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Trends and Prospects for Poverty Reduction in Rural India: Context and Options

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Acronyms

ACA	Additional Central Assistance
ANM	Auxiliary Nurse Midwife
AP	Andhra Pradesh
APDP	Accelerated Power Development Programme
BCR	Balance from Current Revenues
BE	Budget Estimate
BPL	Below the Poverty Line
CACP	Commission on Agricultural Costs and Prices
CAG	Comptroller and Auditor General
CDPO	Child Development Project Officer
CDS	Current Daily Status (of employment)
CIP	Common Issue Price
CPWD	Central Public Works Department
CSS	Centrally Sponsored Scheme
DRDA	District Rural Development Agencies
DWCRA	Development of Women and Children in Rural Areas
EAP	Externally Aided Project
EAS	Employment Assurance Scheme
ECA	Eastern Europe and Central Asia
EUS	Employment-Unemployment Survey
FC	Finance Commission
FCI	Food Corporation of India
FDI	Foreign Direct Investment
FIIRE	Finance, Insurance, Internet and Real Estate
GBS	Gross Budgetary Support
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GNP	Gross National Product
GoI	Government of India
GSDP	Gross State Domestic Product
IAS	Indian Administrative Service
ICDS	Integrated Child Development Scheme
IMF	International Monetary Fund
IRDP	Integrated Rural Development
JRY	Jawahar Rozgar Yojana
LAC	Latin America and Caribbean
LHW	Lady Health Worker
LPG	Liquid Petroleum Gas
MDM	Mid Day Meal
MENA	Middle East and North Africa
MICS	Multiple Indicators Cluster Survey
MIS	Management Information Systems
MLA	Member of Legislative Assembly
MO	Medical Officer
MOU	Memorandum of Understanding
MP	Madhya Pradesh
MSP	Minimum Support Price
MTFRP	Medium Term Fiscal Reforms Programme
MTR	Mid-Term Review of the Ninth Five-Year Plan

NDC	National Development Council
NFHS	National Family Health Survey
NSDP	Net State Domestic Product
NSS	National Sample Survey
NTFP	Non Timber Forest Product
Oda	Official development assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Cooperation and Development
PC	Planning Commission
PDS	Public Distribution System
PE	Public Enterprise
PESA	*Panchayat*s Extension to Scheduled Areas
PHC	Public Health Centre
PRI	*Panchayati Raj* Institution
RBI	Reserve Bank of India
RE	Revised Estimate
SC	Scheduled Caste
SCS	Special Category State
SEB	State Electricity Board
SGSY	Swarnajayanti Gram Swarozgar Yojana (Golden Jubilee Rural Self-Employment Programme)
SLR	Statutory Lending Ratio
SSA	Sarva Shiksha Abhiyan – a scheme for promoting elementary education
ST	Scheduled Tribe
T&D	Transport and Delivery
TPDS	Targeted Public Distribution System
TRYSEM	Training of Rural Youth for Self Employment
TT	Tetanus Toxoid
UNICEF	United Nations Children's Fund
UP	Uttar Pradesh
UT	Union Territory
WFP	World Food Programme
WHO	World Health Organisation

Summary of Findings, Questions and Issues

The purpose of this paper is to set out the macroeconomic and structural contexts for poverty reduction in India. It was written as background for a study,[1] which seeks to identify how government can better support diversification[2] out of low productivity occupations in reducing poverty and protecting against livelihood insecurity in rural India. Essentially, the paper discusses opportunities and constraints in relation to public investment and service provision that have a bearing on rural livelihoods, whether through growth or distribution mechanisms. Evidence from field studies and from other papers commissioned by the study considers how public services and investments have or have not been accessed by poor people at local level. Given the wide range of economic, social and governance dimensions of public policy that, in principle, may have some impact on the livelihoods of the rural poor, this paper has had to be selective. For instance, it deals only superficially with health and education, with rural infrastructure, with foreign investment and with some of the monetary and fiscal aspects of macroeconomic management. Its concerns are principally with:

- clarifying our understanding of who the rural poor are, and, within the context of wider macroeconomic and social relations, examining what the recent performance has been in reducing poverty, and what constraints are faced by poverty reduction efforts;
- examining the growth performance and prospects of agriculture, the sector most directly relevant to the rural poor;
- examining whether fiscal crisis is in prospect, and the changing nature of centre-State fiscal relations, given their importance to State budgets in general, and to poverty reduction efforts in particular;
- examining the constraints faced by those government efforts (especially Centrally Sponsored Schemes, but also subsidies such as the Public Distribution System, PDS) which aim to address poverty directly;
- examining the challenges imposed by low standards of governance at all levels.

In relation to each of these, it summarises a number of findings drawn from such sources as reports of the Planning Commission and of the Prime Minister's Economic Advisory Committee, as well as external assessments such as those made by the International Monetary Fund and the World Bank. It then raises a number of questions that need to be addressed if the scope for public policy to support improved livelihood options for the rural poor is to be enhanced.

Some of the analysis and ideas for policy reform presented here will have a familiar ring, having been discussed, for instance, in the mid-term review of the Ninth Five-year Plan (GoI, 2000) and in the approach papers for the Tenth Plan. But our purpose here is to go beyond merely listing recommendations. It is to stimulate discussions of policy change (or the lack of it) in the context of 'policy process', in other words, to examine what conditions are essential for certain types of policy change, and what the prospects are for such conditions to be put in place. A bleak view of the policy process, for instance, might suggest that difficult changes will not be introduced unless government is faced with a crisis of one kind or another. For instance, the fiscal crisis of 1991 opened the door to reforms recommended by the IMF.[3] A similar crisis may be looming as levels of borrowing by the States and central government have clearly reached unsustainable levels. However, a further

1 See www.livelihoodoptions.info
2 Diversification here is not limited to rural contexts, but is taken to include work in urban areas, whether through daily commuting or migration. Urban links to rural areas are also important in product, factor and capital markets. For all of these reasons, the paper considers opportunities and constraints in a much wider context than simply the rural.
3 Though some observers (notably Jenkins, 1999) have noted the high degree of resistance to change embedded in the bureaucracy.

kind of crisis threatens, namely that of governance, and this has remained largely outside the published analyses of international organisations such as the IMF and the World Bank.

Levels of poverty

In relation to poverty, the paper acknowledges that around 70% of the poor in India live in rural areas, mainly in areas weakly integrated into mainstream economic, political and social infrastructures, and over 70% of these rely mainly on agriculture, more than half being primarily agricultural labourers. Poverty has important structural dimensions – of age, gender and caste. The poor are widely denied access to infrastructure, services and benefits directed specifically towards them through government programmes. Government estimates of the overall rate of poverty reduction appear recently to have been over optimistic – the proportion of overall population below the poverty line is more likely to be in the order of 30% than the claimed 26.1% in 1999–2000.

Economic and social indicators

A wider view suggests some strengthening of certain economic and social indicators, but also a number of areas for concern:

- Substantial economic growth, averaging 6%/yr in the 1990s, but with some evidence of recent slow-down, especially in agriculture. Particularly strong growth in high-skill sectors such as IT-related industries and financial services, which have low multiplier effects on employment prospects for the poor.
- A moderately strong external position with external reserves in excess of 6 months' worth of goods and services imports, and standing at four times the level of short-term external debt, and a decline in external debt to around 22% of GDP, with a current account deficit not exceeding 1% of GDP in recent years.
- Very low Foreign Direct Investment (FDI) and external aid. During 1996–2000, FDI to India actually fell by 2% whereas the cumulative annual rate of growth for the world as a whole was 31% during this same period. It was merely US $2.3 bn for India in 2000–1, as against US $38.4bn for China and US $32.8bn for Brazil in the same year. FDI averaged 0.5% of GDP in India against 8% for all developing countries. Structural and regulatory complexities, and foreign perceptions of an excessively regulated business environment, remain major stumbling blocks to FDI in India. Oda as percentage of GDP fell from 1.4% in 1991–2 to 0.5% in 2000–1. Even in absolute terms, the utilisation of external assistance, which was US $4.69bn in 1991–2 fell to US $3.60bn in 2001–2 (Government of India, 2003: S-96).
- Continuing trade protection: while quantitative restrictions on imports have been removed, the average industrial tariff on imports remains very high – at around 34% compared with the East Asian average of 12%.
- Limited progress in strengthening the financial sector, so that a high proportion of loans remain outstanding and the performance of banks, especially rural banks, is weak. Some privatisation is mooted, but is unlikely to progress far so long as government wishes to retain a controlling share in each institution.
- A deteriorating fiscal situation, both at Union and State levels, with a general government deficit approaching 10% of GDP, which is among the highest in the world.
- Some improvement in social indicators – with an increase in life expectancy from 55 to 63 years over the last 2 decades, and a fall in infant mortality from 108 to 70 per 1000 live births (but

with some recent levelling out), and some increase in literacy levels (but remaining low with one-quarter of men and almost half of women still illiterate).

Agriculture and food

Agriculture is characterised by some slowing in rates of growth as yields level off in Green Revolution areas and environmental problems increase, and growing exposure to competition from imports. Agriculture continues to be by far the most important source of employment and self-employment in rural areas, but is diminishing in importance, with a decline in the proportion of all rural households receiving income from cultivation from 62.4% in 1987–8 to 57.1% in 1999–2000. Patterns of employment change are complex, and there is no doubt that there is much ‘distress’ movement out of agriculture. The sector is also characterised by continuing heavy reliance on input subsidies and minimum support prices as ways of enhancing productivity, with negative effects in terms of crowding out productive investment in public irrigation, marketing infrastructure and so on. Agricultural markets remain highly regulated, and the management of price support, subsidised food distribution and restrictions on the movement of ‘essential commodities’ has shown major weaknesses with wheat and rice stocks recently reaching some 60 million tons. The use of scarce and costly irrigation water for highly water-demanding crops such as paddy and sugarcane, instead of concentrating these in areas having high local water availability, needs to be redressed by appropriate fiscal measures. The weak availability of low-cost sources of farm power (mainly for irrigation), such as electricity, has led to high investment in more costly sources such as diesel engines, which is suboptimal from the perspective of social cost:benefit analysis. There must be questions over whether, in future, agriculture can adapt to the opportunities and pressures resulting from globalisation, given especially the low levels of literacy and weak product and factor markets in many rural areas, whether, if it cannot, there is likely to be an agricultural ‘involution’ back to subsistence crops in many areas, and what the prospects are for agricultural labour, already characterised as it is by increasing casualisation (Ruthven and Kumar, 2002).

Growth in agriculture is likely to have major pro-poor employment effects (providing that operations such as harvesting and threshing are not mechanised with the help of subsidies). Growth in the future must rely less on regulated markets and on subsidies on fertiliser, water and power, and more on higher investments in irrigation, seeds, power and roads (all of which have suffered investment declines recently). The types of investment in wetter (i.e. the east and northeast) versus drier areas (i.e. peninsular India) that are necessary are quite distinct, but improved management of water is essential in both. Among other things, perspectives on the conjunctive use of water need to be reinforced, so that water is managed in ways which ensure year-round access by the poor to clean drinking water, since this is known to impact on women’s time allocations and on certain of the non-income aspects of poverty. Finally, there are compelling grounds for paying at least as much attention in future to demand alongside supply issues, in view of (a) falling open market prices for various commodities even in deficit States, and (b) continuing high levels of malnutrition, especially among children. Pensions and feeding schemes are potentially among the more robust strategies here.

Policies on subsidised food distribution are politically popular, but have caused an enormous drain on public finances. The annual cost of food subsidies rose from Rs120bn in 2000–1 to an anticipated Rs240bn in 2002–3. Guaranteed prices to farmers are also costly and poorly managed, having recently been well above free market prices. They need to be reduced to a level comparable with international prices, so as to promote the diversification of agriculture, environmental sustainability, and reduction in food subsidies. Other policy options in relation to agriculture and food include the removal of controls on the movement of ‘essential commodities’ between States, the phasing out of all arrangements in support of monopoly purchase, the encouragement of wheat and rice exports on private account, the decontrolling of sugar, and its removal from the Public Distribution System altogether, and a lifting of the ban on the futures trading of agricultural commodities.

Centre-State fiscal relations and fiscal crisis

The Constitutional division of responsibilities between the Government of India and the States (including Union Territories, UT) means that the revenue-raising capability of the GoI is substantially higher than that of the States. This is compensated by statutory provision for the transfer of funds from the centre to the States, via the Finance Commission, and, further, administrative provision mandated largely to the Planning Commission for transfer through two routes, via support to States' Plans, and via the Centrally Sponsored Schemes (CSS) of GoI Ministries.

In 2001–2 the States received roughly Rs700bn, Rs400bn and Rs250bn[4] respectively from these three sources. In aggregate, these three sets of transfers were more than the States' tax revenues and amounted to almost 36% of the States' public expenditure. Transfers from centre to States are therefore important, and have been increasing in real terms, but declining in relation to most key indicators. Thus, for instance, they have declined from 9.3% of GNP in 1985–6 to 5.4% in 1999–2000. They have also declined against the revenue receipts of central government, and as a proportion of States' tax receipts, though States have maintained a constant share of the 'pot' of money available to be shared out, i.e. they have received a roughly constant 28%–29% of shareable Union taxes and duties since the 1980s. Some of these relative declines may be accounted for by the declining share of taxation in relation to GNP. Some clear shifts have occurred among the three types of transfer: there has been a shift in favour of transfers via the Finance Commission, reflecting a diminishing importance attached by central and State governments to Five-year Plans. States will no doubt welcome this as a much more flexible source of funds, and one that does not add to their debt burden or require counterpart contributions from them. Within the two types of funds mandated to the Planning Commission, support via the Union Ministries' Centrally Sponsored Schemes has doubled over the last 20 years, increasing their share in the central plan allocations from one-third to a little less than two thirds of the total. Again, this reflects a de-prioritisation of planning, but also a desire on the part of central government to ensure that even the least progressive States introduce what it regards as socially and environmentally enlightened provisions. The same desire is reflected in the shift in allocation of these resources towards the poorer States. But is there any evidence that these administrative measures will have the desired effect in the absence of fundamental governance reforms in several of the poorer States?

The prospects for public investment in general, and for expenditure geared specifically towards poverty reduction, are overshadowed by a severe deterioration in public finances, both at the centre, and (especially) at State levels. The deterioration is driven by several factors: an excessively generous national pay and pensions settlement for public sector employees; severe losses incurred by public utilities, especially in the power sector; the inability of the State and central governments to increase the tax-GDP ration, mounting tax burden, and continued subsidies on both consumer staples (such as rice in Andhra Pradesh) and on inputs (especially fertiliser and rural electricity). Within this context, around 36% of the public expenditure of States (other than Special Category States, for which it is much higher) is accounted for by transfers from the centre. Of these, entirely untied transfers under statutory Finance Commission (FC) provisions are as high as the other two mechanisms combined (support to State plans, and funding for Centrally Sponsored Schemes

4 According to the budget documents this figure is only about Rs100bn. The reason for the discrepancy is that transfers to District Rural Development Agencies (DRDAs) and State Societies are not included in the budget as transfer to States, although this mode of transfer to state level organisations is now about Rs150bn.

(CSS), both of which are tied to agreed categories of expenditure). Historically, the trend has been for FC allocations to increase in relation to the others. The overall share of the States in central taxes (excluding non-Plan grants) improved from a low of 15% in the early 1950s to 28% in 1980–1, but has been stagnating at that level for the last twenty years. If we include share in taxes, non-Plan grants, and Plan transfers to the States from Planning Commission and the central ministries,[5] the proportion of national GNP allocated to all total transfers to the States increased from 4.8% in 1974–5 to 9.3% in 1985–6, but has been falling since then, and was only 5.4% of GNP in 1999–2000 (see Figure A6.1 in Appendix 6). The revenue receipts of centre as a proportion of GDP have declined from 11.3% in 1989–90 to 8.8% in 2001–2, but the debt service payments of the central government have risen from about 30% of tax revenue in 1980–5 to about 70% at present, and nearly two-thirds of the current borrowings go to financing current expenditure. Since 1995–6, the debt stock of the States increased at the compound annual rate of 17.9%, whereas their revenue receipts increased only at 11.2%. Consequently, the share of interest payment in total expenditure increased from 13% in 1990–1 to 21.6% in 2000–1, thereby crowding out productive expenditures.

Informal transfers of centrally sourced funds by the States between Plan and non-Plan categories, especially in order to fund a growing and increasingly costly army of government employees, and the fact that funding for State Plans and for CSS has recently had to be financed by the centre from borrowing, fuel doubts over the continued relevance and viability of Five-year Plans as a vehicle for prioritising public development expenditure in India. If indicative planning is becoming obsolete, should it be replaced simply by expanding untied transfers of the kind mandated to the Finance Commissions? Or, as one school argues, will this simply fuel further profligacy and lack of financial discipline in the States? Should there therefore, as another argues, remain a basic minimum of CSS, independently of whether indicative planning continues or not, in order to urge the less progressive States to adopt socially and enlightened policies focused, for instance, on poverty reduction and environmental regeneration? Although a legitimate concern of the centre, is there any prospect that such good intentions will win through in the absence of more fundamental political reform in weaker States?[6]

Centrally Sponsored Schemes and poverty focused subsidies

CSS are to some degree an expression of affirmative action by government, those of potentially most significance for rural areas including off-season employment, self-employment, pensions, housing, and environmental regeneration through watershed approaches. The annual Plan provision in 2002–3 for CSS in rural development is Rs180bn, for food subsidy Rs240bn, and for fertiliser subsidy about Rs110bn, making a total of Rs530bn. Against this, the provision for irrigation is only Rs28bn and for afforestation only Rs6bn. There is a case for examining whether the resources used for poverty alleviation schemes and for various types of subsidies in the name of the poor may not be more effective in alleviating poverty if directed to various types of asset creation programmes in rural areas. Certainly, CSS suffer a wide range of difficulties ranging from rigidity, non-adaptability to local conditions, late disbursement of funds, reallocation of funds by some States into unrelated recurrent expenditure (especially employment costs), re-branding of schemes to suit party-political purposes within the States, and a wide range of rent-seeking practices, including embezzlement, demanding of bribes, and demands by elected representatives that funds should be allocated to current or potential political supporters. Although some schemes are more robust than others in the face of these difficulties, in many, the proportion of funds reaching *intended* beneficiaries is well under 50%. Given the deterioration in public finances, a question in the minds of some is whether the great majority – perhaps all – of these schemes should be terminated. This might especially apply to Integrated Rural Development (IRDP)-type initiatives in which there is a large element of

5 This still leaves out a small component of transfers from Ministries to DRDAs, etc. on which year-wise figures are not available.
6 The Bihar example in section 8 and the Orissa example in Appendix 3 are illuminating here.

public directive and subsidy in what are essentially private investments.[7] Those taking a more moderate position might ask which types of scheme – perhaps those concerned with environmental regeneration, seasonal employment generation and old-age pensions for the destitute – should be retained and made more robust in the face of chronic implementation constraints. A further question concerns the lowest tiers of government: *Panchayat*s typically receive a large proportion of their funds from CSS. But how far are these allocated in ways that reflect local people's needs? Can shortcomings here be remedied easily? Can employment programmes be tied more closely to the creation of public assets? Is there a case for using rural development funds for enhancing the budgetary allocation of successful rural development schemes that are being run by State governments, or for meeting the State contribution for donor assisted programmes for poverty alleviation. What particular merits are there in supporting women's programmes more fully? How can livelihoods in areas weakly integrated into markets best be strengthened? Do direct transfers such as pensions and feeding schemes offer particular attractions where rent-seeking in government is high? At a different level, if CSS are to be terminated or drastically curtailed, what alternative mechanisms of funding local government should take their place?

Governance

Many have claimed that weak governance influences the quality of performance of the public sector at all levels in India. In the present context, at the higher levels this is witnessed by the allocation of portfolios and funds in ways intended to consolidate ruling alliances, and at middle and lower levels by the diversion of funds towards current or potential political supporters. Ever shorter intervals between transfers of civil servants appear to indicate increasing political interference in the careers of those to whom politicians take a dislike. At all levels the performance of many civil servants is unresponsive to local requirements, and, among certain ones, simply corrupt. One interpretation of the refusal to take difficult decisions at State and central levels (e.g. in relation to the power sector, and to subsidies more generally) is that decisions are dominated by short-term political expediency to the neglect of wider economic, social or environmental concerns. Important questions concerning civil service reform have to be regarded as a long-term prospect – indeed, there are questions over whether it can be achieved at all – in the face of declining standards in political life. In the meantime, or as an alternative, can programmes of public investment or service delivery be redesigned so as to be more robust in the face of chronic administrative weakness? To take a middle road, is there some hope that new information technologies will offer new scope for people to complain successfully about the performance of public services, as the Gyandoot experiment in one district of Madhya Pradesh appears to demonstrate? What of local government – with all the affirmative action it embodies, such as reservation of seats for women, Scheduled Castes (SCs) and Scheduled Tribes (STs) – does it offer scope for strengthening representative democracy at local level, or is it simply reproducing the types of élitism and patron-client relations found at higher levels?

7 IRDP has been renamed SGSY (Swarnajayanti Gram Swarozgar Yojana, Golden Jubilee Rural Self-Employment Programme). For the lineage of several Centrally Sponsored Schemes, see Nayak et al (2002).

1 Who are the Poor in India?

It is estimated that one-third of the world's poor live in India, and there are more poor people in India alone than in the whole of Sub-Saharan Africa. Although official estimates of the Government of India indicate that only every fourth Indian is poor, according to the estimates of the internationally recognised poverty line of dollar a day, 44% of persons in India are poor, and 86% of people earn less than $2 a day. Even official data indicates that two out of three children are moderately or severely malnourished.

Indian poverty is predominantly rural, where landless labourers and casual workers are the worst-off economic group. Scheduled Castes and Tribes, women and female-headed families, old people, and female children face more deprivation than others. The rural poor are primarily those with limited ownership of assets – including land. The vast majority of the rural poor in India are engaged in agriculture (including fishery and livestock), either as agricultural wage labourers or marginal farmers. Table 1 below gives a breakdown of the occupational characteristics of the rural poor in India in 1993–4.

Table 1 Livelihood characteristics of the rural poor in 1993–4 (%)

Livelihood category	Scheduled Tribe (ST)	Scheduled Caste (SC)	Others	All households in livelihood category
Self-employed households in agriculture	5.6	4.8	22.5	32.9
Agricultural labour households	6.5	16.2	18.9	41.6
Self-employed households in non-agriculture	0.8	2.4	7.7	10.8
Other rural labour households	1.5	2.4	4.0	7.8
Other (residual households)	0.7	1.5	4.7	6.9
All households	15.0	27.2	57.8	100.0

Source: Government of India (2000)

Table 1 reveals several important characteristics of the rural poor. First, almost 42% of the rural poor fall into the most economically disadvantaged group of agricultural labour. Furthermore, more than half of this group consists of Scheduled Castes and Scheduled Tribes (SCs and STs).[8] Overall, SCs and STs constitute about 25% of the rural population but account for more than 42% of the poor. This imbalance has prompted a series of affirmative action interventions in favour of SCs and STs. The particular plight of STs is highlighted in Appendix 4.

Poverty is an extremely complex phenomenon, which manifests itself in a range of overlapping and interwoven economic, political and social deprivations. These include lack of assets, low income levels, hunger, poor health, insecurity, physical and psychological hardship, social exclusion, degradation and discrimination, and political powerlessness and disarticulation. Interviews with the poor have suggested that the aspirations of the poor are in fact for survival, based on stable subsistence; security, based on assets and rights; and self-respect, based on independence and choice (Chambers et al, 1989). Therefore, policy instruments should be designed to address not only the low income and consumption aspect of poverty, but also the complex social dimensions. The range of affirmative action undertaken by government towards SCs and STs is one attempt to address some of these social dimensions.

The Tenth Plan Approach Paper argues that the benefits of growth have trickled down only to a very limited extent. At least 60% of rural households and about 20% of urban households do not

8 As defined in the Constitution of India and attached schedules.

have a power connection; only 60% of urban households have taps within their homes, even fewer have latrines inside the house.

Environmental degradation, which was not much of a concern until quite recently, has started to accelerate, particularly in urban areas. Deterioration in the urban environment, increases in slum population, and in air, river and water pollution has vastly affected the quality of life of the urban poor. Land and forest degradation in the rural areas, and over-exploitation of groundwater has seriously threatened sustainability of food production, traditional irrigation systems and even availability of safe drinking water.

Within the household, women are significantly more disadvantaged than men. They have poorer literacy rates (nationally, 54% against 76% for men) and even less control over decision-making within the family and over family assets. Secondly, overall two out of three children are moderately or severely malnourished, and the nutritional status of children from poor families is alarming.

In addition, multiple deprivation linked to poverty, gender and caste is a deeply rooted reality in the countryside, and any comprehensive effort to reduce poverty must confront that reality and its consequences. The realities are visible in the segregated hamlets where many of the lower castes live on the fringes of rural villages, often distant from community services – schools, health centres, public handpumps, and shops that distribute subsidised grains – in principle meant to assist the poor.

The urban poor are characterised by extremely poor living conditions – in slums, on public lands, or often on the road itself. They are generally first generation migrants with no security of jobs or housing, and are subject to police and municipal brutalities. They are in occupations where health and safety provisions either do not exist or are widely flouted, such as hawking or rickshaw pulling (or under contractors who are violating labour and factory laws), and therefore become dehumanised and criminalised by the very processes of survival. What remains to be implemented is more social control over housing space, a ban on certain types of industrial activity in metropolitan towns, and rigorous implementation of labour laws in favour of migrant populations.

As rural people are pushed to the city because of abject rural poverty and unemployment, any effort to deal with urban poverty in isolation is likely to be unsustainable, as it would bring new migrants in search of jobs and better life. In other words, it is far more expensive to create an urban unskilled but non-polluting job with human dignity and basic conditions of living than it is in the rural areas. This paper is concerned primarily with issues of rural poverty.

2 The Measurement of Poverty

Poverty in India is officially measured not on 'dollar-a-day income criteria' but in terms of the current expenditure corresponding to monthly per capita expenditure of Rs49 in rural areas and Rs57 in urban areas at 1973–4 all-India prices, with people below this expenditure considered poor. This expenditure was then considered necessary to achieve specified levels of calorie consumption, namely 2400 calories/day in rural areas and 2100/day in urban. At 1999–2000 prices the new poverty line expenditure varies from State to State, from Rs350 to Rs450 per month per capita, although it is quite possible that people may have shifted their consumption to non-food items from food items, and therefore consuming much less than the desired calories, although classified above the poverty line.[9]

The Planning Commission estimates poverty from consumption distribution reported by the National Sample Survey (NSS). These results obtained from the consumer expenditure data of the 55th Round are compared with the previous estimates in Table 2.

Table 2 Poverty as assessed by the Planning Commission

Year	Percentage below poverty line	Annual decline in percentage points during the period	
1973–4	56.4	-	-
1987–8	39.1	1974–87	1.3
1993–4	36.2	1987–94	0.4
1999–2000	26.1	1994–2000	1.7

Source: Government of India (2000)

According to Table 2 the strongest decline in poverty took place during the period 1994–2000, by 1.7% annually, as opposed to only 0.4% during 1987–93.

However, the large ('thick') sample survey of 1999–2000 (55th Round) on which these figures are based made a significant departure by canvassing information on consumption using two different reference periods on all sample households, and reported two sets of distributions of consumer expenditure. This makes it difficult to compare the estimates obtained from the 1999–2000 survey with those of earlier 'thick' estimates such as the 50th and 43rd rounds, but also with the 'thin' rounds from the 51st to the 54th.

The claim of a very fast decline in poverty during the period 1994–2000 is not supported by data gathered by other agencies, or even by NSS for other purposes. For instance, the National Sample Survey Organisation also carried out Employment-Unemployment Surveys (EUS) in 1993–4 and 1999–2000 that included consumption modules, which were not contaminated by the mixture of recall periods within one survey, as in the expenditure survey for the 1999–2000 NSS. Sundaram (2001) analysed the consumption distributions from the EUS and found that the average annual rate of poverty reduction was only 0.43 points per year, as opposed to 1.7 points declared by the Planning Commission on the basis of the Consumption Survey. This means that the annual rate of poverty reduction has remained broadly the same as in the earlier 1987–8 to 1993–4 period, and that the 1999–2000 level of poverty would be around 30%, and not the 26.1% claimed by the Planning Commission.

9 Per capita cereal consumption per month declined between 1972–3 and 1993–4 from 15.26kg to 13.4kg in rural areas and from 11.24kg to 10.63kg in urban areas. The decline is generally interpreted in terms of a shift to more vegetables, fruits and meat products, and a shift to non-manual occupations.

To take a further set of evidence, the data on per capita Net State Domestic Product (NSDP) of the poorer States that contain almost 60% of India's poor people shows that the rate of growth during 1990–2000 has not been encouraging. In fact it has hardly improved in Bihar, and in other States the rate has generally been below 2% per annum. Out of the total number of people falling below the poverty line, the proportion in the five States of Uttar Pradesh (UP), Bihar, Madhya Pradesh (MP), Orissa, and Assam has gone up from less than 50% in 1973–4 to more than 65% in 1999–2000. Given the poor growth record of these States, it is difficult to believe that overall poverty would have declined rapidly. Chronically weak governance is one reason advanced for the exceptionally poor growth and poverty reduction performance of some States (see the case of Orissa in Appendix 3). Datt and Ravallion (2002) attribute inter-state differences in the poverty-reducing impact of growth more squarely to differences in initial distribution of access to land and in education – though the latter is not inconsistent with weak governance.

As poverty in India is closely correlated with food consumption, it is relevant to look at the consumption of different deciles. The poorest three deciles of the population in 1993–4 consumed 11.76kg of foodgrains per month against 14.77kg for the top three deciles (Saha, 2000):

So long as a significant cereal gap between the top and bottom end of rural population persists, falling foodgrain availability must be taken seriously, as lower consumption by the poor cannot be a matter of choice, it must be viewed in terms of distress. Since the number of officially declared poor people is only 261 million in the country, bridging the gap of 3 kg between the top 30% and the bottom 40% would require only 261x3x12/1000, or less than 10 million tonnes of foodgrains to wipe out hunger and food based poverty in India.

Calorie consumption of the lowest decile has marginally declined from 1895/day in 1993–4 to 1890 in 1999–2000, whereas for all classes it increased from 2542 to 2632 (MSSRF and WFP, 2002) in the same period, whilst government food stocks rose to an all-time high in 2002 of over 60 million tonnes. These figures do not support the notion of a very fast decline in the number of the poor people.

Nor do data on employment and wages support claims of a fast decline in poverty during the period 1993–4 to 1999–2000. There has been a long-term decline in the proportion of the working population dependent on agriculture – from 69.5% in 1961 to 59.8% in 2001. The latest available national-level NSS for 1999–2000 shows an absolute decline in the number employed in agriculture, between 1993–4 and 1999–2000 at the all-India level. Whether this is due to a fast growth in modern non-agricultural sector employment or due to labour-displacing trends in agriculture remains to be seen. Chadha and Sahu (2002) conclude that the rural workforce has been seriously harmed by the worsening employment situation. 'Thus, an employment setback has hit every section of the Indian workforce. In relative terms, the most grievous setback is suffered by rural females, followed by rural males, urban females and urban males, in that order.' According to the NSS, on the basis of Current Daily Status (CDS), unemployment increased in India from 5.2% in 1987–8 to 7.1% in 1999–2000. This trend was even sharper in rural areas where unemployment increased in the same period from 4.6% to 7.2%. The growth rate of employment dropped sharply from about 2% per year in the period 1983–93 to less than 1% in the period 1993–4 to 1999–2000.

Table 3 Employment growth in the last two decades

Period	**Annual rate of growth (%)**	
	Rural	*Urban*
1983 to 1987–8	1.36	2.77
1987–8 to 1993–4	2.03	3.39
1993–4 to 1999–2000	0.67	1.34

Source: Chandrashekhar and Ghosh (2001)

The analysis of the 1999–2000 National Consumption Survey by Sundaram (2001) cited above, together with the persuasive modelling by Datt and Ravallion (2002) suggests a ‘guesstimate’ for this paper of the current proportion of the population below the poverty line of approximately 30%. This is not inconsistent with the estimates by Deaton and Drèze (2002) arrived at through careful careful adjustment of official estimates to reduce the influence of methodological shortcomings. Nor is it inconsistent with the recent slowdown in agricultural growth (see below) or with stagnation in other indicators, such as infant mortality, which has remained at around 70 per 1000 live births over the last several years. In other words, the annual rate of poverty reduction shows little change from its historic (1987–8 onwards) trend, and the official estimate of 26.1% in poverty for 1999–2000 is seriously overoptimistic.[10]

10 The postulated sharp decline in poverty after 1993–4 is at variance with what Sheila Bhalla (2000) calls an ‘economic development disaster’ reflected in the decline in per capita consumption expenditure in constant prices in rural areas in every year of the 1990s after 1991 except for 1997.

3 Macro Economic and Social Contexts

Recent studies by the Prime Minister's Economic Advisory Council (2002) and reports by the IMF and others have commented on progress and constraints in economic and social indicators since the introduction of economic reforms following the crisis of 1991:

- Substantial economic growth, averaging 6%/yr in the 1990s, but with some evidence of recent slow-down. Particularly strong growth in IT-related industries, financial services.
- Continuing heavy reliance in agriculture on input subsidies and minimum support prices as ways of enhancing productivity, with negative effects in terms of crowding out productive investment in irrigation, marketing infrastructure and so on.
- A continuing crisis in the power sector, with widespread theft of power, low payment of bills and low investment in such sources as hydropower generation. Today, combined state utility financial losses are estimated at approximately Rs260bn, i.e. somewhat more than US $5bn a year. To put these losses into perspective, Rs260bn is half of what all the state governments in India combined are spending on all levels of education every year, and three times what they are spending on water supply. If current trends continue, in another three years, state utility financial losses will reach Rs450bn per year (Ferro et al, 2002). This is despite the fact that the industrial electricity tariff in India is one of the highest in the world.
- Some improvement in social indicators – with an increase in life expectancy from 55 to 63 years over the last 2 decades, and a fall in infant mortality from 108 to 70 per 1000 live births (but with some recent levelling out), and some increase in literacy levels (but remaining low with one quarter of men and almost half of women still illiterate).
- A moderately strong external position with external reserves in excess of 6 months' worth of goods and services imports, and standing at four times the level of short-term external debt, and a decline in external debt to around 22% of GDP, with a current account deficit not exceeding 1% of GDP in recent years.
- Very low Foreign Direct Investment and external aid. During 1996–2000, FDI to India actually fell by 2% whereas the cumulative annual rate of growth for the world as a whole was 31% during this same period. FDI averaged 0.5% of GDP in India against 5% in a comparable country such as China, and 8% for developing countries as a whole. Structural and regulatory complexities, and foreign perceptions of an excessively regulated business environment, remain a major stumbling block to FDI in India. Oda as percentage of GDP fell from 1.4% in 1991–2 to 0.5% in 2000–1.
- Continuing trade protection: while quantitative restrictions on imports have been removed, the average industrial tariff on imports remains very high – at around 34% compared with the East Asian average of 12%.
- Limited progress in strengthening the financial sector, so that a high proportion of loans remain outstanding and the performance of banks, especially rural banks, is weak. Some privatisation is mooted, but is unlikely to progress far so long as government wishes to retain a controlling share in each institution.
- A deteriorating fiscal situation, both at Union and State levels, with a general government deficit approaching 10% of GDP, which is among the highest in the world. If unchecked, borrowing at current levels is likely to cause a fiscal crisis. Even if it does not, it is crowding out productive investment and imposing a heavy interest burden on the budget, using resources that could otherwise be directed to development needs. It is difficult to dispute here the IMF's prescription of harder budget constraints at State level, tax reform, reduction in subsidies and more rapid progress with privatisation. Subsidies are particularly problematic: subsidies (overt and hidden) on non-merit goods amount to as much as 10.7% of GDP on an annual basis. This

includes key services such as power, water supply, irrigation, and transport, among others. It is primarily the absence of appropriate pricing of public services and the lack of will to collect the charges levied that has caused the large fiscal imbalance that afflicts the country. There appears little short- term (or, some would argue, even medium-term) prospect of reversing this trend, and it has severe implications for the future investment in public goods or in social protection measures for the poor. These are discussed in detail below.

- Increasingly weak governance, evident in the lack of fiscal rigour especially in the States, loss of confidence in the public administration, apparent reproduction in new local government of many of the ailments of State and national level weaknesses in elected representation and public administration, and especially uneven performance in the implementation of poverty reduction and social protection schemes and programmes.

Traditionally, economists have emphasised growth as a tool for poverty reduction. India's poverty levels remained fairly constant throughout the period 1951–75, when per capita incomes rose by less than 1.5% a year. A decline in poverty during the following 25 years was associated with high annual growth rates of more than 3% in per capita incomes, confirming that growth is essential for poverty reduction.

However, the impact of growth on rural poverty reduction in the 1990s has been much lower than in the 1980s. Despite the failures of policies directed towards the poor, substantial growth in the last two decades did allow some poverty reduction. However, even this advantage may not be available in future. The Ninth Plan target[11] growth rate for GDP of 6.5% per annum has been missed by a significant margin, as it is likely to be only 5.5%, as against 6.8% for the Eighth Plan period. The growth rate for 2002–3 is officially being predicted at 4.4%. Shankar Acharya (2002), who was Chief Economic Adviser for the central Finance Ministry for several years, has recently reviewed India's growth performance and has concluded that it might be reasonable to expect growth in the next five years to fluctuate in the range of 4% to 6%, perhaps averaging close to 5%, provided there is no major economic or financial crisis. This is because of the deteriorating fiscal health of the centre and the States, neglect of vital infrastructure such as power, irrigation, railways, and ports, and an all-round decline in governance leading to inefficient – often illicit – utilisation of resources. This will have serious repercussions on the availability of funds for the social sector, as well as on poverty alleviation.

Many of the features of the Indian political economy protect it from the more extreme swings in the global or regional economy, as its stability during the recent SE Asian financial crisis demonstrated. However, they – especially weak infrastructure, bureaucratic complexities and low foreign investment – also place limits on the extent to which India will be able to capitalise on the potential for growth offered by globalisation. A general correlation between growth (especially in agriculture) and poverty reduction is well-documented for India. To attempt to predict the more detailed effects of limited capacity to seize the opportunities offered by globalisation lies outside the scope of this paper. However, it is clear that more exposure to global markets will require farmers to take well-informed decisions more frequently and rapidly than hitherto in response to changing markets – if literacy levels remain low and communication infrastructure weak, the prospects of their doing so will be reduced, with negative implications for the generation of employment for the poorest in agriculture and rural areas more generally. Prospects in agriculture are considered in section five below. A second effect of the combination of excessive regulation and complex bureaucratic procedures is that it keeps open a wide range of opportunities for rent-seeking, especially where (as in many areas of rural India) the poor have low literacy levels and face highly structured social discrimination, so that their opportunities to exercise the normal vigilance that accompanies active citizenship are severely limited.

11 It was fixed at 7% in 1997, but scaled down to 6.5% in 1999 as the growth rate in 1997–8 was only 4.8%.

4 The Changing Nature of Rural Employment

The sector-wise breakdown of the 388 million employed workers in 1999–2000 was as presented in Table 4.

Table 4 Breakdown of rural employment, 1999–2000

Sector	Total workers (millions)	% of total
Agriculture, animal husbandry, fisheries and forestry	238	60
Unorganised non-agricultural sector	133	33
Organised sector	28	7

Source: Radhakrishna (2002)

Employment in the organised sector increased slowly from 24 million in 1983 to 28 million (out of which some 22 million are in government) in 1999–2000. Evidently, government's share in the absorption of additional labour will remain small in the near future, as employment in the sector is now almost frozen. As a result, a major portion of newcomers to the labour force will have to be absorbed in the unorganised agriculture and non-agriculture sectors.

The composition of employment (self-employment, regular salaried employment and casual employment) has been changing. While self-employment is on the decline, casual employment is on the rise. The share of self-employed in the rural workforce declined from 62% in 1977–8 to 56% in 1999–2000, while the proportion of casual labour increased from 30% to 37%. Regular employment marginally declined from 7.8% to 6.7% during the same period (Radhakrishna, 2002).

The decline in self-employment is largely attributable to a declining share of the (mainly self-employed) agricultural sector in the rural workforce. It declined from 83% in 1977–8 to 76% in 1999–2000, while that of rural non-agricultural sector increased from 17% to 24% over the same period. The annual growth rate of the workforce in agriculture was 1% during 1977–99, while in the non-agricultural sector it was 4.3% during 1977–88 and 2% during 1988–2000. Non-agricultural rural households are gradually withdrawing from cultivation to concentrate on the main non-agricultural occupations in agriculturally-developed states. This is also because of increasing uncertainty and risk in agriculture. A study by Praxis (2001) of Bolangir district, a drought- and hunger-prone district in western Orissa, showed that many marginal farmers were forced to migrate under exploitative conditions almost as bonded labour, leaving their own lands fallow because they could not depend on an uncertain crop from degraded lands. Technology is also becoming more capital intensive, often outside the reach of poor farmers. The structure of operational holdings is becoming more skewed than in the past (Vaidyanathan, 2000), although more rigorous analysis is needed here.

As a result, the proportion of rural households receiving incomes from cultivation fell from 62.4% in 1987–8 to 57.1% in 1999–2000. The shift in the workforce from agricultural to non-agricultural activities (i.e. a kind of diversification) is both an outcome of growth as well as a 'distress' phenomenon. The experience of India in the 1990s shows that higher GDP growth rates were accompanied by a decline in growth of rural employment. In fact agricultural employment has fallen in absolute terms too. Thus the increasing dependence of the poor on non-farm incomes cannot be viewed purely as a sign of a healthy rural economy. Of course, there are strong regional differences that need to be captured. Expansion of the rural non-farm sector has been influenced by growing commercialisation in the rural economy. Employment potential in the non-farm sector is higher where agriculture is commercialised, or where the villages are close to growing urban centres.

5 The Need for Agriculture and Food Policy Reform

During the 1980s the yields of crops such as rice, oilseeds and pulses registered high growth in India. Even the States with high incidence of poverty – Assam, Bihar, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh and West Bengal – registered significant improvements in crop yields, thus contributing to a decline in poverty. However, this trend did not continue in the 1990s. During the 1990s (1989–90 to 1999–2000), the growth of agriculture decelerated as compared to the 1980s (1979–80 to 1989–90). The overall growth rate of crop production declined from 3.72% per annum to 2.29% per annum and productivity from 2.99% per annum to 1.21% per annum. During the 1990s, the growth rate of foodgrains production declined to 1.92% per annum from 3.54% per annum during 1980s. Similarly the growth rate of productivity in foodgrains decelerated to 1.32% as compared to 3.33% per annum during the 1980s (GoI, 2002). This has also resulted in a slower increase of real agricultural wages from 4.68% during 1981–91 to 2.04% in 1991–9, with the poorer States showing no increase or even a decline in wages. In addition, the casualisation of a mass of rural workers without safety nets, the feminisation of agricultural labour accompanied by low wages and the persistence of child labour are worrying trends.

The index of agricultural production (with triennium ending 1981–2 taken as 100) rose to 148.4 in 1990–1 and 175.7 in 1996–7, but since then has remained stagnant at this level and may end up at 172 in 2002–3. Similar is the trend for foodgrains. The increase in agricultural GDP during the last five years has been because of higher relative prices, and not higher production.

The policy approach to agriculture, particularly in the 1990s, has been to secure increased production through subsidies on inputs such as power, water and fertiliser, and by increasing the minimum support price[12] rather than through building new capital assets in irrigation, power and rural infrastructure. However, official procurement covers primarily Haryana, Punjab and parts of Andhra Pradesh. This has shifted the production base from low-cost regions to high cost regions, causing an increase in the cost of production, regional imbalance, and increasing the burden of storage and transport of foodgrains. The equity, efficiency and sustainability of the current approach are questionable. The subsidies do not improve income distribution or the demand for labour. The boost in output from subsidy-stimulated use of fertiliser, pesticides and water has the potential to damage aquifers and soils – an environmentally unsustainable approach that may partly explain the rising costs and slowing growth and productivity in agriculture, notably in the Punjab and Haryana. Moreover, deteriorating State finances have meant that subsidies have, in effect i) 'crowded-out' public agricultural investment in roads and irrigation and expenditure on technological upgrading, ii) limited maintenance on canals and roads, and iii) contributed to the low quality of rural power. These problems are particularly severe in the poorer States. Although private investment in agriculture has grown, this has often involved macroeconomic inefficiencies (such as private investment in diesel generating sets instead of public investment in electricity supply). Public investment in agriculture has fallen dramatically since the 1980s (Figure 1) and so has the share of agriculture in total Gross Capital Formulation (GCF) (Figure 2). Instead of promoting low cost options that have a higher capital-output ratio, present policies have resulted in excessive use of capital on the farms, such as too many tubewells in water scarce regions.

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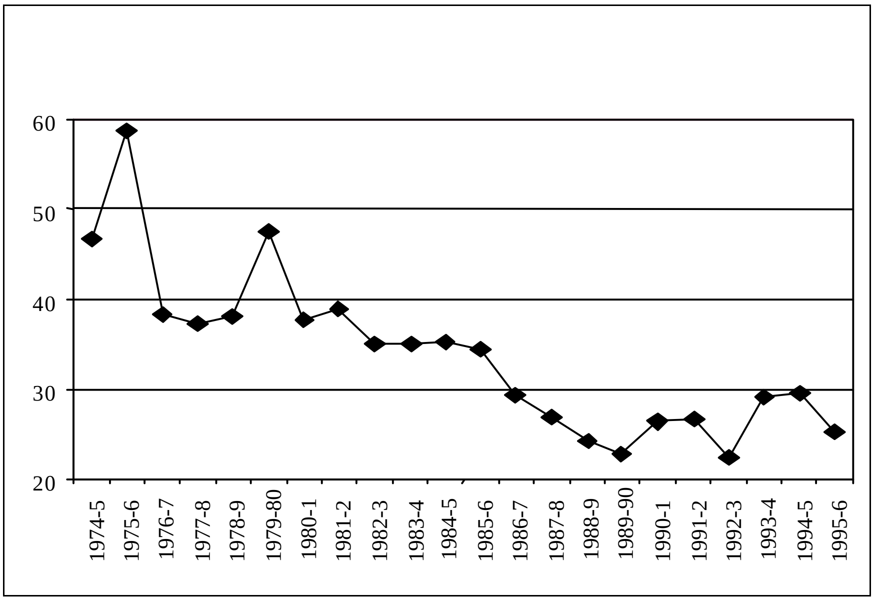
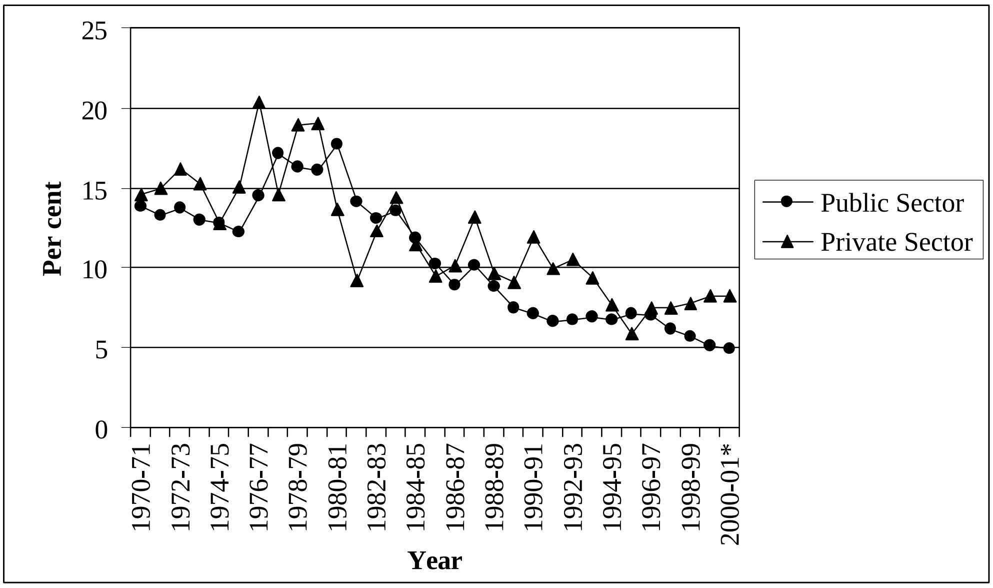
12 The average excess of actual procurement prices announced for wheat over cost of production during the 1980s was 63%, which increased to 96% during the 1990s. A similar trend is observed in the case of rice.

Figure 1 Public capital investment in agriculture, 1974–5 to 1995–6 at 1980–1 prices (bn Rs)



Source: Government of India (2000)

Figure 2 Share of agriculture and allied sector in total GCF (%)

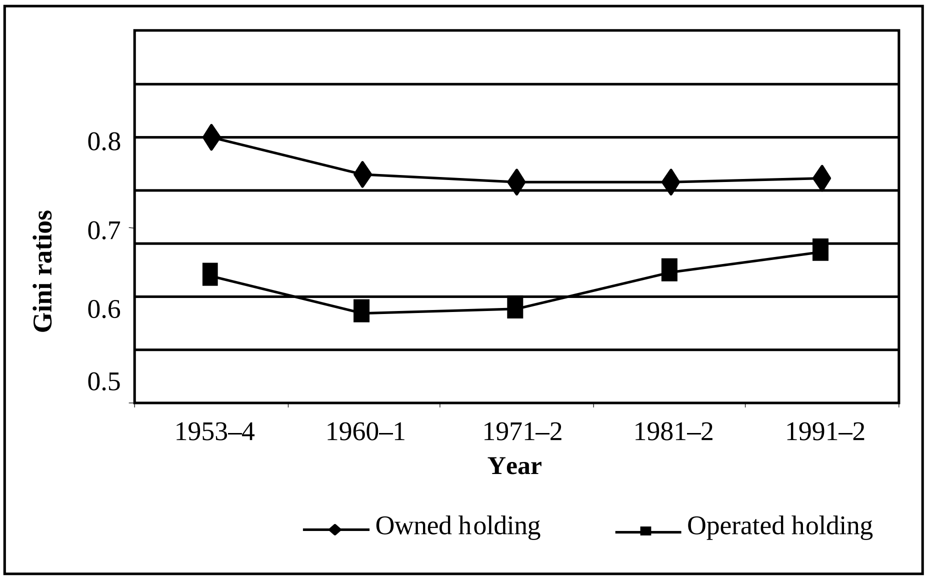


Source: Government of India (2000)

The intensity of private capital is in fact increasing for all classes of farmers, but at a faster pace in Green Revolution areas and for large farmers. Thus, fertilisers, pesticides and diesel accounted for a mere 14.9% of the total inputs in 1970–1 but 55.1% in 1994–5. For a large farmer in commercialised regions their contribution could be as high as 70%. But the proportion of output sold has increased at a much slower rate than the proportion of monetised inputs, including hired labour. The implication of this is a resource squeeze in agriculture. Whereas the need for resources to purchase these inputs has been increasing, the marketable surplus has been increasing at a slower rate to contribute to this, as the growth of non-farm employment has become very sluggish. It is not surprising that the repayment of loans is such a problem in Indian agriculture and has even led to suicides in some cases. A better strategy would be to concentrate on small and marginal farmers, and on eastern and rainfed areas where returns to both capital and labour are high. The need is also for better factor productivity in agriculture and for new technologies, which would be more labour intensive and would cut cash costs. However, a major question is whether substantial and equitable productivity gains in agriculture can be made there without significant improvement in the quality of governance in these States.

Another set of recommendations would be to look at increasing concentration of land (Figure 3). The Gini coefficient for operational holdings increased in the 1980s, and this trend may have further intensified in the last ten years. The distribution of operated areas happens to be less unequal than owned areas at all points in time, since smaller holdings predominate as lessees. Over time, however, the trends in concentration in operated areas have shown a pattern nearly similar to that of owned areas and from 1971 onwards, the gap between the two Gini ratios has narrowed. At the all-India level, the Gini ratio for operational holdings declined during the 1950s and remained stable during the 1960s. However during the 1970s and 1980s there was a significant and steady increase in the concentration ratio of operated areas. The Gini ratio increased from 0.587 in 1971 to 0.624 in 1981 and further to 0.641 in 1991. The concentration in operated areas thus increased at faster rate during the 1970s, followed by the 1980s, which coincided with technological change in agriculture in India. Rising inequality in the operation of land further dampens the demand for foodgrains.

Figure 3 Concentration ratios of owned and operated land in India



Source: Srivastava et al (2003)

And lastly, the eastern and central regions should be the focus of attention during the next ten years, as discussed below.

5.1 Agricultural intervention and the regional dimensions of poverty

As far as spatial distribution is concerned, the poor in India can broadly be classified into two groups. Poverty in wet areas is generally associated with landlessness, as even a small farmer is able to rise above the poverty line because of high annual productivity through multiple cropping. The situation is different in dry areas where even a farmer with four hectares may be quite poor, with land that hardly produces enough to sustain the family. Here landed farmers often undertake wage labour, especially when the crop fails, to supplement their incomes. In such areas poverty is linked with low productivity and its cyclic fluctuation, rather than with landlessness.

Thus there are two regions of concentration of poverty:

1. eastern India – East UP, North Bihar, North Bengal, Coastal Orissa, Assam and Tripura (all with plenty of groundwater);
2. central tribal India – Bundelkhand, Jharkhand, Vidarbha, Madhya Pradesh, Chattisgarh, Rajasthan, Western Orissa, Telangana (regions of low agricultural productivity with plenty of degraded and forest lands).

The eastern region has fertile soils with plenty of groundwater, but:

- smaller holdings;
- heavy dependence on grain production;
- less diversity of rural incomes;
- less developed infrastructure;
- less marketed surplus;
- credit markets which are imperfect, and inter-locked with output markets;
- more dependence on the village merchant/big landowner for marketing small surpluses;
- poor human capital as far as entrepreneurship is concerned.

On the other hand, the characteristics of peninsular India are:

- mono-cropped land of low productivity;
- soil and water erosion;
- vast areas of uncultivated and forest lands;
- high levels of distress migration;
- deteriorating road and rail network;
- depleted groundwater levels; but
- cohesive rural population amenable to community participation.

Although these regions have different features, each in its own way requires improvements in water management as a basis for higher productivity.

5.2 Water and agriculture

Despite large investments in irrigation in the past, only about 40% of India's agricultural area is irrigated. The progress on this front has slowed down considerably in recent years, particularly in terms of major and medium irrigation projects, largely due to resource constraints faced by governments both at the centre and in the States. However, resources are not the only problem. Most of the favourable locations for irrigation have already been developed, so that future irrigation may exhibit lower marginal returns and possibly greater environmental sensitivity. A major revival of public investment in irrigation capacity and water management is needed. The Accelerated Irrigation Benefit Programme is a potentially important instrument for providing resources to State governments in support of ongoing irrigation schemes. Allocations under this programme need to be massively increased. Greater attention will also have to be paid to rain water harvesting and increasing the irrigation potential through micro-watershed development. There is also considerable scope to improve the efficiency of existing irrigation infrastructure through better and more participatory management practices.

Much of the decline in poverty during the 1980s was due to increases in paddy production in eastern India. However, a collapse in the supply of electric power in this region in the last ten years combined with no new breakthrough in seeds and technology has led to a plateauing of yields. Stimulating groundwater development is crucial to kickstart the Green Revolution in this region as only around 20% of ground water resources are being utilised. Studies have revealed that diesel pump subsidy schemes operated by the State Governments involve both higher capital costs than electric power and have fared poorly due to lengthy, irksome and complex procedures and heavy transaction costs which leave little real subsidy for the farmers. East Indian States should reform their pump subsidy scheme to ameliorate the pump capital scarcity that lies at the heart of the problem. It is also equally important to promote cost effective improved manual irrigation technologies, such as treadle pumps, for sub-marginal farmers.

For drier areas, largely in peninsular India, watershed development programmes are being implemented by several departments of the Government of India, often with different and conflicting guidelines. Even when approaches or guidelines are common, the allocation of funds is done by different departments and each does separate monitoring. The need for ‘a Single National Initiative’ has been felt for some time, and was also articulated in the 1999–2000 budget speech of the Union Finance Minister, and in the President’s address for 2000–1.

Evaluation reports have shown that watershed projects cannot succeed without the full participation of project beneficiaries and careful attention to issues of social organisation. This is because success depends on consensus among a large number of users, whose livelihoods are affected differently by the range of resources (agricultural land; common grazing land; forest) being rehabilitated. Moreover, collective action is required for management of the commons and the costs and benefits of watershed interventions are unevenly distributed among the people affected. Unfortunately most projects have failed to generate sustainability because of the failure of government agencies to generate consensus among the people in the light of these differences. Field staff have no incentive to make the effort to pursue participatory approaches. Pressure to spend substantial resources by a fixed deadline is not conducive to developing people’s capabilities, nor is strict orientation towards physical targets. There is continued insecurity about the availability of funding at the grassroots level, as there is no guarantee that funds would be released in time by GoI or other funding agencies. There is also no arrangement for handing over structures or for the maintenance of newly planted areas after a project is completed.

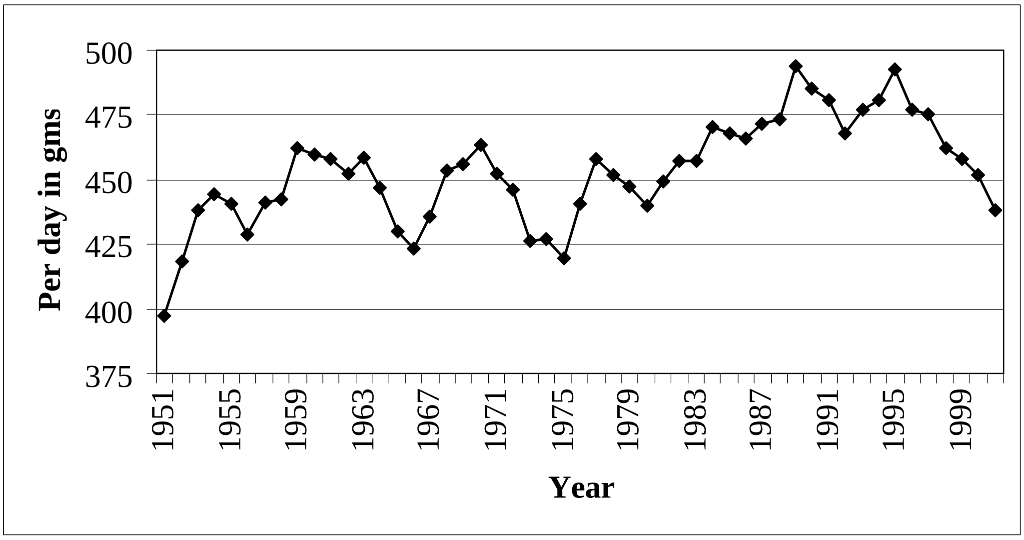
In summary, the following changes in agricultural policies in relation to water are suggested:

- Agricultural output grew in the 1990s because of higher output support prices and input subsidies. Now growth must come from higher investments in irrigation, seeds, power and roads. Therefore public investment in irrigation, power and roads should be stepped up by reducing subsidies on fertilisers, water and power.
- Canal systems are in poor shape owing to inadequate funding of operations and maintenance. These should be improved by stepping up plan allocations for maintenance, involving users’ groups in management and appropriate pricing of water to cover operation and maintenance costs.
- Water resources need to be developed in ways which will ensure year-round access by the poor to clean drinking water, since this is known to impact on women’s time allocations and on certain of the non-income aspects of poverty.
- Demand issues that have remained neglected in preference for supply issues need urgent attention in view of (a) falling open market prices for various commodities even in deficit States, and (b) continuing high levels of malnutrition, especially among children.
- Eastern and central regions should be the focus of attention during and beyond the Tenth Plan.

6 The Public Distribution System and Food Security

The per capita net availability of cereals and pulses per day has shown significant improvement in India during the last half a century. The three year moving average figures of per capita net availability of cereals and pulses has been plotted in Figure 4. The average for the period 1951–3 was 397.3g per day and this has gone up to 475.8g during the period 1997–9 as can be seen from Figure 4, signifying a growth rate of 0.26% per annum during the 1951–99 period.

Figure 4 Net foodgrain availablity



Source: Government of India (2000)

Despite the poor record in production in the last ten years, the level of foodgrains stock with the Food Corporation of India (FCI) has been increasing, signifying lack of purchasing power among the poor, and distorted food security policy. The per capita foodgrain availability has reduced from an average of 494g per day in 1989–91 to 459g during 1998–2000. While the growth rate in availability of foodgrains per capita was 1.20% per annum during the 1980s it dropped to minus 0.28% per annum during the 1990s.

At the same time, there has been a hefty increase in the annual food subsidy in just two years; from Rs120bn in 2000–1 to Rs180bn in 2001–2 to an anticipated Rs240bn in 2002–3. The number of food based schemes have increased lately, and so have leakages, which have started affecting farmers. Had it resulted in improved consumption by the poor and hungry, market prices would not have been affected.

All is not well with food-based schemes in India. There is 36% diversion of wheat, 31% diversion of rice and 23% diversion of sugar from the Targeted Public Distribution System (TPDS) system at the national level (GoI, 2000). TPDS does not seem to be working in the poorest eastern and northeastern states. The allocation of poorer states such as UP, Bihar and Assam was more than doubled, as a result of shifting to TPDS in 1997, yet due to poor off-take by the States and even poorer access by families living below the poverty line (BPL), the scheme has not made any impact on nutrition levels in these States.

High procurement price and unloading of foodgrains in the market at a throw-away price has meant that often foodgrains bought from the TPDS or other such schemes are sold back illegally to government (*Outlook*, 26th August, 2002). To correct this, market prices should be higher than the PDS price, which in turn should be higher than the support price for farmers. The reverse is the picture today; the support prices for wheat and common rice is Rs6.4 and Rs8.2 per kg, whereas the issue price for various schemes varies from Rs2–4 for wheat and Rs3–6 for rice, with market price ruling somewhere in between.

A recent study (Parikh et al, 2003) that examined the consequences of increasing the MSP of wheat and rice by 10% shows that it leads to a decline in overall GDP, increase in aggregate price index and reduction in investments. Even the increase in agricultural GDP resulting from higher MSP dwindles rapidly and only a minuscule positive impact on agricultural GDP remains by the third year. More importantly, in terms of welfare the bottom 80% of the rural and all of the urban population are worse off.

MSP should therefore be reduced to a level comparable with international prices. Lowering output price will shift the factor proportions in agriculture away from capital and towards labour, thus leading to market-led land reforms, as economies of scale will operate in favour of those who have more labour, and thus they will start buying land from those who are short of family labour, generally rich farmers.

This will also discourage black-marketing and reduce the burden of subsidies. Saving should then be targeted to the poorest areas by doubling the number of old age pensioners, increasing the amount from Rs75 to Rs200 per month. The fund allotment for Mid Day Meal Scheme and ICDS should be doubled in those districts where 50% or more people are below the poverty line. These measures will improve purchasing power and consumption of the poor, without much leakage.

Contrary to popular belief, there has been significant political intervention to increase the MSP only in a few years, otherwise the price recommended by the CACP (Commission on Agricultural Costs and Prices) have generally been accepted with some marginal upward movement (especially for wheat) as shown in Table 5 below. Therefore, the formula for calculating the input costs should be changed, and be more realistic. Continued setting of MSP at C2 levels means that returns to family labour, land and capital are determined by the government rather than the market. This is not compatible with market economy principles. It should aim for A2 which covers the cash costs incurred that could serve as a true safety net for farmers.

Moreover, the CACP should calculate the cost for not only Punjab and Haryana, which are high cost regions, but also for east UP and other such regions, where more labour and less capital is used to get the same output of grain.

Table 5 Procurement prices for fair average quality wheat and paddy (Rs/Quint)

Crop year	**Paddy**		**Wheat**		**Wholesale price index**
	CACP	*Government*	*CACP*	*Government*	
1990–1	205	205	200	215	74.3
1991–2	235	230	225	225	84.3
1992–3	260	270	245	250	90.2
1993–4	310	310	305	330	100.0
1994–5	340	340	350	350	117.1
1995–6	355	360	360	360	122.2
1996–7	370	380	380	380	128.8
1997–8	415	415	405	475	134.6
1998–9	440	440	455	510	141.7
1999–2000	465	490	490	550	150.9
2000–1	510	510	550	580	159.2
2001–2	520	530	580	610	161.8
% increase since 1990	**154**	**159**	**190**	**184**	**118.0**

Source: GoI (various years) Commission on Agricultural Costs and Prices.

As surpluses decline from Punjab-Haryana with a reduction in the MSP, it will be essential to realise the potential for production surpluses in central and eastern India where presently prices are below full costs of production. A basic focus of policy should therefore be to ensure effective price support in States and areas with future production potential. In January 2002, one of the authors (NCS) found that farmers in eastern UP were getting only Rs330 to 350 per quintal for paddy whereas Punjab farmers were getting Rs540 for the same crop. In other words, the MSP should truly be a national level floor price, rather than remaining confined to established surplus regions.

In addition we consider it vital to shift FCI's focus to east and central India. If decentralisation has to proceed to its logical conclusion in the long-term, the entire subsidy in the PDS has to be devolved to the States (Sen, 2002). This can be done by giving States in cash the difference between the full State-specific economic cost and the CIP on their entire PDS distribution, in addition to the cash component already provided for the poor.

To persuade Punjab and Haryana to move away from wheat and rice, the government would have to take three steps. One, to reduce the MSP, so that there is economic incentive to move to other crops. Two, to give a part of food subsidy thus saved to farmers in these regions as compensation for the first few years. And three, ask the State governments to take over procurement, and keep surplus grain in State government accounts, with part of the subsidy to be given to State government for storage etc. The surplus States will be free to export it, or sell it in deficit states, and thus make profits. State governments are likely to accept this, because their overheads are much less than those of the FCI, which is a highly inefficient and expensive organisation, and the surplus States will be able to make profits, a part of which can be used to augment rural welfare for farmers in the State. This will also act as incentive to them to improve the quality of produce. At the same time, FCI should be asked to extend its operations to eastern and central India, where the benefits of the MSP are hardly available to the farmers as of now.

The Abhijit Sen Committee set up by GoI (Sen, 2002) has worked out the economics of this package. The total compensation to both farmers and State governments would be at most Rs60bn in the first year, and declining from this subsequently. As against this, the savings on acquisition and carrying costs on the reduced procurement, envisaged at about 10 million tonnes, will be about Rs100bn in the first year, Rs125bn in the second year, Rs150bn in the third year and so on, assuming that the entire reduction in procurement will save on additional stockholding. There may be further savings in subsidies which would have been required to dispose of additional stocks. Thus reducing MSP will be truly a win-win policy with environmental benefits thrown in as a side benefit.

Besides there are other inefficiencies in demand management. Most storage *godowns* (warehouses) with the FCI are small-scale low quality structures, or food grains are stored in the open, leading to high storage losses. The present extraction rates for both wheat and rice are about 10% to 30% below international standards due to the reservation of agro-processing units for the small enterprise sector which uses inefficient technologies. On the distribution side, there is lack of infrastructure and shortage of funds among government parastatals in most States except a few in the west and south. Private transporters are given low priority by the railways, forcing them to rely on more expensive truck transport. Similarly selective credit controls by the Reserve Bank of India (RBI) restrict access to trade financing by the private sector. Finally, regulated markets were supposed to improve efficiency, but many market places such as in UP, Punjab and Haryana make it illegal for farmers to sell through alternative channels (i.e. selling directly to millers). The markets have thus emerged as taxing mechanisms, rather than facilitating farmers to get the best price. Licensing on storage and controls on movement have recently been relaxed,[13] though this is taking time to work through, since local officials do not wish to lose a valuable source of illicit revenue.

On the whole, laws and controls have repressed private foodgrain marketing, undercutting its potential contribution to long-term food security.

The challenge is to reduce government food stocks to roughly half its present level and use it for reducing malnutrition, without adversely affecting farmers. This would need the following legal and policy changes, which would enhance the role of the private sector and make markets less distorted than at present:

- reduce support price to a level comparable with international prices, so as to promote the diversification of agriculture, environmental sustainability, and reduction in food subsidies;
- further promote the removal of controls on movement between States;
- phase out levy or monopoly purchase;
- encourage wheat and rice export on private account;
- take out wheat, rice and sugar from the Essential Commodities Act;
- completely decontrol sugar and take it out of the PDS;
- lift the ban on Futures Trading of agricultural commodities;
- take measures to reduce the food ‘demand deficit’ among the more vulnerable, by, for instance, spreading old-age pensions for the destitute, and broadening school feeding schemes.

13 In order to facilitate the free trade and movement of foodgrains, the Government issued a Control Order titled, ‘Removal of (Licensing Requirements, Stock Limits and Movement Restrictions) on Specified Foodstuffs Order, 2002’ on 15 February 2002. The Order allows any dealer to freely buy, stock, sell, transport, distribute, dispose, acquire, use or consume any quantity of wheat, paddy/rice, coarse grains, sugar, edible oilseeds and edible oils, without a licence or permit. State governments would require the centre’s prior permission before issuing any order for regulating, by licences or permits, the storage, transport and distribution of the specified commodities.

7 Poverty Alleviation Programmes

Over the years, poverty alleviation programmes of various types have expanded in size and today there is a wide variety of such programmes absorbing a large volume of resources. The annual Plan provision in 2002–3 for CSS in rural development is Rs180bn, for food subsidy Rs240bn, and for fertiliser subsidy about Rs110bn, making a total of Rs530bn. Against this, the provision for irrigation is only Rs28bn and for afforestation only Rs6bn. There is a case for examining whether the resources used for poverty alleviation schemes and for various types of subsidies in the name of poor may not be more effective in alleviating poverty if directed to various types of asset creation programmes in rural areas.

For instance, several evaluations of the then Integrated Rural Development Programme under the Ministry of Rural Development show that the projects undertaken under the programme suffer from numerous defects including especially sub-critical investment levels; non-viable projects; lack of technological and institutional capabilities in designing and executing projects utilising local resources and expertise; illiterate and unskilled beneficiaries with no experience in managing an enterprise; indifferent delivery of credit by banks (high transaction cost, complex procedure, corruption, one-time credit, poor recovery); overcrowding of lending in certain projects such as dairy; poor targeting with a high proportion of the non-poor included; absence of linkage between different components of the IRDP; rising indebtedness; and the capacity of government and banks to implement the IRDP being outstripped by the increase in its scale. A disturbing feature of the IRDP in several States has been the rising indebtedness of its beneficiaries. Besides, the programme for upgrading skills, TRYSEM (Training of Rural Youth for Self Employment), was not dovetailed with IRDP, until its absorption into SGSY. Some reviews discovered non-existent training centres and non-payment of stipend in some cases. However, the programme for women, Development of Women and Children in Rural Areas (DWCRA) did well in some States (AP, Kerala and Gujarat).

Evaluation of the programmes for wage employment also reveals serious weaknesses: inadequate employment and thin spread of resources; violation of material-labour (60:40) norms; fudging of muster rolls; and schemes implemented universally through contractors who sometimes hired outside labourers at lower wages. Central norms of earmarking, such as 40% of funds for watershed development and 20% for minor irrigation, have not been followed. Today Rs60 out of Rs100 in wage schemes is reserved for wages, but in reality only Rs10 to Rs15 actually goes to the labourer, the rest is illegal income for bureaucracy, contractors and politicians.

In flagrant violation of the guidelines, in many States projects are being executed by using excavators, trucks and tractors instead of more labour intensive approaches. This is being done with full knowledge of the senior officials. For example, in Krishna district (Deshingkar and Johnson, forthcoming), out of 54 works, excavators were employed in 40 cases. Poclaines (the trade name for a kind of earth excavator) are becoming the preferred machine for undertaking a variety of village works through all kinds of programmes from the point of view of the rich (often MLAs and other political leaders) who own the machines and hire them out for public works. One Poclaine can displace 17x8 persons in an eight hour day (at 17 person-days per hour), whereas it costs Rs800 to hire a Poclaine for an hour. The ideal policy should be to discourage its use even by construction Ministries, such as Railways and CPWD, and compensate them financially to build incentives for employing more manual labour. However, the reverse is happening. Not only is labour being displaced in the so-called employment oriented schemes, food meant for the poor is then sold in the market, thus distorting the markets faced by farmers.

The programme for rural housing, although quite popular because of the large sum involved (a grant of Rs20,000 per beneficiary), has led to a strengthening of dependence of the rural poor on the élite.

Given the large number of potential beneficiaries awaiting the allotment of a free house and limited resources, a situation has been created wherein the poor are divided among themselves. There would also be pressure from the local MLAs and MPs to ensure that their followers are prioritised for the allocation of a house. Thus the scheme dis-empowers the poor collectively while providing a small number of them individually with a valuable asset. Instances of corruption to the tune of Rs5,000 to 8,000 out of the approved amount of Rs20,000 have also been detected. The mandatory provision for joint registration of houses in the name of both husband and wife is flouted in most cases. In many States, field-level functionaries are unaware of the existence of such a provision.

The changes recommended for the Tenth Plan, which remain relevant today, were that:

- SGSY (IRDP) should be transformed into a micro-finance programme to be run by banks with no subsidy, on the lines of Rashtriya Mahila Kosh.
- Funds should be provided to *gram sabha*s (village assemblies) only when the people contribute a substantial amount, say, 25% in normal administrative blocks and 15% in tribal/poor blocks.
- Employment programmes should be replaced by the food for work programme to be run only in areas of distress. In all areas, the focus should be on undertaking productive works and their maintenance, such as rural roads, watershed development, rejuvenation of tanks, afforestation and irrigation.
- Rural development funds should also be used for enhancing the budgetary allocation of successful rural development schemes that are being run by State governments, or for meeting States' contributions to donor assisted programmes for poverty alleviation.
- Grassroots women's groups should be empowered and encouraged to implement selected poverty alleviation schemes, particularly food-for-work schemes in areas affected by natural disasters.
- Direct income transfer schemes should be promoted for particular categories of the poor, such as Integrated Child Development Schemes (ICDS) and mid-day meal schemes, and at the same time take into account wide differences in the efficiency of implementation of different kinds of support. Old-age pensions are administered with only minor mis-allocation or leakage (Nayak et al, 2002) but severely underfunded. For instance, GoI arrives at its annual pension allocation of approximately Rs5bn on the basis of two assumptions: first, that 50% of those above the age of 65 and below the poverty line are looked after by their relatives and so do not require a pension, [14] and second, that the States will supplement the Rs75/person/month provided by central government. In fact, the nominal State supplementation varies between Rs25 and Rs125/person/month, and in practice, fiscal crisis in the States means that its payment is not guaranteed. Further, the individual pension allocation is extremely low, and inadequate to provide even the barest subsistence. In these circumstances, the current GoI allocation of some Rs6bn/year could easily be increased by a factor of three or four with little danger of wastage. Insofar as Centrally Sponsored Schemes continue to exist into the future, then the provision of old-age pensions to the needy must be one of the most enlightened policies that central government could promote – and one of the most robust in the face of chronic implementation weaknesses.
- Special efforts should be made to strengthen the economy of marginal and small farmers, forest produce gatherers, artisans, unskilled workers, etc. The poor should not merely benefit from growth generated elsewhere; they should contribute to growth.

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14 This assumption is unlikely to be valid, because if they had the means to look after their old parents, children would not be below the poverty line in the first instance.

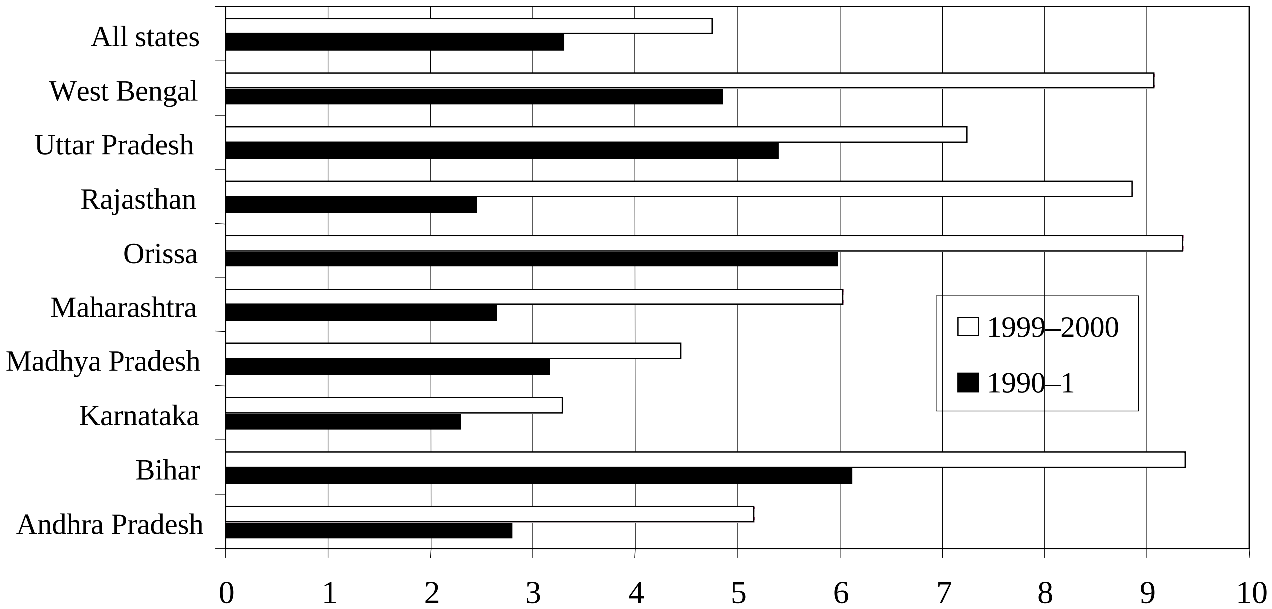
8 Fiscal Crisis and Rural Poverty Reduction

The volume and type of resources for public sector support to rural poverty reduction are likely to be profoundly affected by the deteriorating fiscal situation, both within States, and in relations between the States and centre, which are reaching crisis proportions. The revenue receipts of the centre as a proportion of GDP have declined from 11.3% in 1989–90 to 8.8% in 2001–2. On the other hand, debt service payments of the central government have risen inexorably from about 30% of tax revenue in 1980–5 to about 70% at present. A rise in debt service burden has meant that revenue deficit, which was 17% as a proportion of fiscal deficit in 1980–5, has now increased to about 70%. In other words, more than two-thirds of the current borrowings go to financing current expenditure. The result of falling revenue receipts, increasing interest burden and mounting salary and pension liabilities has meant that the Gross Budgetary Support to Plan (that finances Plan schemes of GoI Ministries and central assistance to States via the Planning Commission – see Appendix 6) has fallen from 7.3% of GDP in 1986–7 to less than 4% in the last five years.

The State Governments' finances also deteriorated precipitously in the 1990s. The contribution of the balance of current revenue (BCR, defined as the revenue receipts including tax share and other grants from GoI minus non-Plan expenditure) to the financing of State Plans, which was as high as 28% of total Plan resources in the Sixth Plan has now fallen to (-) 52%, and the share of borrowing in Plan expenditure has increased from 46.5% in the Fifth Plan to 108.1% in the Ninth Plan. Since 1995–6, the States' debt stock increased at the compound annual rate of 17.9%, whereas the revenue receipts increased only at 11.2%. Consequently, the share of interest payment in total expenditure increased from 13% in 1990–1 to 21.6% in 2000–1 to crowd out productive expenditures (Govinda Rao, 2002). It has moved from 10.6% in the Sixth Plan period (1980–5) to 19.4% in the Ninth Plan period (1997–2002). In States such as Orissa, West Bengal and Himachal Pradesh, salaries, pensions and interest payments are more than 100% of their total revenue receipts including transfers from the centre, forcing States to borrow indiscriminately.

While the borrowings of the State governments have grown sharply, a major portion of the borrowed funds are being diverted to bridging the revenue gap, leaving very little funds for investment in core sectors. The revenue deficit accounted for 60% of the Gross Fiscal Deficit in 1999–2000 as against only 28% in 1990–1 (see also Figure 5). As a result, there has been a deceleration between 1980 and 2000 in the growth of capital expenditure from 26% to 13% of total State expenditure (Govinda Rao, 2002). This can only lead to a further worsening of the fiscal situation in the coming years. If reckless borrowing is not kept in check, some States may be forced to declare financial emergency in the Tenth Plan.

Figure 5 Statewise fiscal deficit as per cent of Net State Domestic Product (NSDP)



Source: Ministry of Finance (2002)

There are several implications of fiscal deterioration for the delivery of programmes, even those funded by GoI Ministries.[15]

First, GoI funds are often diverted for paying salaries, and not passed on to the development departments for months, or even years, thus defeating the intention of funding social sector schemes by the centre. In such a scenario the commitment of the field staff cannot be sustained, nor can people's participation, which is essential for the success of programmes. Second, States do not release the counterpart funds in time, leading to further uncertainty about the availability of funds at the field level. Third, lack of counterpart funds leads States to demand CSSs (Centrally Sponsored Schemes) to be 100% funded by GoI, which dilutes the sense of ownership of development schemes by the States. When States do not contribute, the political and bureaucratic leadership does not put its weight behind the implementation of such schemes. Fourth, some States are unable to find counterpart funds for CSSs, and hence are not able to draw the earmarked allocations. Since CSSs generally require only 25% contribution from the States, in effect it means that if the States could pay one rupee less to their staff, they could get Rs3 from GoI to spend on development programmes.

And lastly, even when some projects/programmes are completed, their sustainability is a serious concern. The precarious financial position in many cases prevents the State Governments from taking up committed liabilities of the project such as repairs or maintenance after completion, thus drastically reducing the life of the project. States' growing preoccupation with trying to make ends meet on current account – whether by excessive borrowing from the market or even by 'stealing' funds from GoI – is seriously distracting attention from investment needs.

Two decisions will have to be taken to achieve the required fiscal correction. First, a widespread and bold imposition of user charges of all non-merit goods, such as higher education, fertilisers, irrigation, water supply, power, and railway travel. Hidden subsidies on non-merit goods amount to as much as 10.7% of GDP on an annual basis. It is primarily the absence of appropriate pricing of

15 There are three sources of financial assistance for States from the centre. One is via the Finance Commission, the other via the Planning Commission, and the third from GoI Ministries. States received roughly Rs700bn, Rs400bn and Rs250bn in 2001–2 from these sources. The first two are counted towards their Plan, whereas the third one is generally known as Centrally Sponsored Schemes, and States have little discretion in changing the nature of scheme, which is decided by GoI Ministries. See Appendix 6.

public services and the lack of will to collect the levied charges that has caused the large fiscal imbalance that afflicts the country.

And secondly, the number of government employees needs to be reduced by 3% per year with little new recruitment in future. Public sector salaries and pensions constitute a very heavy burden on the State exchequer, which many States are not able to bear today, especially after the Fifth Pay Commission's award in 1997. The total *additional* annual salary bill resulting from the award, over the four-year period 1997–2001 works out to Rs700bn. For comparison, the size of GoI's Plan budget including Central Assistance to the States in 1999–2000 was Rs760bn. Thus the Plan size could have been doubled if there had been no increase in government salaries.

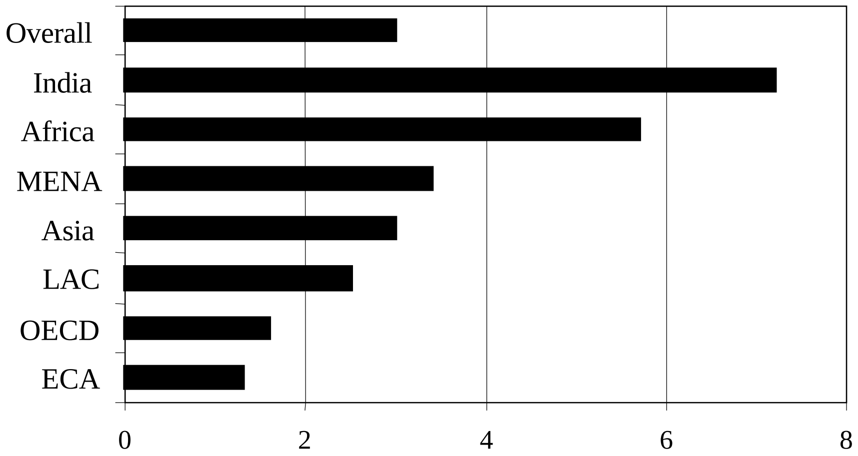
When compared internationally (Figure 6) India is not over-staffed, but there are too many clerks and messengers, and not enough front line workers. More teachers and para-medical staff, for instance, are certainly needed. However, most clerks and messengers who constitute the bulk of bureaucracy today have become redundant in the wake of new technology and the extent of automation that has taken place in most offices in the last two decades. With the changing role of government the size and scale of the civil services no longer relates to the nature of functions that government can or should undertake. Therefore, one should identify surplus staff, set up an effective redeployment plan, and a liberal system for exit.

Some further and unconventional suggestions to reduce government expenditure on staff are:

- no increases in dearness subsistence allowance for the next five years;
- a stipulation that three years from now not more than 50% of revenues can be spent on establishment by those State governments which borrow from GoI, or have to obtain GoI's permission before borrowing;
- an increase in the period a government servant can be out of the system from 5 to 7 years, without losing his seniority;
- encouragement to civil servants to join voluntary organisations of repute, or educational and research institutes during mid-career.

Since expenditure on staff has increased to an unsustainable level, serious consideration must be given to changing the service conditions at least for new government recruitment. For many categories of Group C and D posts the minimum age of recruitment in the new system should be increased to 45, and for Group A posts requiring high performance, 25% to 50% of officers should be retired at the age of 52 to 55, as it is done in the Army. New recruits to government service should be required to take leave without pay for 5 years at a stretch after they have put in 10 years of service. A shift should also be made to a contributory pension system for the new set of employees.

Figure 6 Average government wage as multiple of per capita GDP



Source: Farrington and Saxena (2002)

However, these radical changes are unlikely to be introduced, as they will command the support of neither politicians nor bureaucrats. Therefore one may have to proceed more slowly, keeping in mind both the morale of government servants as well as the necessity for ensuring high performance and achieving fiscal balance. Secondly, without improvements in accountability, downsizing and more adequate incentives may result in a small and well-paid but no less inefficient or corrupt civil service. This is exactly what has happened in India, substantial salary increases have hardly improved government servants' productivity. We discuss this below.

9 Fiscal Crisis and Governance

The fiscal crisis described above has several implications for governance. First, declining capital investment leads to slow growth, which in turn makes it even more difficult to raise revenue for public expenditure. Second, financially weak infrastructure sectors (such as power – see Appendix 8) have placed a massive burden on the States, and this problem has been accentuated by the deepening culture of non-payment by customers for public utilities. And third, governance problems have accelerated the fiscal crisis both directly and indirectly.

In almost all States people perceive bureaucracy as wooden, uninterested in public welfare, and corrupt. This perception of the collapse of ethical standards has a number of implications for fiscal discipline. The States' reluctance to confront entrenched government servants, take action against the corrupt ones, reduce their numbers or make changes in their service conditions further confirms the belief among people that the state apparatus exists only for government servants. The problems of law and order in some States, the culture of harassment, long delays, administrative secrecy, and the seeming inability to check organised power theft (transmission and distribution losses are close to 40%) – all discourage formal sector, large scale, law-abiding tax paying units from investing in these States. But it is the growth of the latter upon which prospects for future productivity, growth and higher wage jobs will largely depend. These States will neither be able to end the fiscal crisis nor restore growth unless they are able to address problems of governance. Whether the issue is tax compliance or investment climate for the private sector or the State's physical and social infrastructure, progress will be impossible without a significant redirection and improvement in the way these States run their administration so that the administrative apparatus implements what it is paid to do.

Box 1 How are the poor affected by deterioration in governance?

- The poor are particularly vulnerable in the face of rent seeking behaviour by police and other local officials
- The government's social sector spending yields no benefits – teachers do not teach and doctors do not attend public health centres
- The distrust of government increases, and people are not willing to collaborate with government
- As politicians and civil servants are seen by the people to be amassing wealth because of their position, the work ethic suffers as manipulation is considered more rewarding than hard work
- Ultimately it impinges on growth which again harms the poor

Source: Saxena (2002)

Hence it is important that along with wiping out the revenue deficit, simultaneous efforts are launched to improve governance and restore people's confidence in the reform process. This will not only reduce government expenditure but will also make people more inclined to accept lower subsidies. When people are convinced that the additional tax payments are going to improve roads or increase the quality of power and water supply, and not merely be pocketed by avaricious civil servants, they are more likely to respond to the national need for better fiscal health. A civil service renewal programme that improves public satisfaction therefore has to be an essential component of proper fiscal management.

The burden of weak governance falls directly and indirectly on the poor, who are more dependent on services provided by government. They are more vulnerable to predatory behaviour on the part of government officials, particularly the police. And resources intended for the poor are often diverted for the use of the wealthy and politically well-connected. One result is that the poor frequently lack access to basic services, and those that reach them are of inferior quality. Indirect impacts are equally pernicious: the poor, especially tribals, are confined to the sidelines in the state's political life; while they carry heavy weights in their daily lives, they carry little or no weight in the offices, agencies and Assemblies where, without their active or informed consent, their lives are often shaped. Many live in isolation and lack basic information about their rights and statutory provisions. Moreover, they lack the resources to access public services and use private providers when unable to get the services to which they are entitled from the public sector.

Box 2 Health and education for the poor

A World Bank study of villages in UP and Bihar revealed that health problems emerged as one of the most common causes of persistent poverty. Illness of the breadwinner or other members of the family not only reduced their daily incomes but also led them to indebtedness and even loss of assets as treatment from government services was simply not available.

Nearly all the informants said that transport costs to government centres was too high when outcomes were so uncertain. Medical staff assigned to public health centres are usually absent, and therefore a trip to the centre results in waste of transport money. The quality of care was not mentioned as an issue; if care is generally unavailable, its quality is hardly relevant. Even when primary health care staff are on site, they only give prescriptions, as they do not have medicines on hand. Poor patients then must visit the market and incur a second transport expense.

A similar study of the schools showed that in most places either teachers were absent, or teaching was being conducted by proxy teachers who were hired by the regular teachers on very low wages.

Source: Saxena (2002)

Good governance is undermined by lack of transparency, weak accountability, poor organisation and lack of technical capacity, lack of responsiveness, inefficiency and poor motivation. It is important to be clear about the *sources* of poor governance, as possible remedies will vary accordingly. And it is important to assess the extent of demand for reform, which requires an understanding of the *incentives* of the main actors involved. Corruption is often both a cause and an effect of weak governance. Finally, it helps to understand the specific *mechanisms* and nature of the costs imposed on the poor by weak governance, in order to design realistic action plans for dealing with it.

Deterioration in governance is not uniform throughout the Indian States. Whereas States like Andhra Pradesh, Karnataka and Madhya Pradesh have taken concrete measures to improve the responsiveness of their administration, many officials and politicians in other States such as Bihar, UP, Punjab and most of the northeastern States have often tolerated and even encouraged corruption and have looked upon the state as an open treasury.

A recent issue of *India Today* (May 27, 2002) carried a story about how Chandrababu Naidu (Chief Minister of Andhra Pradesh) manages to get a disproportionate amount of central aid, in contrast to Rabari Devi's Bihar. The magazine ascribed this to Naidu's political alignment in the governing coalition. The story however also mentioned that Naidu carried detailed presentations on various subjects whenever he went to Delhi, and that he made presentations at every Ministry, backed by data and arguments. Is perhaps this the reason of his success – and not merely that the governing coalition needs his backing? It is no surprise that the Antyodaya programme (of distributing subsidised foodgrain to the poorest) has been highly successful in Andhra Pradesh, because of the dynamic leadership provided by the Chief Minister. The State also succeeds in obtaining a disproportionate share of external donor funding.

On the other hand, a State like Bihar has been captured by those who have no faith in (or capacity for achieving) development. The pervasive view among politicians and administrators appears to be that unpopularity resulting from tighter administration is immediate, and any benefit is uncertain and delayed. Élites benefit from the present arrangement, and they do not like giving up their discretion, or being made accountable. The individual politician or civil servant perceives no benefits for himself through promoting ‘poverty alleviation’ or economic growth. Improving governance is seen by politicians as the transfer of discretion from individuals to institutions, and hence is opposed by them.

In any case, even if political will were not lacking, technical capacity in the civil service to reform itself is almost zero. There is complete paralysis of decision-making in the Bihar civil administration, especially at the secretariat. Not only have IAS officers decided to avoid taking decisions (for fear of being questioned by the Central Bureau of Investigation, which has become much more active following the fodder scam in which senior politicians were indicted) but procedures have been so devised in the last five years that it is simply not possible to take a decision, even if one wanted to. The harm caused by indecision cannot be attributed to any particular individual or political party, and hence has no political costs. Thus the goal of ‘development’ does not appear attractive to the rulers, nor is the road map very clear.

The political system in Bihar (and indeed also in some other States) is accountable not to the people but to those who are behind the individual Members of Legislative Assembly (MLAs); these are often contractors, mafia, corrupt bureaucrats, and manipulators who have made money through using the political system, and are therefore interested in the continuation of chaos- and patronage-based administration. People have unfortunately accepted the position as *fait accompli* and resigned themselves to their fate. They too tend to seek shortcuts and exploit the system by breaking rules or approaching mafia gangs and politicians for favours. One of the greatest impacts of the present political system in Bihar has been the killing of people’s expectations concerning clean administration; they see a criminal bringing more personal benefits to them than an honest politician who has to remain ineffective in the present system. Because of low expectations there is no build up of anger or feeling of deprivation among the majority, and hence people do not organise themselves to reform the system, although there are minority militant movements seeking to overthrow the system.

Democracy in Bihar and several other States, including many north-eastern States, is not about people, it is about access to State power. Where power is highly personalised and weakly institutionalised, the political process is replaced by arbitrary and behind-the-scene transactions. In such an environment, the exercise of power for its clients demands a fudging of the rules (‘show me the person, and I will show you the rule’), dependence upon corrupt civil servants, plundering of the public treasury, and decay of governance.

Thus in these States neither politics nor administration has the capacity for self-correction, and therefore only external pressure can coerce them to take hard decisions. In the Indian situation (where foreign donors provide very little to the States as compared with what is provided by the centre) this can come only from the centre, backed by strong civil society action.

Some effort (however ineffective it may have remained so far) has been made by the central government towards correcting fiscal deficit by linking the transfer of funds to reductions in revenue deficits (described in Appendix 6). As regards improvement in governance, the impulse from central government has been feeble. In May 1999 the Planning Commission decided to link the central assistance under its mandate (i.e. support to States’ Plans and Centrally Sponsored Schemes, but not transfers via the Finance Commission) with performance, and a circular to this effect was sent to the States. It was felt that measures to improve accountability and transparency, and to make the civil service more productive and pro-poor would not be taken by the States on their own unless a superordinate body monitors and helps the States in such an endeavour, coupled with a threat of withdrawing assistance in case of default on agreed programmes. Commitments to reform have been made several times in the past but these have remained mere rhetoric because there were no immediate disincentives associated with inaction.

However, the States resented such monitoring by the Planning Commission, and pressurised the Planning Commission to continue approving central assistance without linking it to output. The circular issued in May 1999 died a natural death. Since then there has been no new initiative in that direction.

The States argue that the GoI does not have any moral authority to improve governance in the States, as it has done little to take similar steps to reform its own administration. Whether it is downsizing or reduction of subsidies on fertilisers, food, gas and higher education, or passing a Freedom to Information Act, or reducing the number of Centrally Sponsored Schemes, or providing long tenure to its senior civil servants,[16] GoI's record is almost as dismal as that of the many recalcitrant States. Contitutionally too, the States are elected governments in their own right and GoI does not have any constitutional right to 'discipline' them through administrative measures.

It is interesting to note here that the States accept several stringent conditions while borrowing from the World Bank and other donors (including conditions such as implementing any transfer of project staff only after consultation with donors) but fiercely defended their autonomy when the Planning Commission sought to introduce financial discipline and monitor projects in 1999.

The way forward is clear. India needs to find better ways to empower its poorest citizens and bring them into decision-making at all levels. In addition to ensuring that the recently created *Panchayati Raj* Institutions (PRIs) include the poor fully as decision makers, India needs to transform its public sector so that the conduct of the police, the courts, and the bureaucracy in general is transparent and accountable to citizens at all levels. Government must open its activities to public scrutiny, provide the public with the information they need to express their opinions to the government, and establish mechanisms to take into account citizens' feedback. Accountability is at the root of the reform process (Ferro et al., 2002), and evidence from the Gyandoot experiment in Madhya Pradesh (Jafri et al, 2002) illustrates how administrative performance can improve in response even to the fear of complaints to a higher level. Whilst efforts by the centre to 'discipline' the States by administrative measures may be resisted, there is clearly a case for the centre to monitor, and where necessary, enforce constitutional provisions concerning the conduct of elections at State and local levels, and to monitor much more fully the ways in which central funds are utilised, with refusal to undertake future funding if necessary. For the future, if legislation were to be introduced concerning a wide range of citizens' rights, then this again would be an arena in which the centre should monitor, and if necessary, insist that they be respected.

Concerted policy action is needed in India to lift the 260 million poor out of poverty, and, if fiscal crisis is held at bay, and some of the innovations proposed above introduced, there is some prospect that the conditions of the poor located in the better performing States will improve. However, the poor are increasingly concentrated in the poorer States which are characterised not merely by low growth, but also by increasing class- and caste-based strife and by the near-total breakdown of the normal functions of government. There is growing recognition that, to support people on trajectories out of poverty is not so much a matter of additional resources, as better policies, sound delivery mechanisms, and commitments from both from the centre and from the States to improve fiscal management and governance. For as long as such commitment is not forthcoming from the States, and the centre remains reluctant to use powers to 'discipline' recalcitrant States, there is little prospect in the States where the poor are increasingly concentrated that public investment will meet the needs of the poor, that teachers will attend schools and teach, doctors attend health centres and provide health care, or that social protection measures will reach intended beneficiaries.

16 On the 1st July 2000, only six out of 82 non-technical Secretaries to GoI had been in their jobs for more than two years. Many Ministries see a six-monthly change in its top incumbent (GoI, 2000).

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Appendix 1 Tables and Figures

Figure A1.1 Growth Rate of Indian Economy during the last Fifty Years (% per annum

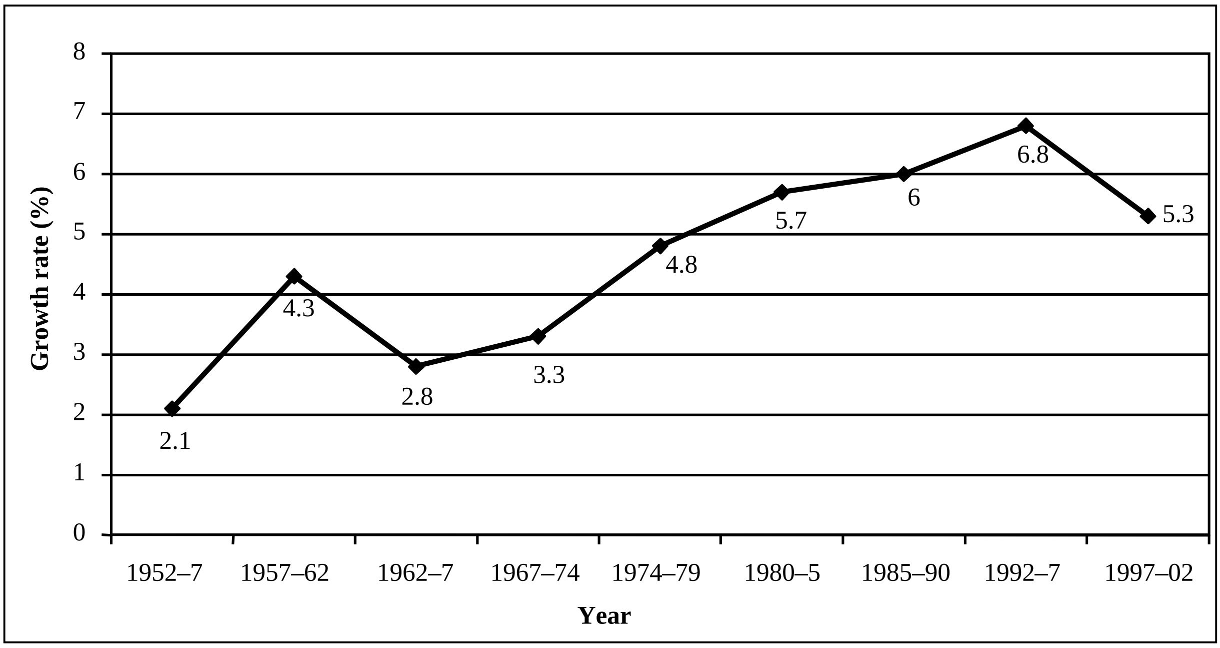

Table A1.1 Per capita net state domestic product at constant prices (1993–4, Rupees)

State/Union Territory	1990–1	1991–2	1992–3	1993–4	1994–5	1995–6	1996–7	1997–8 (P)	1998–9 (Q)	1999–2000 (A)	2000–1 (A)
A. Pradesh	6873	7120	6803	7447	7739	8086	8531	8214	9018	9318	9697
Assam	5574	5686	5621	5715	5737	5760	5793	5796	5664	5978	6157
Bihar	4476	4132	3803	3810	4068	3723	4093	4203	4397	4475	–
Gujarat	8788	7923	10285	9796	11535	11649	13206	12937	13493	13022	12975
Haryana	11125	11093	10846	11090	11617	11570	12664	12544	13003	13709	14331
H. Pradesh	7129	7040	7211	7364	7934	7966	8326	8583	8905	9177	–
Jammu & Kashmir	6272	6255	6385	6543	6619	6732	6978	7128	7296	7435	–
Karnataka	6629	7354	7406	7835	8095	8363	8997	9228	10282	10928	–
Kerala	6851	6892	7293	7938	8516	8748	8987	9079	9542	10107	10712
M. Pradesh	6321	5732	6030	6537	6441	6686	6962	7022	7407	7564	–
Maharashtra	10248	10001	11290	12290	12299	13406	13784	14114	14312	15410	–
Orissa	4300	4757	4589	4797	4913	5053	4652	5272	5264	5411	–
Punjab	11779	12079	12414	12714	12778	12989	13687	13705	14007	14678	–
Rajasthan	6771	6119	6886	6192	7158	7209	7851	8641	8735	8272	8088
Tamil Nadu	7872	7988	8315	8952	9944	10191	10583	11240	11775	12504	12954
U. Pradesh	5342	5261	5222	5258	5411	5498	5965	5848	6117	6373	–
West Bengal	6013	6355	6433	6781	7121	7514	7903	8438	8900	9425	10012

Source: * Based on 1970–1 series.
Key: P Provisional; Q Quick Estimates; A Advance Estimates; – Not available.
Note: Owing to differences in methodology and source material used, the figures for different States are not strictly comparable.

Table A1.2 Percentage of people below the poverty line in rural areas for selected States (Planning Commission estimates)

States/UTs	Percentage of persons					
	1973–4	*1977–8*	*1983*	*1987–8*	*1993–4*	*1999–2000*
Bihar	62.99	63.25	64.37	52.63	58.21	42.60
Orissa	67.28	72.38	67.53	57.64	49.72	47.15
Uttar Pradesh	56.53	47.6	46.45	41.10	42.28	31.15
West Bengal	73.16	68.34	63.05	48.30	40.80	27.02
Madhya Pradesh	62.66	62.52	48.90	41.92	40.64	37.43
Maharashtra	57.71	63.97	45.23	40.78	37.93	25.02
Tamil Nadu	57.43	57.68	53.99	45.80	32.48	21.12
Karnataka	55.14	48.18	36.33	32.82	29.88	20.04
Haryana	34.23	27.73	20.56	16.22	28.02	8.74
Rajasthan	44.76	35.89	33.50	33.21	26.46	15.28
Kerala	59.19	51.48	39.03	29.10	25.76	12.72
Gujarat	46.35	41.76	29.80	28.67	22.18	14.07
Andhra Pradesh	48.41	38.11	26.53	20.92	15.92	15.77
Punjab	28.21	16.37	13.20	12.60	11.95	6.16

Source: Government of India (2000)

Table A1.3 Average growth of real GDP over 50 years (%)

Sector	1951–2 to 1960–1	1961–2 to 1970–1	1971–2 to 1980–1	1981–2 to 1990–1	1991–2 to 2000–1	1992–3 to 2000–1
(1) Agriculture & allied	3.1	2.5	1.8	3.6	2.7	3.2
(2) Industry	6.3	5.5	4.1	7.1	5.7	6.4
(3) Services	4.3	4.8	4.4	6.7	7.5	7.8
(4) GDP (factor cost)	3.9	3.7	3.2	5.6	5.6	6.1
(5) Per capita GDP	2.0	1.5	0.8	3.4	3.6	4.0

Source: Government of India (2000)

Table A1.4 Average of percentage change in real wages 1980–1 to 1990–1 and 1990–1 to 1998–9

States	1981–91	1991–9
Andhra Pradesh	5.43	0.12
Assam	5.09	-1.93
Bihar	5.25	0.09
Gujarat	2.86	5.45
Karnataka	3.04	3.34
Kerala	2.59	8.06
Madhya Pradesh	6.51	1.78
Maharashtra	7.60	1.64
Orissa	5.29	0.79
Punjab	4.10	-0.13
Rajasthan	4.97	1.56
Tamil Nadu	2.46	6.07
Uttar Pradesh	4.95	3.18
West Bengal	6.59	1.29
All India	**4.68**	**2.04**

Source: Government of India (2000)

Table A1.5 Measures of total (urban plus rural) poverty incidence (% living below the poverty line)

State	1993/94 Survey estimate: headcount index (%)	1999/00 Forecast (one-step): headcount index (%)
Andhra Pradesh	29.5	24.1
Assam	44.5	46.9
Bihar	60.3	61.8
Gujarat	33.7	26.8
Karnataka	37.4	29.7
Kerala	28.8	14.4
Madhya Pradesh	44.0	41.5
Maharashtra	43.2	40.4
Orissa	40.3	34.3
Punjab	21.4	17.0
Rajasthan	43.3	34.2
Tamil Nadu	34.9	28.2
Uttar Pradesh	40.1	35.4
West Bengal	25.9	16.1
All India	39.1	34.3

Source: Datt and Ravallion (2002)

Appendix 2 Alternative Models for Assessing Current Poverty Levels

Two alternative models have been suggested: one by Deaton (2001), and the other by Datt, Kozel and Ravallion (2002). Deaton makes two key assumptions. First, he assumes that the survey results for the goods with the common 30-day recall period were unaffected by the change in NSS survey design. Secondly, he assumes that the distribution of total consumption has not changed over time and so can be inferred from the 1993–4 round. With these assumptions Deaton finds that the rural poverty rate fell from 37.2% in 1993–4 to 30.2% in 1999–2000, while urban poverty fell from 32.6% to 24.7%. After weighting these reductions by the urban and rural population shares, Deaton's estimates imply that the national poverty rate fell from 36.2% in 1993–4 to 28.8% in 1999–2000 and not to 26.1, as estimated by the Planning Commission.

Datt, Kozel and Ravallion have linked earlier poverty trends to plausible determining factors, and using information on those factors to calculate what we might expect poverty to be. The model builds on past research suggesting that the key determinants of the rate of poverty reduction at State level are agricultural yields, growth of the non-farm sector, development spending, and inflation. The model is used to predict the rates of poverty reduction over the period 1994–2000. The overall incidence of poverty is projected to have fallen from 39% to 34% over this period, suggesting that the rate of poverty reduction in the 1990s is lower than the 1980s, and much lower than one would have expected given the high growth in the 1990s.

The model also suggests more rapid rural progress in faster growing states like Kerala, Karnataka, Maharashtra, and Gujarat. Official 55th Round results also suggest rapid progress in these States, albeit substantially higher than model outcomes. These overall results suggest that growth in the non-farm sector, and in particular urban growth, is becoming a stronger driving force for poverty reduction in India. As the poorer States have not performed well, inequalities have increased during the reform period. The rise in inequality has been the result of several factors: (i) a shift in earnings from labour to capital income, (ii) the rapid growth of the services sector – particularly the FIIRE sectors[17] – with a consequent explosion in demand for white collar skilled workers, (iii) a drop in the rate of labour absorption during the reform period, and (iv) a sharp deterioration in governance for the poorer States, especially UP, Bihar, Jharkhand, Assam, and Orissa.

17 FIIRE is an acronym referring to Finance, Insurance, Internet and Real Estate. These sectors have been experiencing the most buoyant growth in recent years in many countries, including India.

Appendix 3 Governance and Poverty Reduction in Orissa

The fiscal position in Orissa is alarming. As against State revenues of Rs26.84bn in 2001–2, the interest burden itself was Rs30.2bn, whereas other non-Plan expenditure, mainly salaries and pensions, was a staggering Rs54.73bn. In a short period of four years, liabilities on account of interest payment have jumped from 91% to 113% of State Tax Revenues. Despite GoI's liberal assistance, the State has to borrow heavily, which has further added to its debt burden. By the end of 2001–2, the outstanding loan was of the order of Rs244.95bn which roughly works out to 61% of the estimated GSDP for the year. Orissa is caught in a debt trap.

The State Government has brought out a White Paper detailing the problems faced. The deterioration in Orissa's finances (at current prices) can be seen from the following Table taken from the White Paper:

Table A3.1 Orissa Finances in Rs billion

Year	State revenues	Total revenues incl. GoI transfers	Salary + pension + interest	Total revenue expenditure	Revenue surplus
1980–1	2.66	6.21	2.79	5.47	0.75
1990–1	8.70	21.71	13.22	21.91	(-) 0.20
1999–2000	24.21	58.87	57.33	84.59	-25.74

Source: Farrington and Saxena (2002)

Thus whereas State revenues at current prices increased only by 9.1 times, expenditure on salaries, pensions and interest increased by 20.5 times (with civil service pensions increasing by almost 100 times), with the result that whereas the State had a small revenue surplus of Rs0.75bn in 1980–1, and a small deficit of Rs0.20bn in 1990–1, it ended up with a huge deficit of Rs25.74bn in 1999–2000, which was even higher than its total revenue collection. The position further worsened in 2001–2, as the interest payment galloped from Rs12.92bn in 1997–8 to Rs30.20bn in 2001–2 (at current prices).

One of the factors responsible for high non-Plan expenditure in Orissa is the high number of government servants, as can be seen from Table A3.2.

Table A3.2 State Government Employment

State	Population	Core civil service	Ratio (per 1000 population)	Total govt. employees	Ratio (per 1000 population)	Govt. & PE employment	Ratio (per 1000 population)
AP	75,110,584	553,972	7.4	965,892	12.9	1,328,550	17.7
Karnataka	51,152,000	240,969	4.7	530,984	10.4	693,246	13.6
Orissa	35,391,000	480,000	13.6	581,400	16.4	660,928	18.7
Gujarat	47,267,000	206,000	4.4	502,000	10.6	800,000	16.9
UP	162,000,000	880,000	5.4	1,576,226	9.7	1,730,093	10.7

Source: unpublished estimates by The World Bank.
Note: The figures for total government employees include work charged and daily wage labourers, grant-in-aid institutions and other employees whose salaries are covered by the State government. It does not include employees of municipalities. PE= public enterprises.

High expenditure on salaries is crowding out essential non-wage components of expenditure, such as on school books, medicines, travel, equipment and maintenance. Most government hospitals have not paid their electricity dues for years. Power is often cut off during the immunisation campaign risking storage of vaccines, etc. Orissa has banned government recruitment, which has meant that today there are too many clerks and messengers, whereas new para-medical staff and teachers cannot be appointed.

The following quote from a recent report by one of the authors (NCS) for UNICEF regarding health services in Orissa illustrates many of the problems of weak government:

> ‘The problems of weak delivery are present in Orissa too. There are staff vacancies at all levels, amounting to almost 50% of the total staff in the poorer districts of Orissa. Since the present staff is in these backward districts mostly against their will (they would like to be in coastal districts where opportunities for private practice exist; most staff also come from those districts), their morale is very low and staff absenteeism is high. This is compounded by the fact that seniors in a district (up to the Chief District Medical Officer) make no effort to supervise, guide and motivate the junior staff. State government often treats posting to tribal districts as a means of punishment, but in the process the poor tribals get punished. There is quick turnover of the staff posted, so that no one stays on her/his post for more than 3 to 6 months. Doctors with no experience of public health are posted to public health because of bad cadre management.
>
> I visited a remote tribal village Bhitarmunda on the border between Mayurbhanj and Keonjhar districts with Dr. Ramani (UNICEF) and the District Collector, Mrs Arumugam. This village has not been visited by the Auxiliary Nurse Midwife (ANM) for the past five years at least. After the Collector’s visit last month, the ANM has visited once. The Collector had given several orders to improve delivery, but none of them were carried out. Perhaps the field staff thought that the Collector would not visit this village again, or soon be transferred out (indeed she was, fifteen days later), and therefore her orders need not be taken seriously. Records of the ANM are extremely poorly maintained, cards given to the children were incorrectly filled up. She had no idea of the number of births and deaths in that village this year. The Tetanus Toxoid (TT) campaign was not carried out and no measles campaign held. Antenatals are not given chloroquine. Male worker was not present. ANM is supposed to be based at Manoharpur village about 10 km away, but lives about 55 km away in the block HQ. The Anganwadi helper also does not live here, but comes from a nearby village, so she too is unaware of births and deaths in the village, as were the Child Development Project Officer (CDPO) and Lady Health Worker (LHW). The school has been closed for over 10 years due to the absence of the teacher. The Mid Day Meal (MDM) rations are handed over to the children – about 1 kg a month, according to the villagers (allocation is 3 kg rice/month/child). ANM was advised to apply for a moped loan but she did not look keen about it. Medical Officer (MO) said that some applications have already been sent, but no one has received the loan, though Mayurbhanj has received the money. MO is alone at block PHC, 3 of the 8 single doctor PHCs are vacant, none of the staff stay in their place of posting, and hence supervision is difficult.
>
> The financial crisis in the state leaves no money for consumables like stationery, or even bandages for dressings; or fuel for mobility. We saw a huge building in district Keonjhar that was constructed as a hospital, but had neither doctors, nor equipment, nor medicines.
>
> The National Family Health Survey (NFHS)-II report (1998–9) shows that only 43.7% of the children aged 12–23 months had received all immunisations. Figures on immunisation and health coverage as reported by the districts seem to be exaggerated when compared with the Multiple Indicators Cluster Survey (MICS) survey, the results of which are now available, as shown below for district Keonjhar.

Table A3.3 Incorrect reporting by the district

	Reported by district admin	**As per evaluation (MICS)**
% delivery by trained hands	64	21
% of fully immunised children	100	56

The scheme of giving Rs500 to each BPL pregnant mother is not running well at all. Fund allocation in Keonjhar district was so meagre compared to the requirement that there is a four year backlog. According to the district figures, roughly 25,000 births take place in a year. If half of them are BPL families, the scheme should be benefiting 12,500 women, against this number only 1,818 women were given assistance during 2001–2 under the scheme.’

Appendix 4 The Specific Vulnerability of Scheduled Tribes

From the viewpoint of policy, it is important to understand that tribal communities are vulnerable not only because they are poor, assetless and illiterate compared to the general population; often their distinct vulnerability arises from their inability to negotiate and cope with the consequences of their forced integration with the mainstream economy, society, cultural and political system, from which they were historically protected as the result of their relative isolation. Post-independence, the requirements of planned development brought with them the spectre of dams, mines, industries and roads on tribal lands. With these came the concomitant processes of displacement, both literal and metaphorical – as tribal institutions and practices were forced into uneasy existence with or gave way to market or formal State institutions (most significantly, in the legal sphere), tribal peoples found themselves at a profound disadvantage with respect to the influx of better-equipped outsiders into tribal areas. The repercussions for the already fragile socio-economic livelihood base of the tribals were devastating – ranging from loss of livelihoods, and land alienation on a vast scale, to hereditary bondage.

As tribal people in India perilously, sometimes hopelessly, grapple with these tragic consequences, a small clutch of official programmes has done little to assist the precipitous pauperisation, exploitation and disintegration of tribal communities. Tribal people respond occasionally with anger and assertion, but often also in anomie and despair, because the following persistent problems have by and large remained unattended to:

- land alienation;
- indebtedness;
- relation with forests, and government monopoly over Non-Timber Forest Products (NTFPs);
- ineffective implementation of *Panchayat*s (Extension to the Scheduled Areas) Act of 1996 (PESA, 1996) for Schedule V areas;
- involuntary displacement due to development projects and lack of proper rehabilitation;
- shifting cultivation.

In at least one-third of tribal blocks in central India extremists groups are active and normal administration does not function.

Appendix 5 The Concepts of Plan and Non-Plan Disbursements

As is well known, government expenditure comprises two broad categories, Plan and non-Plan. Plan funds are utilised for new projects and programmes. Non-Plan funds cover the expenditures on on-going programmes. Over the years, however, the term non-Plan has acquired a pejorative meaning as if Plan expenditures are productive and non-Plan expenditures are not. Plan being equated with development has distorted the meaning of non-Plan. This is incorrect, for non-Plan is the sum of previous Plans, as completed Plan schemes are classified as 'non-Plan'. There has also been inadequate appreciation of the fact that expenditure under State Plan schemes and centrally-sponsored schemes leaves a large committed liability, which can cause the revenue deficits to expand year after year. This too has left a legacy of large committed expenditures.

Most expenditure on education and health is classified as non-Plan, as the schemes pertaining to this sector are continuing since the last several Plan periods. For instance, for secondary and higher education the GoI spent Rs47bn in 2000–1 out of which Rs30.7bn or 65% was non-Plan. Such a percentage would be higher for the States, as most staff in education and health are hired by them. The difference between Plan and non-Plan is being further reduced because since the Seventh Five-year Plan committed liabilities under the Plan have not been transferred to non-Plan at the end of each Plan period. The reason given by the Planning Commission is that such a transfer would impact negatively on the Balance from Current Revenues (BCR) and adversely affects Plan sizes. Similarly, expenditures on maintenance of roads, irrigation works and buildings are certainly productive, and inadequate provision for these to contain non-Plan expenditures has been a major shortcoming in expenditure management in the States. Many irrigation schemes are not being shown as complete, although they started in the 1960s, so that they continue to be in the Plan and receive adequate funds for salaries, etc. Thus the distinction between Plan and non-Plan is mostly artificial; similar nature of expenditures is sometimes booked under Plan, and sometimes under non-Plan.

Since the claims of non-Plan expenditure consisting of salaries, interest payment etc, are often more pressing and cannot be avoided or reduced in the short run, it was earlier thought that States should raise their own resources (including transfers via the FC) to meet non-Plan expenditure, and the transfers via the Planning Commission would act as a carrot to the states to raise revenues and have a positive and significant BCR to induce the creation of new assets via Plan expenditure.

None of these assumptions are being met now. As the States have a huge negative BCR, about one-third of borrowing, ostensibly for Plan investment, is being diverted for meeting non-Plan expenditure. In many States most Plan funds are also being used for payment of salaries. Staff who were being paid out of non-Plan budgets earlier are now being shown against the Plan; a complete reversal of what used to happen in the early decades of planning, when after each Plan period the staff was shifted from Plan to non-Plan. Operations and maintenance have been cut back heavily, with the result that while new assets are being created, old ones have a very short life because of non-maintenance, which makes very little economic sense.

Sustainability of projects/programmes on completion is a serious concern. Their precarious financial position in many cases prevents State governments from taking up even committed liabilities of the project after completion, let alone continuing with the developmental activities initiated during the project period. While this aspect is invariably taken up at the time of approval of the project, there is no other procedural mechanism in place than to rely on the written commitment given by the State governments. At least at the level of the Planning Commission, there is no follow-up action to see whether the State governments comply with the commitment.

For instance, many assets created under JRY, EAS, drinking water and other similar rural infrastructure schemes are not able to serve any useful purpose because of lack of funds for maintenance of existing assets. The present system emphasises new investment over the efficient use of existing assets. About 40% of school buildings in Chotanagpur area have no roof, and cannot be used during the rainy months, thus reducing the number of teaching days (GoI, 2000). In 126 out of 915 school buildings constructed during 1994–2000 in Bihar at a cost of Rs300m, major defects like leakage in roofs, cracks in walls, etc. were reported. However, in the absence of any provision for maintenance the defects could not be rectified (GoI, 2001). Instead of sanctioning new buildings, greater benefit would accrue at less cost if funds were available for their repairs. Permitting Plan funds for maintenance more liberally than allowed at present will in itself improve the utility of such assets.

In the case of social services, increasing salary expenditures have reduced technical efficiency, as the required complement of non-salary inputs for the provision of education (books, blackboards, laboratory equipment) and health (equipment, medicines) services has been crowded out. Reducing high priority non-wage expenditure vastly reduces the very purpose of constructing schools and hospitals and employing staff. Rural India is replete with buildings that are languishing now because either complementary investment in furniture and equipment could not be made, or essential repairs were not carried out.

Most government hospitals in Orissa have not paid their electricity dues for years. Power is often cut off during the immunisation campaign (from the point of view of Electricity Boards that is the best opportunity for recovery) risking the storage of vaccines, etc. Orissa has banned government recruitment, which has meant that today there are too many clerks and peons, whereas new para-medical staff and teachers cannot be appointed. The artificial distinction between Plan and non-Plan expenditures has caused expenditure profligacy on the one hand and low productivity of public expenditures on the other.

Thus the segmentation of revenue expenditure into ‘Plan’ and ‘non-Plan’ leaving the task of looking after the gap to two different agencies – the Planning Commission and the Finance Commission – is scarcely conducive to the determination of needs of each State in a holistic way. For the transfers to operate without creating moral hazard, it is necessary to integrate the revenue side and assess the gap objectively, leaving it to the States to raise revenue on their own if they wish to spend more than what is estimated normatively. The transfer system will remain flawed unless its different components are integrated and guided by healthy principles. Hence, all revenue transfers to the States should be brought under the purview of the FC[18] and ultimately the distinction between Plan and the non-Plan must be obliterated.

It may be recalled that the Tenth Finance Commission (1994) report suggested that the distinction between Plan and non-Plan has perverse impacts and should be scrapped in favour of the conventional revenue-capital distinction, although this recommendation was not acted upon. However, the then Finance Minister Sinha announced a committee to take a new look at this issue in 1998–9. The committee under the Chairmanship of Expenditure Secretary met only twice in 1999 but could not reach any conclusion. It felt that the Finance Commission should better examine this subject. No report is thus expected from that committee. However, nor was the matter referred to either the 11th or the 12th Finance Commission for in depth consideration.

18 It should be noted that the Constitution by itself does not place any restrictions on the scope of the Finance Commission. Yet the Commissions have restricted their recommendations to only non-Plan revenue expenditure, even when specifically asked by the Finance Ministry to recommend on Plan revenues (Fourth and Tenth FC), because the FCs wanted to maintain a clear division of functions between the Finance Commission and the Planning Commission.

Although there is wide recognition both among policy makers and professionals to do away with the Plan and non-Plan distinction, in actual practice it has not been pursued because it will be opposed by the Planning Commission, as the size of funds available with them will become less than half if the revenue component of the Plan is taken out of their jurisdiction. Therefore a practical solution will be to do so in stages, so that no organisation grudges the loss of its empire. We suggest the following road map:

- All maintenance and repair activities may be made a part of the Plan. The Planning Commission has already declared protection of forests as a Plan activity, and similar initiatives are needed for other sectors too. In many Plan schemes, such as the Sector Reforms for Drinking Water (carrying outlays of more than Rs2bn a year), up to 20% of funds can be used for maintenance. These examples show that the importance of repairs has already been accepted in the Plans, and therefore nothing earth shaking is being suggested here.
- Simultaneously, all expenditure on health, education, and similar social sectors[19] should be declared a Plan activity, both for the States as well as the centre. Since most expenditure in these sectors is revenue, the FC will handle the devolution to the States, but the Planning Commission will decide what is today classified as Plan and non-Plan budget of development departments for the central ministries. This will compensate for any decline in budgetary support with the PC as a result of FC deciding the devolution of all revenue transfers. The practical implication of this change would be to substantially increase the BCR (as the present non-Plan developmental expenditure will not then be part of the non-Plan). From the political point of view it will result in boosting the Plan size of the States, which the Chief Ministers can take the credit for. The GBS that is currently around Rs1,150bn will lose about Rs200bn (revenue side of Central Assistance to the States), but will gain about Rs 500bn, which is at present the non-Plan budget of development departments of GoI. Enhanced budgetary support will keep the Planning Commission in good humor, as it is their *dharma* (religion) to ask for a higher allocation for the GBS! The Finance Ministry will continue dealing with interest, security, and subsidies, as well as with general services. This simple change in classification will bring smiles on the faces of all concerned, and from the professional point of view it will result in integration of funds, and priorities for expenditure will be decided on rational grounds of efficiency.

In other words, rather than remove contamination from the Plan (caused by too much revenue expenditure and non-withdrawal of continuing schemes), which is not acceptable as it reduces Plan size and GBS, what we suggest is just the opposite: to bring more items from non-Plan (social expenditure, maintenance) into Plan, which not only bolsters the Plan but also integrates all expenditure for a particular sector leading to better fiscal management. This win-win solution should continue for about five years, until every one is mentally prepared for total merger of the Plan and non-Plan categories.

19 This is classified at present as non-Plan development, as distinct from non-Plan non-development sector, such as police, etc.

Appendix 6 Mechanisms for Transfer of Resources from the Centre to States

Summary
The Constitutional division of responsibilities between the Government of India and the States (including Union Territories) means that the revenue-raising capability of the GoI is substantially higher than that of the States. This is compensated by statutory provision for the transfer of funds from the centre to the States, via the Finance Commission, and, further, administrative provision mandated largely to the Planning Commission for transfer through two routes, via support to States' Plans, and via the Centrally Sponsored Schemes of GoI Ministries.

In 2001–2 the States received roughly Rs700bn, Rs400bn and Rs250bn[20] *respectively from these three sources. The modality of these transfers to the States is explained in the chart below. In aggregate, these three sets of transfers were more than the States' tax revenues and amounted to almost 36% of the States' public expenditure. Transfers from centre to States are therefore important, and have been increasing in real terms, but declining in relation to most key indicators. Thus, for instance, they have declined from 9.3% of GNP in 1985–6 to 5.4% in 1999–2000, they have also declined against the revenue receipts of central government, and as a proportion of States' tax receipts, though States have maintained a constant share of the 'pot' of money available to be shared out – i.e. they have received a roughly constant 28% – 29% of shareable Union taxes and duties since the 1980s. Some of these relative declines may be accounted for by the declining share of taxation in relation to GNP (see main paper). Some clear shifts have occurred among the three types of transfer: there has been a shift in favour of transfers via the Finance Commission, reflecting a diminishing importance attached by central and State governments to 5-year indicative Plans. States will no doubt welcome this as a much more flexible source of funds, and one that does not require counterpart contributions from them. Within the two types of funds mandated to the Planning Commission, support via the Union Ministries' Centrally Sponsored Schemes has doubled over the last 20 years from one-third to two thirds of the total. Again, this reflects a de-prioritisation of planning, but also a desire on the part of central government to ensure that even the least progressive States introduce what it regards as socially and environmentally enlightened provisions. The same desire is reflected in the shift in allocation of these resources towards the poorer States. However, there is little evidence that these administrative measures will have the desired effect in the absence of fundamental governance reforms in several of the poorer States.*

Changes since 1970–1 in the total transfer to States (not including transfer to DRDAs etc., as figures on such transfers are not readily available) as a percentage of GNP at current prices are shown below. Thus the share of total transfers to states in GNP generally increased from 1974–5 up to 1985–6, but has been falling since then, and was only 5.4% of GNP in 1999–2000 as against 9.3% in 1985–6 and 4.8% in 1974–5 (these percentages do not include transfer through DRDAs etc). As the share fluctuates from year to year, we have calculated a five-year average of transfer to States as a proportion of central revenue receipts and states' own tax revenues, given as Table A6.5.

The share has also gone down as a percentage of total State expenditure as shown in Table A6.1, largely because an increasing portion of States' expenditure is deficit-financed.

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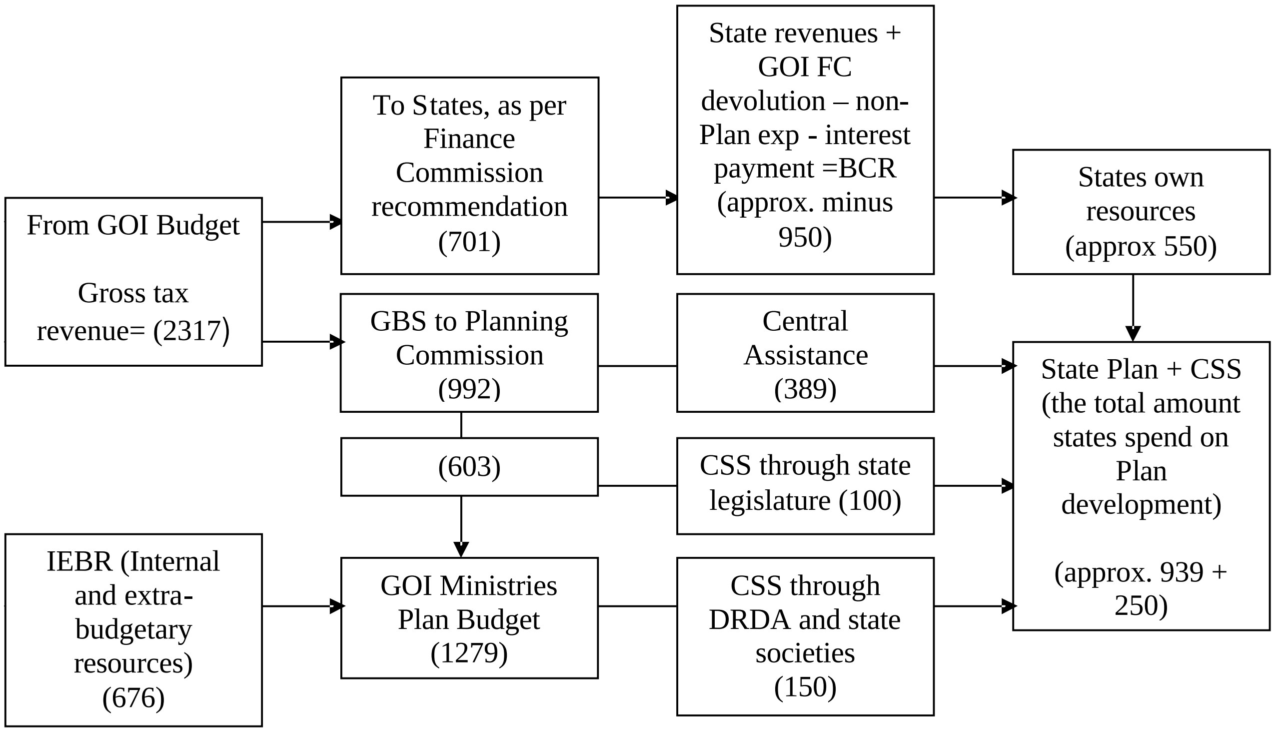
20 According to the budget documents this figure is only about Rs100bn. The reason for discrepancy is that transfers to District Rural Development Agencies (DRDAs) and State Societies are not included in the budget as transfer to states, although this mode of transfer to state level organisations is now about Rs150bn.

Figure A6.1 Devolution of funds from centre to States in 2001–2 (Revised Estimates)



Source: Estimates and flows from authors' own observations.
Note: Figures in brackets is the amount in billion Rs

Table A6.1 Transfer of funds to States, including FC, PC and CSS, but excluding transfer to DRDAs and State Societies

Year	Gross transfer to States	Total expenditure of States	Transfer to States as % of State expenditure
1990–1	42350	80232	52.8
1991–2	46201	95587	48.3
1992–3	51800	106149	48.8
1993–4	58459	120635	48.5
1994–5	63947	143750	44.5
1995–6	70502	163676	43.1
1996–7	82637	181872	45.4
1997–8	88729	206714	42.9
1998–9	80924	243355	33.3
1999–2000	94780	289621	32.7
2000–1 (R.E.)	113857	337176	33.8
2001–2 (B.E.)	127614	369219	34.6

Source: Government of India (2000)

Based on budget estimates (BE) and revised estimates (RE), there has been some improvement in the last two years, although accounts for these years are still to be finalised by the Finance Ministry. (Final central receipts for 2001–2 were about 10% lower than the BE figures, which has also affected transfers to States not reflected in the BE figures in this paper).

Figure A6.2 Proportion of total transfer to States as a percentage of GNP

Source: Government of India (2000) and authors' own observations.

As is argued in this paper, the decline is primarily due to decline in tax-GDP ratio as well as to a reduction in transfers via the Planning Commission, reflecting a decline in the importance of the Planning Commission as well as in the transfer of Plan funds to the States. It has been partly compensated by increased funding to States via the central ministries (see Table A6.2 below), but since this is the smallest component of the three, it has not made much difference to overall transfers, though has certainly increased central ministries' clout with the States.

Table A6.2 summarises the characteristics of each form of transfer, and their modalities are explained in more detail in the following sections.

Finance Commission – The Indian Constitution assigns the levy and collection of certain taxes, such as income tax and central excise, to central jurisdiction, and a Finance Commission (FC) is set up once in five years to arrange sharing of revenue with the State Governments. The transfers via the Planning Commission and GoI Ministries were originally intended to be *additional* transfers from central revenue to the States, over and above the FC allocations. However, fiscal deterioration means that they are now no longer from the revenues of the centre, as the entire budget for Plan for the central Ministries as well as the States (both routed through the Planning Commission) is now funded through borrowing by the centre.

Every five years, the Finance Commission determines the extent of resource transfer from centre to the States and its inter-State distribution. In addition to a share in taxes the Finance Commission also recommends grants-in-aid to the States for filling its non-Plan revenue deficit, for improvement in administration, and for various other purposes. There have been eleven Commissions so far, and their recommendations, though constitutionally not binding, have always been accepted by the central government.

Table A6.2 Summary of the characteristics of the three forms of devolution of funds to the States

	Devolution to States through:		
	Finance Commission	Finance Ministry/Planning Commission	
		Support to States' Plans	*Support to central ministries*
Approx. amount in 2001–2	Rs700bn	Rs400bn	Rs250bn
Share in national Gross Domestic Product in 2001–2	2.8%	1.5%	1.0%
Whether grant or loan	All grant.	30% grant, 70% loan for major states, but 90% grant, 10% loan for special category states (SCS).	Almost all grant to the Ministries, used for financing Centrally Sponsored Schemes (CSSs) and transfers to DRDAs, etc.
Discretion in fund utilisation	States have full control, can be used for both Plan and non-Plan, but due to growing size of non-Plan expenditure and interest burden, FC grants are not being used for Plan.	Non-SCS States can use it only for Plan; SCS can divert 25% of assistance for non-Plan; States decide sector-wise breakup and obtain Planning Commission's approval once a year. However the States are free to formulate schemes without consulting the Planning Commission.	These funds are not part of State Plans; schemes are formulated by central Ministries in consultation with States and States are asked to contribute a part, usually 25%, of the cost; though there are CSS that are up to 100% funded by central government. Implementation of these schemes is by State governments.
Who decides the State-wise breakdown?	Once in five years, the Finance Commission decides the share in taxes, evolves a formula to distribute it among the States, and also gives discretionary grants to some States for covering their non-Plan deficit.	These two components are part of the annual GBS and its size is decided by the Finance Ministry in consultation with Planning Commission. The breakdown of GBS into Central Assistance for States and central Plan for Ministries is decided by the Planning Commission. The breakdown of Central Assistance for States into normal Central Assistance and Additional Central Assistance (generally 50:50) is again at the discretion of Planning Commission. However, the inter-State distribution of normal Central Assistance is guided by the Gadgil Formula that gives weighting to poverty, etc. The distribution of Additional Central Assistance among the States is determined by the nature of the scheme, or is at the discretion of Planning Commission. Most Central Ministries, except Rural Development, do not have a transparent formula for fixing State allocations. The State share in their budget depends on the nature of the scheme and the interest taken by the State.	

Source: Authors' estimates, based on GoI data.

The total share of the States in the net proceeds of shareable Union taxes and duties during the period 1999–2004 has been fixed at 29.5% by the FC. In addition, Rs353.59bn over the five years will be provided to such States that have large deficit on non-Plan revenue account. Rs49.73bn towards upgrading standards of administration and special problem grants to States, and grants amounting to Rs100bn for local bodies (*Panchayats* and Municipalities) have also been recommended by the Commission.

The overall share of the States in central taxes (excluding non-Plan grants) improved from a low of 15% in the early 1950s to 28% in 1980–1, but has been stagnating at that level for the last twenty years. The chart below shows the growth of tax-GDP ratio for the centre, as well as the share of states in central taxes in the last fifty years.

Two factors may have slowed down the rate of growth in transfers via the Finance Commission. First, central tax collection in relation to GDP has come down from 10.69% in 1989–90 to 8.90% in 1999–2000. Second, the constitutional assumption that the centre would have a transferable surplus has been invalidated by the continuous deterioration in its fiscal position. Ever since 1982–3 the centre has had a fiscal deficit greater than the fiscal transfers (including share of taxes, grants and loans net of recoveries) to the States and UTs, so that devolution under fiscal federalism in India has become an exercise in distributing deficits.

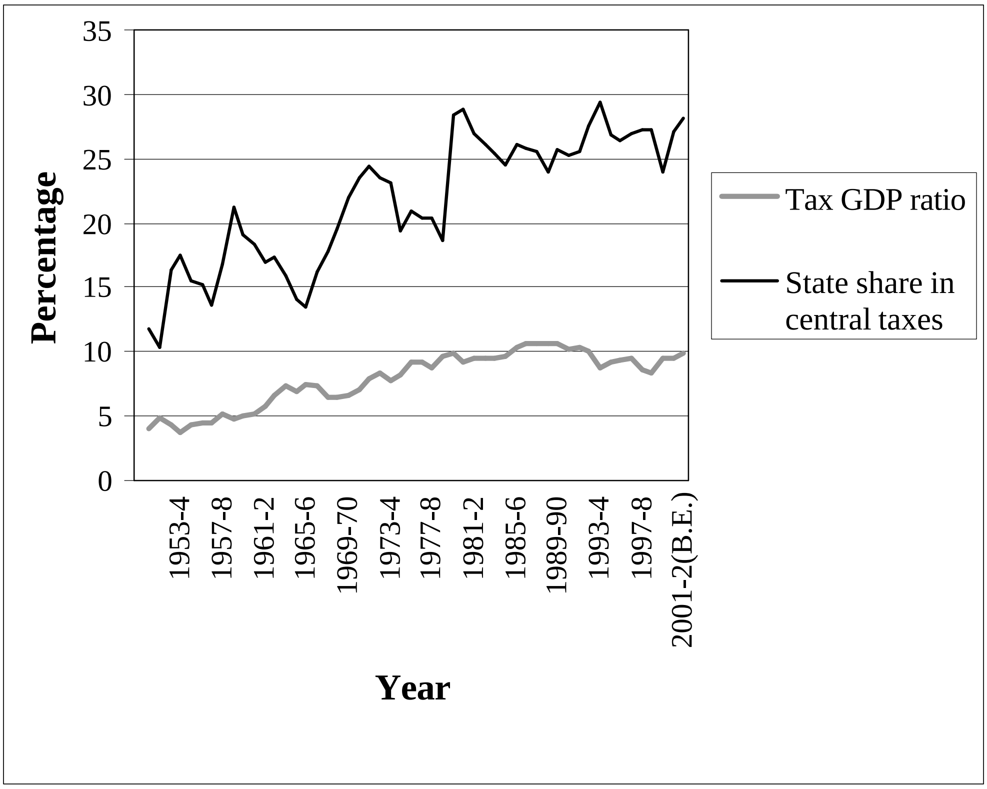
The Finance Commission (FC) fixes its own guidelines to decide the inter-State distribution of available funds. The Commissions have been giving substantial weight to criteria such as poverty, backwardness and the capacity of States to raise revenues on their own. As relative poverty of the poorer states has increased in the last decade, the share of the richer states has fallen rapidly in the overall devolution recommended by the last (Eleventh) Finance Commission. Gujarat, Haryana. Maharashtra, Punjab and Goa (share in population of these States is 18.54%) have suffered a loss in devolution from 13.14% of the total in the Tenth FC to 9.75% in the Eleventh FC. Among the middle income States, the percentage share in devolution has gone down in respect of Andhra Pradesh, Kerala and Tamil Nadu. Andhra Pradesh's share has been brought down from 7.98% to 7.13% and Kerala's from 3.4% to 2.83%. These eight States submitted a joint protest to the Prime Minister in August 2000, but did not succeed in changing the shares.

In addition to deciding the distribution of central taxes, Finance Commissions are asked to lay down the principles that should govern the giving of grants-in-aid to the States out of the Consolidated Fund of India. Past Finance Commissions have tried to assess the gap between expenditure needs and revenue realisations of the States, and bridge that gap through grants. There have been two problems with this approach. Firstly, it gives gap filling grants so that revenue deficit of the States at the end of the period of five years becomes zero. Thus, if a State has been irresponsible and has ended up with a huge revenue deficit, it is likely to get a larger gap-filling grant (West Bengal is a good example). In other words, the FC rewards profligacy. States that have tried to reduce their revenue deficit are likely to benefit less.

Secondly, as each Commission is wound up after giving its report, there is no mechanism to monitor its recommendations. The Finance Commissions' recommendations on fiscal restructuring hardly ever come up for any discussion at the political level in a centre-State forum such as the National Development Council (NDC) or the Inter-State Council. As a result, their recommendations remain only on paper and do not ever form part of any decision-making process either at the centre or at State level. The only recommendations of the Commission that matter to the centre or the States are those relating to the vertical and horizontal devolution of central funds.

Planning Commission/Finance Ministry. The other two forms of central resources that are transferred to the States independently of the FC allocations, i.e. via the Planning Commission as direct support for the States' Plans, and via the central ministries, generally in the form of Centrally Sponsored Schemes (CSS), are part of what is termed Gross Budgetary Support (GBS). This is not a statutory transfer, but is determined every year before the budget by the central Finance Ministry in consultation with the Planning Commission. The breakdown of GBS into Central Assistance to the States' Plans and support to the GoI Ministries for CSS is decided by the Planning Commission.

Figure A6.3 Changes in Tax-GDP ratio and in States' share in central taxes



Source: Government of India (2000)

a) Central Assistance to the States' Plans

Central Assistance to the States' Plans is broken down into normal Central Assistance and Additional Central Assistance. This is done at the discretion of the Planning Commission. However, the inter-State distribution of normal Central Assistance is guided by the Gadgil Formula that weighs according to poverty, population, etc. Here again the share of richer States has been falling over the years, giving rise to a feeling amongst them that they are being penalised for better performance.

Additional Central Assistance (ACA) is now approaching 50% of total Central Assistance, and its share has been increasing over the years, although the National Development Council had desired that most Central Assistance must be in the form of Normal Central Assistance governed by the Gadgil Formula. The increase has been due to a large number of area-based schemes, such as Border Development Programme, Western Ghats and Hill Development Programme, etc. Lately, the resources for several other programmes, such as Rural Roads, Prime Minister's Programme for Basic Needs, etc., are being given to States by the Planning Commission from ACA.

b) Support to the States via the Plan of Central GoI Ministries (CSS etc)

Unil about the end of the 1960s there were few Centrally Sponsored Schemes (CSS), and the GoI Ministries spent much of their Plan allocation on subjects allocated to the centre under the Constitution. The centre's involvement with State subjects started increasing under Mrs Indira Gandhi's regime with her focus on *Garibi Hatao* (poverty eradication). Several subjects, such as education, population control and forests were brought from the State to the concurrent list. This enables the GoI to pass legislation in these sectors without obtaining States' agreement. Many current schemes in rural development, such as IRDP, the creation of employment through public works, Food for Work, etc. were initiated during her regime.

Changes in the nature of central ministries' schemes that are funded by the budget over the last twenty years are shown in Table A6.3.

Table A6.3 Percentage distribution of central Plan outlay supported by the budget through GoI ministries by heads of development

Head of development	Sixth Plan 1980–1 to 1985–6	Seventh Plan 1985–6 to 1989–90	Annual Plans 1990–1 to 1991–2	Eighth Plan 1992–3 to 1996–7	Ninth Plan 1997–8 to 2001–2	Tenth Plan 1st year 2002–3
Industry and Minerals, Energy, Communications	51	44	34.1	25.3	16.9	13
Agriculture, Irrigation, Rural Development, Education, Health & Family Welfare, Water, Sanitation, House, Urban Dev., SCs & STs Welfare	33	40.6	49.8	62.5	61.3	55.3
Transport	14.1	14.1	13.5	9.3	17.3	21.3
Others	1.9	1.3	2.6	2.9	4.5	10.4*
Total	100	100	100	100	100	100

* This includes several new schemes for NE States.

Source: Government of India (2000)

As many schemes in the transport sector (construction of roads) are implemented by the States, one could easily conclude that the share of Centrally Sponsored Schemes (that are funded by the central ministries but implemented by the States) has almost doubled in the last twenty years, i.e. from one-third to close to two-thirds of the total central Plan.

c) *Central Assistance to the States' Plans, plus support through GoI Ministries – the overall patterns of GBS (Gross Budgetary Support)*

To summarise, GBS comprises both Central Assistance to the States' Plans plus the Plan of GoI Ministries. The central Ministries spend a part of central Plan through central government staff and the public sector, and the other part is spent as assistance to States (and their subordinate organisations such as DRDAs and state societies) to undertake Centrally Sponsored Schemes, etc. The amount of GBS as a share of GDP has fallen rapidly from 7.33% in 1986–7 to 4.04% in 2001–2. However, the share of direct assistance to the State and UT Plans in GBS has improved over the last two decades, as shown in Table A6.4.

Table A6.4 Changing composition of Gross Budgetary Support since 1980/1

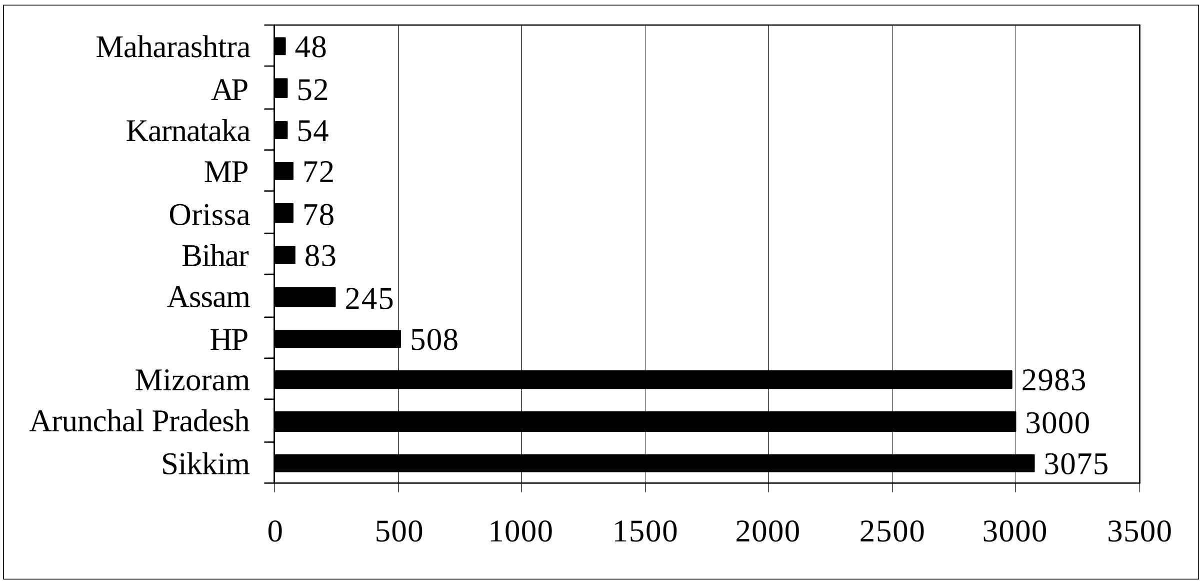
Year	GDP at market prices*	Plan of GoI central ministries supported by the budget	Central Assistance for State and UT Plans	Aggregate GBS (3+4)	Aggregate GBS as % of GDP (5)*100/(2)	State share in GBS (4)*100/(5)	Share of Central Assistance for States as a % of GDP (4)*100/(2)
1	*2*	*3*	*4*	*5*	*6*	*7*	*8*
1980–1	1,44,393	5674	3320	8994	6.23	36.9	2.30
1981–2	1,69,495	6673	3567	10240	6.04	34.8	2.10
1982–3	1,88,866	7456	4457	11913	6.31	37.4	2.36
1983–4	2,19,688	9275	4763	14038	6.39	33.9	2.17
1984–5	2,46,883	11507	5108	16615	6.73	30.7	2.07
1985–6	2,80,258	12791	7063	19854	7.08	35.6	2.52
1986–7	3,13,580	15001	7995	22996	7.33	34.8	2.55
1987–8	3,55,417	14458	9751	24209	6.81	40.3	2.74
1988–9	4,23,497	16333	9618	25951	6.13	37.1	2.27
1989–90	4,87,740	18049	9471	27520	5.64	34.4	1.94
1990–1	5,68,772	17496	10869	28365	4.99	38.3	1.91
1991–2	6,53,298	17096	13865	30961	4.74	44.8	2.12
1992–3	7,47,387	19777	16884	36661	4.91	46.1	2.26
1993–4	8,59,220	23685	19977	43662	5.08	45.8	2.33
1994–5	10,09,906	25800	21578	47378	4.69	45.5	2.14
1995–6	11,81,961	27166	19208	46374	3.92	41.4	1.63
1996–7	13,61,952	29451	24083	53534	3.93	45.0	1.77
1997–8	15,15,646	32455	26622	59077	3.90	45.1	1.76
1998–9	17,58,276	37333	29485	66818	3.80	44.1	1.68
1999–2000	19,56,997	39757	36425	76182	3.89	47.8	1.86
2000–1(RE (e)	21,95,529E	48269	37969	86238	3.93	44.0	1.73
2001–2(BE (e)	24,74,766E	59456	40644	100100	4.04	40.6	1.64

*GDP figures until 1992–3 are at 1980–1 base and from 1993–4 onwards at 1993–4 base
Note: (e) GDP figures are estimates

Thus the share of direct assistance to the States' Plans in GBS, which was only 34.8% and 36.4% in the Sixth and Seventh Plans has increased to 44.8% and 44.3% in the Eighth and Ninth Plans. The net impact of these two factors (a fall in the share of GBS in GDP and a rise in the share of Central Assistance to States in GBS) has been that overall Central Assistance hardly increased (despite rapid growth in GDP) from Rs906bn in the Eighth Plan (1992–7) to Rs917bn in the Ninth Plan (1997–2002), both figures at 1993–4 prices. However, for the Sixth and Seventh Plans, this figure was Rs472bn and Rs739bn respectively (at 1993–4 prices), so that it has almost doubled in real terms from 1982–7 to 1997–2002. During this period the GDP increased by more than 2.5 times. Thus, as a proportion of GDP, Central Assistance to States has fallen rapidly by about 40% from a high of 2.74% in 1987–8 to 1.64% in 2001–2. As the Approach Paper for the Tenth Plan laments, 'Plan outlay has become a residual item of government expenditure'.

By contrast with the Finance Commission's devolution which is 100% grant, the Planning Commission's assistance to the States' Plans is 30% grant, 70% loan for normal States, but 90% grant and 10% loan for special category states (SCS). These are all north-eastern States, including Sikkim, Jammu and Kashmir, Himachal Pradesh, Uttaranchal, and Sikkim. As these States do not have potential for the growth of a secondary sector, being hilly and remote from markets, a special dispensation has been made for them in fixing the loan:grant ratio, so much so that whereas the normal States can use Central Assistance only for Plan schemes, SCS can divert 25% of assistance for non-Plan purposes. Per capita assistance to these States is very high, as seen in the figure below.

Figure A6.4 Share in normal Central Assistance as a ratio of share in population



Source: Government of India (2000)

If every State received Central Assistance in proportion to its population, the share of each State in the above chart would 100. But Sikkim received 30 times the national average per capita assistance, whereas even poorer States such as Bihar and Orissa got less than the average. The overall allocation to these Special Category States is 33% of normal Central Assistance, as against their share of 6% in total population.

If the grant part of all Central Assistance is combined with Finance Commission grants, this gives an indication of total grant-type transfers from the centre to States under all three modalities (except transfers to DRDAs). It is estimated that these grew at 15.52% per annum at current prices in 1980–90 but at a slower rate of 11.68% during 1990–2000 (Govinda Rao, 2002). These transfers were 4.46% of GDP in 1980–1, rose to 4.89% in 1985–6, but fell to 4.20% in 1995–6 and finally to 3.58% in 1998–9. The fall in the loan portion of Central Assistance to states has been even more drastic; it was about 25% of total central revenues in the early 1970s, but was less than 9% in the late 1990s.

The increased attention to State subjects in the agenda of GoI Ministries served a political purpose too. If Mrs Gandhi were to succeed in appealing directly to the masses this would require her to bypass the regional political rulers (by the late 1960s, many State governments were ruled by political parties other than Congress) and she would have to initiate programmes that could be identified with the central regime. This trend continued even after her death. The Prime Minister's speech to the nation on the 15th August every year concentrates more on what the central government is doing on subjects under the States' jurisdiction than on subjects with the centre. The States worsening fiscal position has increased their dependence on the centre and so exacerbated this.

To sum up, despite continuous deterioration in central finances and a falling tax/GDP ratio, the GoI's involvement in State-mandated subjects, such as health, education, and poverty alleviation, has increased in several ways. First, many subjects such as population control and family planning, forests, and education have been brought from the 'State list' to the 'concurrent list' through constitutional amendments. Second, the share of Central Assistance in GBS has increased. Third, the centre has also intruded in allocation decisions on the subjects traditionally under the purview of the States through Centrally Sponsored Schemes (CSSs). GoI Ministries have substantially increased funding of CSS, the budget for which is now about 60% of the Central Assistance (as against a norm of $1/6^{th}$ fixed by NDC); much of it goes straight to the districts, thus bypassing the States and placing district bureaucracy somewhat directly under the supervision of the GoI. And lastly more than half of Central Assistance is given in the form of Additional Central Assistance (ACA), which is often not formula-based but where the GoI Ministries have a great deal of control over the State allocations and releases. Though for budgetary purposes they are shown as Additional Central Assistance, they share many common features with CSS, as these entail adequate control over flow of funds with the central Ministries but States too have flexibility in deciding the details of schemes. This new hybrid form of transfers must be seen as a healthy development, as it can be used for promoting reforms in the States.

We seem to have reached a paradoxical situation; on the one hand central transfers to States as a percentage of GNP or central revenues or States' total expenditure have gone down in the last 15 years, and yet due to fiscal constraints faced by the States, Centrally Sponsored Schemes are often the only schemes in the social sector that are operational at the field level, with States having no discretion to introduce changes in their nature – at least in principle. The political purpose of greater control over States has been achieved without any increase in the actual share of transfer of resources to the States in either GNP or the total revenue receipts of the centre or in the tax receipts of the States.

As regards choosing between transfer via support to their Plans and via Centrally Supported Schemes, States are caught in a dilemma. On political platforms they demand (in the name of autonomy) that the CSSs should be transferred to them, but the implication is that any support for these would then have to come via the former category, which generally has a higher loan component and would therefore increase their debt burden. In general they therefore do not pursue these demands in earnest – quite the contrary, they often seek to get State schemes or projects transferred quietly to the centre. A good example is of the District Primary Education Programme of Andhra Pradesh funded by the World Bank that was a State project until 1999, but the Chief Minister got it transferred to central jurisdiction, which reduced the loan component of World Bank's assistance from 70% to zero.

The Planning Commission has been of the view that there are too many schemes under the CSS. This has meant large and ineffective expenditure in the name of development. Ministries are unwilling to accept poor performance, for fear of being questioned by Parliament or adverse press publicity. Hence a vested interest develops up to the top to overlook shortcomings, and not to encourage independent evaluation. Most schemes follow a blue print and top-down approach, with little flexibility given to field staff. For instance, there are regions in India where labour is scarce, such as the north-east and Uttaranchal. However, public works are carried out in these regions too, for which the field staff employs labour from other regions, but records are fudged to show employment of local labour. It would be much better for States to have discretion in deciding the mix of poverty alleviation programmes.

Is greater allocation for State plans the answer? Despite these problems, it must be admitted that reducing funds for CSS and devolving more resources to the States for State Plans may not always improve efficiency, at least in the poorer and badly governed States. In addition to the problems associated with CSS (poor monitoring, too many schemes) which are common to State sector schemes too, releases by the State Finance Departments in many States for their own schemes is highly ad hoc, uncertain, delayed, and subject to personal influences. One important factor behind fiscal indiscipline is the artificially inflated Plan of some of the States approved by the PC, which is often 50% to 80% higher than the available resources.

The wide gap between the approved Plan and the resources plays havoc with fund releases for the sectoral schemes, which are often approved on the basis of the approved Plan size, but for which resources are not in sight. Even when financial sanctions are issued as per budget and Plan provisions, the Treasury does not release money when the bills are presented. Finance Department issues formal/informal instructions for not honouring the bills even though they may be within the budgetary provisions. Thus wholesale replacement of CSS by State sector (or by PRIs) is neither desirable nor politically feasible, at least for quite some time to come. GoI has employed a huge bureaucracy in the social sector Ministries, and they too resist any such reduction in their budgets.

A possible way out

A more practical solution and acceptable to all would be to reduce the number of schemes without hitting at the outlay of the Ministries. This was attempted in the terminal year of the Ninth Plan, and of the 360 CSS in operation, the Planning Commission recommended weeding out 48 schemes, merging 161 schemes into 53 schemes, and retaining the remaining 135 schemes, implying a carrying forward of 188 CSS to the Tenth Plan. In some of the merged schemes, such as SSA (Sarva Shiksha Abhiyan – a scheme for promoting elementary education) and macro management in agriculture, Ministries have adopted a cafeteria approach whereby a cluster of CSS have been clubbed together under one umbrella scheme and the option to select schemes has been left to the the States as per their needs and priorities.

Time thus saved should be used by the central ministries in capacity building, inter-sectoral coordination, and detailed monitoring of State sector projects. CSS compare unfavorably with EAPs as far as the practice of frequent reviews and evaluations are concerned. Third party reviews should be periodically undertaken.

Medium Term Reforms Facility

Based on the recommendations of the Eleventh FC, 15% of the deficit grants recommended by the Finance Commission with an equal contribution from the centre (in all, Rs110bn in four years) is to be distributed to the States according to their fiscal performance to be measured on the basis of a single monitorable fiscal objective: improvement in the revenue deficit by at least 5% of its revenue receipts. If a State fails to fulfill the condition, the fund will be rolled over to the next year. If the withheld portion is not claimed by 2005–6, the fund will lapse.

Nineteen of the 28 States have already signed the MOU with the centre to operationalise the scheme. Releases of Rs14.57bn were made in 2001–2 to 13 States, mostly on their promise to reduce revenue deficit, whereas releases from 2002–3 onwards were to be based on actual performance. Upto the end of February 2003, Rs4.89bn has been released to eight States. It does not seem to be always based on their performance, as Punjab has received Rs0.47bn, although its revenue deficit to revenue receipts ratio rose from 25% in 2000–1 to 42% in 2001–2. Assam was given Rs0.33bn in 2002–3, although its ratio increased from 13.83% to 19.30% in the same period.

Moreover, seven States were permitted additional open market borrowings of a total of Rs23.63bn during 2002–3. Here again it is difficult to link this with States' performance. Orissa was permitted to borrow Rs3bn, although its performance continues to be dismal.

Therefore the scheme has not resulted in any substantial reduction in State deficits, because of lack of will on the part of the institutions concerned. The amount of funds available for incentive payments is also not enough to incentivise the reduction. Conditionalities should apply to all funds amounting to Rs1275bn in 2001–2 (including share in taxes, Central Assistance, and CSS) and not just the 15% of funds released to the States under Article 275 of the Constitution, which amounts to just 2% of total transfers.

It is significant that the PC, FC, and Ministries control substantial funds but are indifferent or averse to conditionalities, whereas MOUs were being monitored by the Finance Ministry, which has no such pool of funds. It tried in the past two years to promote reforms by permitting States to do additional market borrowing (SLR), which has further added to the debt burden of the States. To facilitate proper coordination between various wings of government it may be worthwhile to create a small cell within the Prime Minister's Office so that all institutions are encouraged to take unpopular decisions in a coordinated manner and these are backed by political sanction.

It is equally necessary that similar conditionalities govern the releases of funds to the municipal and *Panchayat Raj* bodies. The golden rule must be not to release any funds unconditionally. Suitable conditionalities may even be attached to the utilisation of tax receipts by the centre. The FC should therefore become a permanent body, so that it monitors the fulfillment of criteria by the States and PRIs as well as GoI before they actually receive share of taxes or other grants.

To sum up, a good transfer system should distribute funds based on needs, capacity, and effort. Capacity is the end result of effort, which is the intermediate stage. A State may be low on capacity, which takes time to build up, but if does not even make efforts in that direction surely does not deserve sympathy just because it is poor. Mere gap filling transfers foster dependency and ultimately block the incentive to reform. Matching and conditional transfers have economic and fiscal advantages in terms of allocative efficiency. They introduce elements of local involvement, commitment, accountability and responsibility for the aided activities.

Table A6.5 Transfer of funds to States, including FC, PC and CSS, but excluding transfer to DRDAs and State societies – annual average of five years at 1993–4 prices in billion Rs

Years	Revenue receipts of central government	State tax revenues	Gross transfer to states	Share of transfer as a proportion of state tax receipts	Share of transfers in revenue receipts of central government
1970–5	324.76	117.13	184.88	1.58	0.57
1975–80	476.48	181.39	242.36	1.34	0.51
1980–5	586.42	242.65	329.92	1.36	0.56
1985–90	866.99	343.41	486.71	1.42	0.56
1990–5	1030.42	448.05	572.69	1.28	0.56
1995–2000	1364.88	592.37	609.77	1.03	0.45

Source: Calculated by the authors from diverse GoI sources.

Appendix 7 Fiscal Crisis in the States

The finances of the State Governments have deteriorated precipitously in the 1990s. The States' Balance of Current Revenue (BCR) has continuously declined from Rs31.18bn in 1985–6 to a massive figure of minus Rs323.06bn in 2000–1. The contribution of the balance of current revenue (BCR) to the financing of State Plans, which was as high as 28% of the total Plan resources in the Sixth Plan has now fallen to (-)52%, the deficit being financed by borrowing. During the same period the States' overall debt has multiplied from Rs536.6bn in 1986–7 to Rs5878bn in 2001–2. Since 1995–6, the debt stock of the States increased at the compound annual rate of 17.9%, whereas the revenue receipts increased only at 11.2%. Consequently, the share of interest payment in total expenditure increased from 13% in 1990–1 to 21.6% in 2000–1 to crowd out productive expenditures (Govinda Rao, 2002). Plan expenditure has fallen from 27% of the total State expenditure in the Sixth Plan to 19% in the Ninth Plan.

Not only has the share of Plan resources to GDP been declining over successive Plans, but the Plan is entirely funded from loans, thus increasing debt for future generations.

Table A7.1 Overall State Plan resources and its funding (as a percentage of GDP)

Plan	Overall Plan resources	States' own non-debt contribution	Revenue Plan transfers from centre	Net debt receipts
Fifth (1974–9)	4.3	1.2 (27.9)	1.1 (25.6)	2.0 (46.5)
Sixth (1980–5)	5.1	0.6 (11.8)	1.5 (29.4)	3.0 (58.8)
Seventh (1985–90)	5.1	0.4 (7.8)	1.7 (33.3)	3.0 (58.9)
Eighth (1992–7)	4.2	0.0 (0.0)	1.6 (38.1)	2.6 (61.9)
Ninth (1997–2002)	3.7	(-) 1.5 ((-) 40.5)	1.2 (32.4)	4.0 (108.1)

Note: Figures in parentheses indicate percentage share in overall Plan resources (Tenth Plan papers). The share of States in overall Plan outlays has also fallen relative to the centre, as illustrated in Table A7.2.
Source: Calculated by the authors from various Tenth Plan documents.

Table A7.2 Share of States in Plan outlays (%)

Plan	Centre	States
Fourth (1969–74)	50	50
Fifth (1974–9)	48	52
Sixth (1980–5)	53	47
Seventh (1985–90)	58	42
Eighth (1992–7)	59	41
Ninth (1997–2002)	63	37*

* Against a target of 43% for the Ninth Plan
Source: Govinda Rao (2002)

While the borrowings of State Governments have grown sharply, a major portion of the borrowed funds are being diverted to bridging the revenue gap, leaving very little funds for investment in core sectors. In fact, once the States have paid salaries and interest on loans, scarcely any resources remain for productive investment. The revenue deficit accounted for 60% of the gross fiscal deficit in 1999–2000 as against only 28% in 1990–1. As a result, there has been a deceleration between 1980 and 1998 in the growth of capital expenditure from 26% to 17% of total State expenditure. It further fell to 13% in 2000–1 (Govinda Rao, 2002). Taking both non-Plan and Plan expenditure together, the share of infrastructure fell from 2.8% of GDP in the Fifth Plan period to 2.3% in the Ninth Plan period. This decline has led to increasing infrastructure bottlenecks.

In fact in many States most Plan funds are also being used for payment of salaries. Staff being paid out of non-Plan budgets earlier are now being shown against the Plan; a complete reversal of what used to happen in the early decades of planning, when after each Plan period the staff was shifted from Plan to non-Plan. As an illustration, in Appendix 3 we discuss the case of Orissa, one of the poorest States of India.

There are several implications of fiscal deterioration on the delivery of programmes, even when funded by GoI Ministries (see Appendix 6 for modalities of transfer between centre and States).

First, GoI funds are often diverted for paying salaries, and not passed on to the development departments for months or years, thus defeating the very purpose of funding of social sector schemes by the centre. In such a scenario, neither can the field staff's commitment be sustained, nor can people's participation (essential for the success of programmes) be encouraged. Second, States do not release the counterpart funds in time, leading to further uncertainty about the availability of funds at the field level. Third, lack of counterpart funds leads States to demand 100% funding by GoI of CSSs, which in turn would inevitably dilute the sense of ownership and commitment by the States. Fourth, some States are unable to find counterpart funds for CSSs, and hence are not able to draw the earmarked allocations. Since CSSs generally require only 25% contribution from the States, in effect this means that if the States could pay one rupee less to their staff, they could get Rs3 from GoI to spend on development programmes.

And lastly, even when some projects/programmes are completed, their sustainability is a serious concern. Their precarious financial position in many cases prevented State Governments from taking up committed liabilities of the project such as repairs or maintenance after completion, thus drastically reducing the life of the project.

The following decisions have to be taken to achieve the fiscal corrections needed at the centre and the States.

- A widespread and bold imposition of user charges of all non-merit goods, such as higher education, fertilisers, irrigation, water supply, power, and railway travel.
- Reduction in the number of government employees by 3% per year with little new recruitment in future. All additional requirements should be made through redeployment and rationalisation of various Ministries**.**
- Non-Plan expenditure excluding interest payments, defence allocations and pay and allowances to be held constant in real terms at current level.
- Gross tax to GDP ratio should rise from 8.8% in 2001–2 to 11.7% in 2006–7.
- The process of disinvestments should be accelerated to yield Rs160bn to Rs170bn per year from less than Rs10bn/yr in the last four years.

For tax revenues to increase as a share of GDP, the imposition of indirect taxes on the services sector is imperative. This can essentially be achieved by the imposition of a widespread value added tax on all sectors of the economy.

Table A7.3 shows the financing pattern of State Plans for the Sixth, Seventh, Eighth and the Ninth Five-year Plans. It may be noted that State Plan resources at constant prices have increased by only 21% in ten years from the Seventh to the Ninth Plan. Besides, Central Assistance has hardly increased in the Ninth Plan as compared to the previous Plan. In the face of slowing assistance from GoI and their own mounting non-Plan revenue expenditures, State governments are forced to borrow more and more. This can only lead to further worsening of the fiscal situation in the coming years. If reckless borrowing is not kept in check, some States may be forced to declare a financial emergency during the Tenth Plan period.

Table A7.3 Financing pattern of State Plans (all figures at 1993–4 prices)

Sources	Sixth Plan 1980–5		Seventh Plan 1985–90		Eighth Plan 1992–7		Ninth Plan 1997–2002	
	Rsbn	*%*	*Rsbn.*	*%*	*Rsbn.*	*%*	*Rsbn.*	*%*
States own contribution	351.69	28	302.20	18	-64.80	-4	-1054.07	-52
Total borrowings	436.91	35	613.77	37	906.43	52	2153.34	107
Total State resources	788.59	63	915.96	55	841.63	48	1099.27	55
Central Assistance	471.74	37	738.54	45	906.43	52	917.19	45
Total resources	1260.34	100	1654.51	100	1748.06	100	2016.45	100

Note: The Scheme of Financing of Annual Plan 2001–02 used in the table is as per the official level discussions.
Source: Govinda Rao (2002)

One of the important causes of poor implementation of social sector schemes is the fact that, after paying for salaries and interest on previous loans, States have no money left for planned development or capital investment. The Balance from Current Revenues has become negative, as shown below.

In a communication dated September 4, 1998 addressed to the Deputy Chairman, Planning Commission, the Comptroller and Auditor General of India concluded that public investment no longer has the ability to remain the engine of growth because of lack of financial discipline in the States. He has also hinted that there should be drastic reduction in the amount of Central Assistance to the States. Since these are very serious observations, they cannot be simply brushed aside. His findings are quoted below:

1. Approved State Plans and Revised State Plans were far too ambitious. In the event, actual expenditure was well below the revised Plans.
2. State contribution to resources for financing State Plans in most cases was modest/ negligible. The Plans were largely financed by Central Assistance, market borrowings plus resources transferred for Central Sector Schemes and Centrally Sponsored Schemes.
3. Some States financed more than 100% expenditure from Government of India funds and diverted substantial amounts to non-Plan Expenditure. One State built a cash balance (held as Treasury bills) of Rs11.00bn at the end of the Plan period, producing the rather piquant situation of Government of India borrowing funds from the Reserve Bank of India (RBI), and giving it to the State, which in turn provided funds to RBI to invest Government of India Treasury bills.
4. There has been considerable diversion of funds from Centrally Sponsored Schemes and Central Sector Schemes. States' contribution to Centrally Sponsored Schemes has been negligible.
5. The size of the Plan was beyond the States' capacity to implement. Our reports contain enough material on the systematic transfer of funds from the Consolidated Fund to the Public Account because expenditure rates were much slower than transfer of resources.
6. These transfers have occurred in the main with regard to Social Sector. There is enough evidence in the State Reports of transfer of funds to Public Account, Savings and, in many cases, diversion of funds to other sectors. In other words, outlays on Social Sector were beyond the implementation capacity of the State governments.
7. Given the difficult situation of Union finances, the large fiscal deficit and the considerable inflationary pressures it is a moot point whether the present policy of generous transfers to the States should continue.

8. Public investment no longer has the ability to remain the engine of growth. Its capacity to do so will be further compromised by obligations to pay huge public sector salary increases under the Fifth Pay Commission.
9. As the country moves towards the next Plan and the Commission undertakes exercises to prepare the Plan, some of these issues would require consideration before adopting the age old approach of the bigger the better.

An alternative to the CAG's suggestion of cutting down centre-State transfers would be to link them to specific projects and policies, with regular monitoring. The Planning Commission should also resist the tendency of central ministries to control expenditure on social sector by proliferating Centrally Sponsored Schemes, as these subjects are in the State domain, and most funds on these programmes must be a part of the State Plans. However, the Planning Commission should improve the effectiveness of public expenditure in these sectors by better monitoring and impact studies, so that approved though unpopular policies are not lost sight of. The States would gain in fiscal respectability if they adopt the agreed measures, but there must also be a system of strong disincentive of losing out on Central Assistance if the unpopular measures of increasing user charges or improving governance are not put in place.

Table A7.4 Balance from current revenues (as a percentage of GDP)

	Fifth Plan	Sixth Plan	Seventh Plan	Eighth Plan	Ninth Plan
I. States' own revenue receipts	**9.0**	**9.6**	**10.4**	**10.1**	**9.4**
Share in central taxes	2.0 (22.2)	2.4 (25.0)	2.6 (25.0)	2.5 (24.8)	2.4 (25.5)
States' own tax	4.4 (48.9)	4.9 (51.0)	5.4 (51.9)	5.3 (52.5)	5.2 (55.3)
States' own non-tax revenue	2.0 (22.2)	2.0 (20.8)	1.9 (18.3)	1.9 (18.8)	1.5 (16.0)
Non-Plan grants	0.6 (6.7)	0.3 (3.2)	0.5 (4.8)	0.4 (3.9)	0.3 (3.2)
II. Non-Plan revenue expenditure	**7.6**	**8.5**	**10.0**	**10.3**	**10.8**
Interest payments	0.8 (10.5)	0.9 (10.6)	1.5 (15.0)	1.9 (18.4)	2.1 (19.4)
Pension payments	0.2 (2.6)	0.3 (3.5)	0.6 (6.0)	0.6 (5.8)	1.0 (9.3)
Other non-development	1.6 (21.1)	1.7 (20.0)	1.7 (17.0)	2.0 (19.4)	1.8 (16.7)
Development	4.9 (64.5)	5.5 (64.7)	6.1 (61.0)	5.7 (55.3)	5.7 (52.8)
Local bodies	0.1 (1.3)	0.1 (1.2)	0.1 (1.0)	0.1 (1.1)	0.2 (1.8)
III. Non-Plan revenue account-BCR (I–II)	**1.4 (118.4)**	**1.1 (112.9)**	**0.4 (104.0)**	**(-) 0.2 (98.1)**	**(-) 1.4 (87.0)**

Note: Figures in parenthesis indicate the percentage share. Figures in parenthesis under BCR indicate the percentage of States' own revenue receipts over its non-Plan revenue expenditure.
Source: Government of India (2001)

Appendix 8 Weak Public Management of Infrastructure: the Case of the Power Sector

Poor management of the energy infrastructure will be a major constraint on any effort to achieve a significant acceleration in the growth of GDP in the coming decade. The quality of these services in terms of both price and reliability are as important as availability. Serious problems on both counts were identified as much as ten years ago, but no corrective action has been taken and the result is that the power sector faces an imminent crisis in almost all States. No State Electricity Board (SEB) is recovering the full cost of power supplied with the result that they make continuous operating losses. These losses cannot be made good from State budgets, which are themselves under severe financial strain, and the result is that the SEBs are starved of resources to fund expansion and typically end up neglecting even essential maintenance. The annual losses of SEBs at the end of the Ninth Plan are estimated at Rs240bn and this has led to large outstanding dues to other branches of government, amounting to Rs350bn. SEBs overcharge industry and commercial users, but some of these do not pay, resorting instead to theft of electricity, typically with the connivance of the staff in the distribution segment, resulting in actual transmission and delivery (T&D) losses as high as 45–50%. Operational efficiencies in generation are also very low in many States. Overstaffing is rampant. Political interference on the management of SEBs has become the norm in most States, making it difficult to ensure high levels of management efficiency. Government has also failed to attract private investors into power generation, given the inability of power distributors to pay. The result has been that the inflow of private investment has been much below the targeted level.

Fortunately, consensus is beginning to emerge on what needs to be done in this area and a handful of States have started the process of reform. The main elements of power sector reform are the following:

- Power tariffs must be rationalised and the process of tariff fixation de-politicised by entrusting it to State Electricity Regulatory Commissions. Ideally, power tariffs should cover the cost of production with reasonable levels of efficiency. If any section of consumers has to be subsidised, the necessary subsidy should be provided explicitly from the budget. Cross-subsidisation should be avoided. If it is felt that power consumers as a whole should pay for subsidies to certain categories of consumers, this is better done by levying an excise duty on power (which is within the domain of the States) and using the proceeds to subsidise targeted consumers.
- The traditional vertically integrated public sector monopoly model in which generation transmission and distribution are all bundled into one does not provide maximum incentive for efficiency in all stages of the operation. SEBs should therefore be unbundled to separate generation, transmission and distribution as distinct activities which can then be corporatised and ultimately also privatised.
- Reforms in the distribution segment are the most critical for restoring viability in the power sector since this is the segment which realises sales proceeds and therefore ensures financial viability. Public sector controlled distribution systems dealing with millions of consumers are unlikely to ensure efficiency in collection. Many States are willing to begin the process of privatising distribution. This will help to provide competitive benchmarks against which the rest of the system can be judged.
- Even States unwilling to privatise distribution at this stage should give top priority to distribution reforms. Immediate metering of all 11kv sub-stations and the introduction of appropriate management information systems (MIS) which would help locate pockets of high T&D losses should have top priority. In the medium term, the system must move to 100% metering if all consumers, or groups of consumers in areas where individual metering is not

feasible.

- Bulk consumers should be allowed to access power directly from producers paying a suitable wheeling charge to the transmission and distribution companies. This open access to the transmission network on a non-discriminatory basis is critical for opening up the electricity sector to competition. If implemented, it will force distribution companies to improve the quality of service.
- Captive power generation has an important role to play in an environment where there is an overall shortage. However, most State governments have not formulated clear policies which would enable efficient use of existing resources. A rational policy for captive generation should be drawn up which would enable surplus captive power to be sold to the grid at a reasonable price. Captive power producers should also be able to sell to individual consumers on paying a suitable wheeling charge.

It is encouraging that a handful of States have started the process of reforms in the power sector. However, it is important to note that the process will necessarily be drawn out. Systems that are operating at a T&D loss of 45% cannot suddenly improve their management to reach a 10–15% level, even if this is technically feasible. And yet, unless they make this transition, they cannot be expected to provide power of assured quality to Indian industry at a reasonable price. As States embark on power sector reforms it will be necessary to deal with the problems of the very large outstanding dues of SEBs and also the medium term restructuring of the SEBs to bring about viability in operations over a 3 to 4 year period. Substantial financial resources will be needed to help States make the transition. The Accelerated Power Development Programme (APDP) introduced in the Ninth Plan needs to be greatly expanded to serve as a vehicle for assisting States willing to undertake power sector reforms.

The optimum mix of power generation in terms of primary energy sources is an important issue for long term planning of the power sector. Over the years, the balance between thermal and hydro-electricity has shifted steadily against hydro-electricity, which now accounts for only 24% of total power generation whereas an ideal level would be much higher. Special efforts need to be made to restore the balance. Hydro-electricity not only avoids carbon emissions; it is also particularly well suited to dealing with situations where there are large peaking deficits. India has large untapped hydro resources and although there are environmental constraints in tapping these resources, a concerted effort at exploiting this potential, while at the same time protecting against environmental damage and ensuring fair resettlement compensation, is definitely needed.

Appendix 9 Findings of the Comptroller and Auditor General in Relation to the Implementation of Centrally Sponsored Schemes

The CAG studied the implementation of a number of Centrally Sponsored Schemes (CSSs) and observed as follows in his 1999 report (GoI, 1999):

> ‘The result of the performance reviews of these schemes carried out in the controlling Union ministries and the different states disclosed a common pattern of shortcomings in the execution of all Centrally Sponsored Schemes as under:
>
> - Inability of the Union ministries to control the execution of the schemes with a view to ensuring the attainment of the stated objectives in the most cost effective manner and within the given time-frame, as a result of which, the programmes continued to be executed in uncontrolled and open-ended manner without quantitative and qualitative evaluation of delivery.
> - The controlling Union ministries confined their role to the provision of budget and release of the funds to the State governments rather mechanically without reference to the effective utilisation of the funds released earlier in accordance with the guidelines and capacity of the respective State governments to actually spend the balance from the previous years and releases during the current year.
> - The ministries were unable to ensure correctness of the data and facts reported by the State governments. Overstatement of the figures of physical and financial performance by the State governments was rampant. No system of accountability for incorrect reporting and verification of reported performance were in vogue.
> - The Ministry was more concerned with expenditure rather than the attainment of the objectives. Large part of funds were released in the last month of the financial year, which could not be expected to be spent by the respective State governments during that financial year.
> - The State government's attitude to the execution of the programmes was generally indifferent. They laid emphasis on release of assistance by the ministry rather than ensuring the quality of expenditure and attainment of the objectives. Misuse of the funds provided for vulnerable sectors and sections of the society was rampant. The State governments' attitude towards such misuse was one of unconcern. The controlling Union ministries had no clue to such misuse. Thus, in many cases, the figures of expenditure booked in accounts assumed precedence over the bonafide and propriety of the expenditure.
> - Nobody could be held responsible for shortfall in performance, poor delivery of output, wanton abuse of the authority to misuse the funds provided for succour to the victims of calamity, economic upliftment of the poor Scheduled Tribes, eradication of malaria, sheltering from the suffering of repeated droughts, etc.’

CAG has thus indicted both the central and State governments for shabby implementation of the CSSs. It has however looked at the end result, but not analysed the causes why the outcome is so much below the desired level. The reasons for poor implementation of Centrally Sponsored Schemes are many, such as:

- There are too many schemes to be monitored. The Department of Agriculture has for instance some 50 Centrally Sponsored Schemes. The number needs to be curtailed drastically so that systems for their effective monitoring can be developed.
- There is unwillingness to investigate poor performance, for fear of being questioned by Parliament or receiving adverse press publicity. Senior officers feel that they would be taken to

task if failure is admitted. Hence a vested interest develops up to the top to conceal shortcomings, or not encourage independent evaluation. Since weaknesses are not highlighted, no corrective action is taken to set them right.

- Since schemes are implemented by the States, sensitivity associated with centre-State relations often precludes the centre from asking embarrassing questions. Moreover, ministries are hesitant to monitor State sector schemes, although it may have important bearing on the sector with which the central ministry is concerned.
- Uniformity of schemes all over the country from Mizoram to Kerala, without sufficient delegation to States to change the schemes to suit local conditions, leads to a situation where the States even knowing that the scheme is inappropriate become indifferent to its implementation.
- Many States are ruled by a political party different from that at the centre. These governments do not put their weight behind CSSs formulated by the Union Government as they see no political advantage in successful implementation of such schemes.
- A number of new CSSs get initiated at mid-stream through announcements in annual budgets, at the time of Independence day, etc. The need for evaluation, both concurrent and post-project, as a part of the project schedule has yet to be recognised. In this respect, externally aided projects definitely have an advantage since the donor agencies conduct regular evaluations of the projects. Absence of such a mechanism in the case of other national projects makes it difficult to know the progress in various components and apply mid-course corrections.
- In addition to effective delivery machinery, successful implementation of development programmes requires an appropriate policy framework. Pro-people policies are often not in place.
- States do not release the counterpart funds in time, leading to uncertainty about the availability of funds at the field level. This breeds corruption. States' burgeoning fiscal problems exacerbate this trend, as already discussed.
- Capacity to do effective monitoring is limited, and often does not exist. Thus there is neither will nor capability for the task.
- Routine has taken over the functioning of government at all levels. Little time is left for officers to initiate reforms or change schemes. With the best of commitment it often takes two years to get a scheme changed. In the meantime the officer gets transferred, and his efforts come to naught. Perception of short tenure dampens the enthusiasm to undertake reforms.

Many schemes assume a highly committed delivery machinery which will act as 'friend, philosopher and guide' of the people. Even if such rare individuals existed in government they do not stay at a particular post for a long time to make lasting impact. Incentive structures are also weak.