken yet. Subsidies have proved, and will prove, difficult to cut. For instance, while it is easy to demonstrate the facts that the power subsidy is economically inefficient, received mostly by high income people, and by encouraging excess water use, is environmentally damaging, the elections of 2004 proved again the electoral power of the power subsidy.

Equalizing Accelerators: Labor Law Reform and Finance

Labor law. The National Common Minimum Program “recognizes that some changes in labor laws may be required,” but also states that “the UPA rejects the idea of automatic ‘hire and fire’” and that “such changes must fully protect the interests of workers and families.” This Report agrees on both counts. But the current ill-designed regulation can have large economic costs and, even worse, can be disqualifying among workers. On any given day the Indian economy has four times more people unemployed (around 35 million) as employed in the organized private sector—and the reported number of such workers fell from 2001 to 2003 (figure 13). A primary concern for inclusive growth should be vibrant creation of employment. Recent research has demonstrated that these restrictive labor laws and practices impose large costs—in lost output and productivity growth, in lost job growth, in distorting the size of firms, and in casualization of labor.

Figure 13: For every worker in the organized private sector there are four unemployed—and the number of organized private sector jobs is falling

Number of workers employed in the organized private sector or unemployed, 2001–03



Source: GOI Planning Commission 2005, tables 8.1 and 8.2

The “dualism” in Indian labor markets is not between the rural and urban sectors, but between the “organized” and “unorganized.” After adjusting the characteristics of the workers urban workers outside the organized sector do not have higher real wages than rural workers, but salaried workers make about 28 percent more than casual workers—even when workers are similar in age,

education, etc. Although they might benefit the roughly 7 percent of workers in the organized sector, this protection comes at a high cost to other workers. Moreover, the dualism created between “good” jobs and casual work or self-employment allows discrimination against women and facilitates caste bias in hiring.

The existing labor regulations do not protect “workers and families,” but only protect those workers with protected jobs. If, as it increasingly appears, those regulations prevent good jobs from being created, they are working against the general interests of workers and their families. Labor reform will have to work to find solutions by searching for incremental steps but which provide institutional continuity and credibility for future progress. These solutions will require consultation among all parties, including trade unions.

Finance. Improving the efficiency of financial intermediation and ensuring broader access to financial services is a critical accelerator for equalizing growth. Problems in accessing finance are often cited as a major impediment to the performance of small and medium-size businesses in India. The ratio of private credit (from deposit money banks and other financial institutions) to GDP in India remains low, at under 40 percent, compared with over 100 percent for countries such as China, Korea, and Malaysia. Only 54 percent of small businesses in India have active bank credit lines, against Brazil’s 75 percent. Problems in credit access are rooted in: (a) weaknesses in the legal framework for loan recovery, bankruptcy, and contract enforcement, together with inefficiencies in the court system, with the latter largely accounting for interstate variations in the time and cost of loan recovery and bankruptcy; (b) institutional weaknesses, such as the absence of good credit appraisal and risk management and monitoring tools in banks, which increase transaction costs in dealing with small and medium-size enterprises; (c) the absence of reliable credit information on such enterprises; and (d) the lack of sufficient market credibility among small and medium-size enterprises. It is difficult for lenders to assess risk premiums properly for small and medium-size enterprises, creating differences in the perceived versus real risk profiles and resulting in untapped lending opportunities.

A recent World Bank (2004) study indicates that over 60 percent of India’s rural poor do not have a bank account, and 87 percent have no access to credit from a formal source. Informal financiers, who charge exorbitant rates of interest, remain a strong presence in rural India. If the financial sector is to contribute more fully to inclusive economic growth, it must reach out to more people. Indeed, there is a growing consensus, based on theoretical and empirical work, that better access to finance, if embedded with other reforms that empower the poor to participate in markets on fair terms, can be an extraordinarily effective tool for promoting economic growth and poverty reduction. Policies to expand competition in the finance markets for rural and small and medium-size enterprises and to improve the governance and management of financial institutions can go a long way in helping the underserved access finance on better terms. These policies need to be accompanied by better laws and regulations governing financial transactions; a judiciary that can enforce contracts, however small; the demarcation of property; improvements in land titling; and better credit information.

Accelerating Agriculture: Region Specific Approaches

Perhaps the most worrying feature of the recent growth performance has been the performance of agriculture. Average agricultural growth over the past three years has been 1.3 percent—against a Tenth Plan target of 4 percent per year. Agricultural growth appears to be decelerating: from 3.2 percent in 1980–92, to 2.4 percent in 1992–2003, and to 1.3 percent over the past few years. As two-thirds of India’s people depend on rural employment for their main source of income, this is directly affecting many households. The deceleration seems to be general across all crops and

appears to reflect a broadly based deceleration in productivity growth (GoI Planning Commission 2005).

As one approaches the issue of how to address the lagging sector (agriculture) and the lagging regions (even within prosperous states) there are four basic strategic directions:

- *Intensification*: Increasing the output of existing activities
- *Diversification*: Shifting into higher value added crops or products.
- *Non-farm linkages*: Fostering linkages between farm and non-farm value addition.
- *Exit*: Shift into non-agricultural activities.

The potential for achieving a higher agricultural growth trajectory in any area is significantly influenced by area-specific natural features (soil, water, proximity to urban markets), infrastructural (accessibility, feasibility of transport) and human capital endowments and by general ease of access to input and output markets. The right mix of agricultural sector objectives (among intensification, diversification, linkages and exit) depends on regional potentials. A “one size fits all” agricultural strategy will not be effective and can lead to dead-ends as, for instance, increasing inputs in infrastructure (power), credit, and technical support are poured into economically and environmentally non-viable agricultural activities. Conversely, continued “intensification” can lead to situations in which nearly all of the massive price subsidies for a stable crop like wheat continue to flow to a few prosperous states.

A workable strategy for acceleration of productivity in agriculture has to attack the binding constraints to agricultural productivity that requires tailoring the right mix of actions with the specific potentials of regions—high potential irrigated areas, moderate to and marginal dry lands need entirely different approaches.

While adopting a strategic approach tailored to a region’s potential may sound like a truism, there are deep and difficult problems this raises.

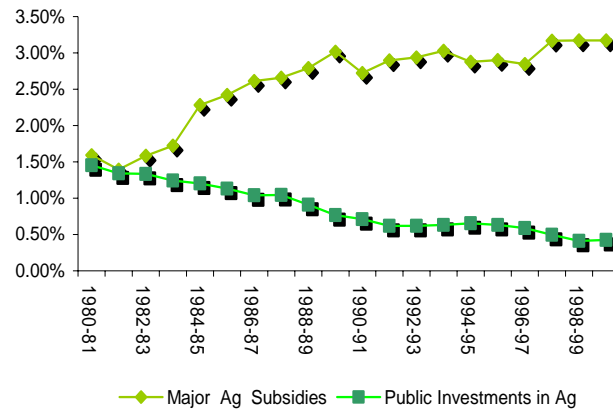
First, pursuing a differentiated strategy, across states and within states, will require a quite substantial continuation of the on-going shift in the government’s stance from “command and control” to a more market-oriented approach—in agricultural marketing, land policy and administration, agricultural research and extension, and watershed management. For instance, the “intensification” phase of providing for the expanding physical productivity of existing stable crops was something of a success as yields on wheat in high productivity states like Punjab and Haryana are high by international standards. But the diversification and promotion of non-farm linkages require a very different mode of engagement—from direct market participant to catalyst and facilitator through policies and investments—that is difficult for governments everywhere, including India.

Second, however much the outlines of a new agricultural strategy might sound like “truisms”, implementation will be complicated by political dynamics. Increasing spending in the “right” way will require getting rid of many current subsidies, and the government is well aware of the problem of misdirected and unsustainable subsidies. But subsidies, especially those directed at agriculture, are a politically complex and sensitive subject.

Since 2004, several states, such as Punjab, Tamil Nadu, and Andhra Pradesh, that had made a beginning in reforming their power sectors reversed track to once again provide free power to their farmers. Most states have yet to begin seriously addressing the issue of sustainable water management, and the national government too is cautious about touching the Minimum Support Price (MSP) regime.³

The logic that the present regime benefits better-off farmers disproportionately, is economically inefficient, and is environmentally unsustainable has failed to carry much political weight with either the rural elite or the rural poor. Richer farmers believe that they are better off precisely because of these subsidies and that they still need the subsidies for sustenance, and to avoid falling into poverty. Besides, being better off does not necessarily free one from vulnerability, given that even so-called “big landlords” in Green Revolution areas often operate smaller than optimal farms or own scattered parcels of land. For the landless poor and marginal farmers, there is a big stake in the present system, despite its obvious inequity, as their employment opportunities stem from the subsidized viability of bigger farmers. And small and medium farmers (especially those in arid areas) depend crucially on subsidized inputs, such as seeds, fertilizer, and groundwater (often purchased cheaply from a richer neighbor using free electricity to operate a pump to mine it). Attacking subsidies, therefore, translates politically into a direct assault on all farmers’ interests. Even when farmers understand the benefit of moving to a more sustainable and nondiscriminatory system based on agricultural technology and infrastructure investments instead of subsidies *in principle*, neither rich, middle nor poor farmer is confident of the transition. The strategy will have to be one of negotiated rationalization of the present system.

Figure 14: Subsidies have gone up, productive investments down...



Notes: Agricultural subsidies include GOI foodgrain and fertilizer subsidies, state government power and irrigation subsidies.
Source: Ministry of Agriculture, Acharya and Jogi 2004.

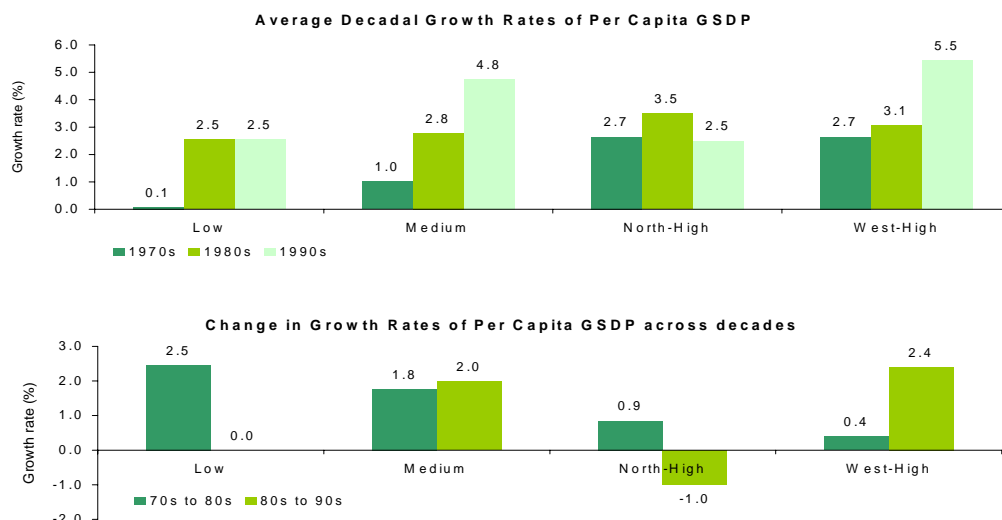
Bringing up the Lagging States: Basics of Investment Climate

Another worrisome feature of India’s economic growth is that the states with the lowest income have also been experiencing the least rapid growth. This is causing the gaps between the medium income states (particularly in the south and west) to increasingly diverge from that of the north and east. Happily, this gap is not because growth has slowed down, on average, in the lagging states. The source of the increasing divergence is that, for the most part, India’s low income states did not share in the acceleration of growth in the 1990s. Whereas the per annum rate of growth of per capita Gross Domestic State Product in the middle income states rose from 2.8 ppa in the 1980s to 4.8 ppa, that of the low income states remained stagnant at 2.5 ppa.

³ In his 2005 budget speech, Finance Minister Chidambaram made clear that food grain procurement would be made cost effective “without impairing the present MSP-based procurement.” This is not to say that sometimes the government of India does not “touch” the MSP in a backdoor fashion. The minimal adjustments to the MSP since 2002 have resulted in the MSP declining in real terms—which has incentive and fiscal effects.

Figure 15: Growth accelerated in nearly all states in the 1980s, but gaps widened dramatically in the 1990s.

Decadal growth of per capita gross domestic product in Indian states, by income group or region, 1970s to 1990s



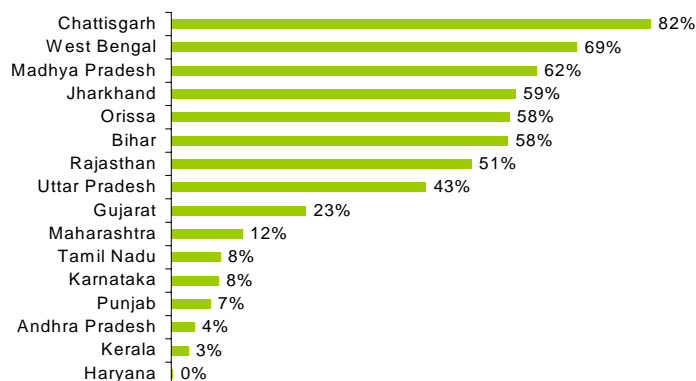
Note: Low-income states include Bihar, Madhya Pradesh, Orissa, Uttar Pradesh, and Rajasthan. Medium-income states include Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, and West Bengal. North-High includes Punjab and Haryana, and West-High refers to Gujarat and Maharashtra.

Source: Authors' calculations.

Therefore the key question is: “how can the currently lagging states improve their investment climate to substantially accelerate their growth rate?” This is clearly a case where the “binding constraints” approach is valuable as when one compares the lagging states to their more prosperous neighbors to the West (e.g. Gujarat) or South (e.g. Tamil Nadu) everything is worse. A recent study compared the states that were “leading”, “middle” and “lagging” (the lagging states were MP, Chhattisgarh, Assam, UP, Orissa, Jharkhand and Bihar) on indices of investment climate, infrastructure penetration, financial sector strength, mass media penetration, primary school in English, and Adult Literacy rate, and an index of the impact of land tenure arrangements. Lagging states were far behind on every single indicator—often with less than half the value of the leading, or even middle states.

Improved Infrastructure. A better rural infrastructure (including access to power, roads, and telecommunications) is critical to rural economic transformation. Better access to roads can play a dramatic role in transforming the rural landscape by integrating the rural population into the formal economy. But more than 50 percent of rural habitations are not connected by road in the states of Bihar, Jharkhand, Madhya Pradesh, Orissa,

Figure 16: In most of the lagging states over half of habitations are not connected by roads



Source: All data from Ministry of Rural Development, Government of India.

Rajasthan, and West Bengal, and in Chhattisgarh, for instance, some 82 percent of rural areas remain unconnected by road (figure 16). Investing in road infrastructure is a critical priority in these states. Access to power can also have a transformative impact on the rural economy. Among the major Indian states, the challenge of rural electrification is the greatest in Uttar Pradesh, which reports the lowest proportion of electrified villages (under 60 percent). Access to a phone line can help link rural producers with markets, raise incomes, and change lives. Again, the lagging states, particularly Bihar, Chhattisgarh, Jharkhand, and Uttar Pradesh, have much catching-up to do on this front.

To address the issue of upgrading rural infrastructure, the United Progressive Alliance government recently (May 2005) announced the Bharat Nirman program. Under this program, the government is set to earmark a major investment for rural infrastructure in six areas: irrigation, drinking water and sanitation, roads, electrification, telecommunication, and housing:

We are committing over Rs1,74,000 Crores. Bharat Nirman should unleash the growth potential of our villages...in the next four years we need to ensure that every habitation has potable water. Every village of over 1,000 population or over 500 in hilly and tribal areas, must have an asphalted road...we must also ensure that over one crore hectares of land is irrigated and that at least 60 lakh houses are built.”⁴

While Bharat Nirman signals the government of India’s commitment to the transformation of the rural economy and is a potentially useful program, the key to success will lie in detailed design and implementation. Bharat Nirman can be a vehicle for rolling out new ways for doing business across states by addressing the issues highlighted in part I of this report on service delivery—or it can be a fiscally costly continuation of business as usual.

Improved investment climate. The real question for the lagging states is whether jobs are going to move to people, or whether the already evident dynamic of outward migration (both seasonal, temporary, and permanent) of people moving to jobs will predominate. For jobs to move to people the lagging states will have to create an attractive destination for investment. Lower wages cannot be the major attraction for sustained investment; rather these states need to identify and attack those constraints that make investment costly.

Almost paradoxically, those states with the intrinsically least attractive locations make themselves even less attractive through their own actions. Regulatory procedures governing entry, exit, and day-to-day operations are cumbersome and require private investors to deal extensively with the state bureaucracy. Delays and harassment in these interactions are common complaints, and such governance failures impose severe costs on firms. In 2004, starting a business cost 51.5 percent of per capita income in Rajasthan, 45.8 percent in Uttar Pradesh, and 44.9 percent in Orissa.

State specific strategies need to identify the key investment climate bottlenecks in economic governance. In some states, establishing law and order has to be the key priority while in others, the climate for natural resource investment (that balances business interests with social concerns to create a stable platform for investment), while in others rural finance may be the key constraint.

⁴ Prime Minister Speech on October 2005. See <http://news.indiainfo.com/2005/10/08/0810nirman-flagship-upa.html>.

Individual Empowerment and Opportunity

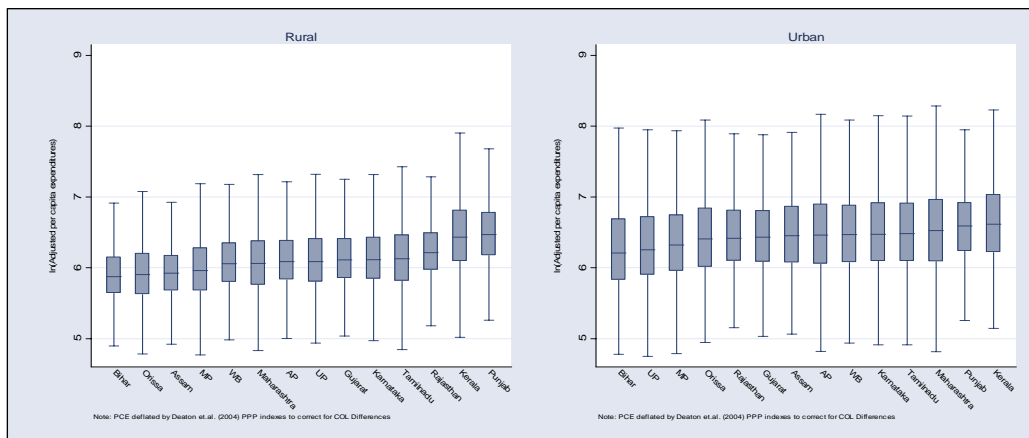
While poverty is tending to be more concentrated in certain states and regions and while there are concerns about lagging rural areas and the lagging growth in agriculture, in the end there are poor people in nearly every state. Figure 17 shows the distribution of income state by state with boxes that show the 25th and 75th percentile of the distribution of consumption expenditures. So, even though Tamil Nadu is a much more prosperous state than Bihar or Orissa, more than a quarter of the population of Tamil Nadu has a lower standard of living than the typical person in Bihar.

So, policies for inclusive growth cannot be content with focus merely on broad aggregates like sectors or states (or even districts) as individuals, households, and communities matter—and there are weak sections of even the most prosperous economy. Empowerment and opportunity has three key dimensions:

- Fair access to markets for assets, inputs and outputs,
- Equitable opportunities for the creation of human capabilities,
- Social protection for major household risks.

Figure 17: The poorer sections of the wealthier Indian states are very nearly as poor as those in the poorer states.

Distribution of per capita expenditures, by state, 1999–2000



Note: The box plots show the 25th, median, and 75th percentiles and upper and lower adjacent values of the logarithm of per capita expenditures adjusted for cost-of-living differences across states.

Source: Authors' calculations using 1999–2000 Schedule 1.0 unadjusted 30-day consumption distribution and multilateral prices indexes for cost-of-living adjustments across states from Deaton and others 2005.

Fair access to markets. There has been a seismic shift from a view that the poor need to be protected *from* markets to the view that a better route out of poverty is to help them to strengthen their own livelihoods strategies through empowerment and fair *access to* markets for credit, labor, land and products. The Self-Help Group (SHG) movement has shown that with efforts at mobilization and empowerment even the poorest women can manage their own resources well and benefit from economic opportunities. The expansion of micro-credit is an important tactic in an overall strategy for rural growth. The experience of private firms with expanding into credit and into marketing (e.g. e-chaupals of ITC) shows that there is no intrinsic contradiction between commercial viability and fair access for the poor.

A key disadvantaged group are tribals, who suffer from both geographic and socio-cultural exclusion. A central factor affecting tribal livelihood possibilities is secure access to and control over natural resources. The Panchayats Extension to Schedule Areas (PESA) Act, 1996, which attempts to redress inequities by transferring rights to ownership of minor forest produce to Gram Sabhas has had limited impact largely due to uneven implementation and inconsistencies with state government provisions. Draft legislation to confer forest rights to forest dwelling tribals is a progressive step in restoring social justice but its success will depend largely on resolving implementation constraints.

As unskilled labor is the key asset of the poor, it is a key concern. There are still social cleavages in the labor market across caste and gender. Women make only 55 percent of men's wages, even in casual labor markets and very little of the difference can be accounted for by the usual determinants of wages. In spite of far-reaching changes, some occupations continue to be caste based, even within the public sector. India has long had caste based reservations in jobs that until recently were the most coveted – regular salaried work in the public sector – and there is evidence to suggest that reservation policies are helping SC/STs to overcome occupational barriers. However, while there are positive impacts of some types of reservation, the mere extension of reservation to larger and larger spheres without accompanying reforms creates real risks of freezing up rather than freeing up opportunity. To make the playing field more even across castes and gender, the most significant reform that India can undertake is to reform labor laws. Perhaps paradoxically, the very dualism created between formal sector jobs and the casual and self-employed workers, created in large part by existing labor regulations, facilitates rather than prevents discriminations, such as gender and caste-bias, in hiring.

Equity in the creation of human capabilities. Investments in human development are important, not just to make the most of livelihood opportunities but also for ensuring that inequities are not perpetuated across generations. However, there are large gaps in human development outcomes across states and between rich and poor in most states. Many of the core public services addressed in part I are related to health, nutrition, and schooling. Implementing reforms in currently lagging areas is particularly important for addressing the inclusiveness of growth—the health, nutritional and educational outcomes for children today will determine their economic capability for decades to come.

Social Protection. Of course, even with the best of access to markets and opportunities there are needs for the government to engage in social protection to assist the poorest and help in coping with the risks and vulnerabilities that citizens face. Well-designed social protection systems can promote not only equity but also dynamic efficiency by mitigating market failures and enhancing opportunities for the poor. India has a long tradition of social protection. However, its social protection system has only just begun to adjust to developments in poverty and vulnerability in recent decades. While it spends a significant amount on social protection, this remains largely focused on social assistance and formal sector social insurance programs, with very limited efforts at insurance-type interventions for the unorganized sector. A strategy is called for which relies on a more balanced mix of efficient and accountable social assistance programs, expanded contributory systems where feasible (with provision for non-contributory programs for certain groups), and programs which perform an insurance-like function such as workfare. The rebalancing of the social protection would also result over time in greater reliance on cash rather than in-kind benefits over time.

The new National Rural Employment Guarantee Act (NREGA) embodies the use of an employment guarantee in a bold effort to provide social protection and transform the rural economy. The international (and Indian) experience has been that a well designed employment

program can be a useful component of a social protection strategy but the devil is in the design and implementation details, two in particular. First, keeping wages low is a key design element of employment schemes as it encourages self-selection among potential beneficiaries and prevents fiscal costs from “rationing” jobs (explicitly or implicitly). In this context the decision to set wages at the state agriculture minimum wage will likely prove problematic as, at that level of wage, demands may exceed available funding, an issue that may have to be addressed based on the experience with the first round of districts. Second, the desirability of employment programs depends to a large extent on the value of the assets they create. The success of the proposed use of greater PRI involvement in implementation of the Act is a promising initiative and could, if done well, constitute a model for other programs—but the accountability mechanisms for GPs will need to be strengthened.

Conclusion

The two major themes of this Report are:

- The need for institutional reforms for greater accountability to improve the delivery of services in core areas, and
- Expanding the inclusiveness of growth by creating greater market opportunities in the lagging sector of agriculture, in more and more states, and empowering people to participate on fair terms in the market

India in 2006 is not yet at, but is nearing a point where paths diverge. One branch of the path leads to a downward spiral into a vicious circle while on the other there is a positive reinforcing virtuous circle.

People cope with weak public provision of services—water, power, education, health, transport, irrigation, security—by finding alternative means of meeting their needs. The wealthy and poor cope with deficient public services in different ways. A recent census of schools in a neighborhood of Delhi found 249 schools, including 68 unrecognized private schools and found that in the last ten years the neighborhood saw 112 new schools created—1 government school, 11 aided schools, 44 private unaided but recognized schools but the category with the most growth was the creation of 56 new private *unaided* and *unrecognized* schools. A recent study in rural Rajasthan found that publicly provided health care was only sporadically available and that all groups sought private care, but that the poorest groups were more likely to seek help from traditional healers or go without care altogether as they were even less likely to use public facilities than the rich. A recent study of drinking water in Delhi found that both rich and poor paid more to cope with inadequate water supply than they paid for water—the rich through storage tanks and wells, the poor through time spent in queues and private water taps (Misra, 2005).

The path of government only as a source of “jobs, contracts, and subsidies” and a commitment to public sector *providers* over a commitment to public sector *provision* of services can lead into a downward spiral. As services deteriorate citizens opt out of reliance on the public sector, even for core services. As more citizens opt-out—the rising urban middle class into private providers and higher quality substitutes and the poor into doing without or lower quality alternatives—they also lose interest in reform. Citizen disenchantment leads to a view of the state, even though democratically controlled, as parasitic on, rather than as an organic part of, the economy and society. As one nears the bottom of this spiral, the only ones with an interest in government or politics are those with a vested interest: pressures for reform evaporate as the rich lose interest and the poor lose hope.

Sustaining rapid economic growth requires continuous effort. As figure 11 illustrated, international experience shows that the quickest route to slow economic growth is complacency during periods of high growth. This effort to push reform ahead is impossible to sustain without political pressure. If the sentiment that economic growth is insufficiently inclusive grows, then the political pressures for reforms to sustain and accelerate growth diminish and dangers increase from the politics of envy and a willingness to risk killing the golden goose to redistribute the existing golden egg.

But there is also an upward spiral of a virtuous circle of increased empowerment and accountabilities leading to improved services and deeper engagement with, and commitment to, core services. India has proved that it can maintain high quality institutions: the Supreme Court, the Election Commission. Moreover, there are many examples of successes in service delivery reform, but for both sustainability and scalability these need to be institutionalized. There is also an upward spiral of bringing more regions, sectors, and people into the benefits from rising living standards, which in turn creates support for continuing to press ahead to create a larger pie rather than fights over its distribution.

In 1991 India faced an incipient macroeconomic crisis and could have easily succumbed to policy paralysis that would end the growth of the 1980s. But bold action turned challenge into an opportunity and laid the foundations for the next 15 years of sustained growth and beneficial globalization. The actions taken in the early 1990s were simultaneously visionary—informed by a clear long-run goal--and pragmatic—taking specific concrete incremental steps to make that vision a reality. We believe that there is a window of opportunity to address both service delivery and inclusive growth with similarly bold action—but that the time for such action will never be better than now.

The agendas of service delivery and of inclusive growth will not be addressed overnight. Years, if not decades, of hard work and adaptation will be required to address the satisfaction gap. But actions today, even modest actions today, if part of an articulated strategic agenda, serve as signals of commitment today to the India of tomorrow.

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