Infrastructure Development for Inclusive Growth

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Prologue

Inclusive growth – development for the common man – is of paramount importance for sustainable growth in India. The Author has written a very in-depth Article on the issues / deficiencies in infrastructure development for inclusive growth. He has highlighted the need for addressing deficiencies in infrastructure and bridging the gap between the regional and rural/urban divides. An economist of great repute, he has in his treatise covered, amongst others, the agriculture, non-farm, social and financial sectors.

Dr. Rao reiterates that since government initiatives and investments in the infrastructure development in the less developed regions and the rural areas would by themselves not be adequate, there is a pressing need for investments through the public private partnership route.

Introduction

Economic reforms introduced in the country in the early 1990s released the initiative and enterprise of those adequately endowed with infrastructure, resources, skills, power and influence. Such sections are generally concentrated in states and regions that are relatively well developed and less so in other areas. People in the less endowed regions too have the spirit of enterprise, but in the absence of productive outlets and the requisite resources owing to the absence of necessary physical, social and financial infrastructure, fail to display their initiative and enterprise. The situation turned worse for them as the post-reform policy failed to effectively counteract such adverse initial conditions by according greater priority for public investment in infrastructure, agriculture and social sectors in general, because of its faith in ‘trickle down’ mechanism and the belief that greater role for the private sector, by itself, can make good these gaps.

Economic polarization was a logical corollary of such a policy. The climax of this was witnessed six years ago when the GDP growth rate was at its peak and the
'India Shining' campaign, then in full swing, coexisted with widespread rural distress and suicides by a large number of farmers. The government which came to power at the Centre under these circumstances in 2004 came out with an economic and social policy which, for the first time after 15 years of economic reform, tried to integrate the objective of growth with social justice and promised to pursue reforms with human face.

**Inclusive Growth: The Issues**

It is not inevitable that growth in GDP should lead to rise in inequalities in income - whether before or after the reforms. Much depends on the level and spatial distribution of physical infrastructure, human resource development, prevailing social structure, social policies and governance patterns. Therefore, the sharp rise in inequalities in the post-reform period can not be attributed to economic reforms as such. Rather, they can be traced to the initial conditions obtaining in the pre-reform period itself. In China, for example, where land reforms were successful and infrastructure development was high in the pre-reform period, there was a rapid reduction in poverty following economic reforms and acceleration in GDP growth (Rao, 2005), even though inequalities in income started rising. The quality of reform package is, of course, important. It has to be such as to make good the infrastructural and other gaps inherited from the pre-reform period. It should also be effective in coping with the adverse social consequences that predictably result from the implementation of reforms under the given unfavourable initial conditions.

Inadequate physical and social infrastructure like irrigation, power, roads, transport and communications, education and health and access to bank credit in the less developed regions and rural areas in general in the country is a major factor responsible for the growing rural-urban and regional disparities. This is also responsible for the slow growth of manufacturing and other activities in the rural non-farm sector, which explains the slow shift of labour force from agriculture and hence slow reduction in rural poverty.

In the present context of globalization, associated with trade and financial liberalization, the contribution of information and communication technology to GDP growth is rising sharply and becoming the driving force behind rising inequalities, as it raises the demand for skills that are in short supply and highly unequally distributed between different regions, income groups and between males and females (Rao, 2009b). This underlines the need to step up investment in social infrastructure for expanding the opportunities for education and acquisition of necessary skills in the less developed areas and for the socio-economically disadvantaged sections.

**Recent Experience and Challenges Ahead**

Notwithstanding the impact of the global economic meltdown on the domestic economy in the recent days, there has been a sustained high GDP growth, with
strong recovery in the manufacturing sector. This particular configuration has brought a boom in tax revenues for the government, led by the revenues from direct taxes, especially from the corporate sector. The tax-GDP ratio registered a significant rise recovering and even exceeding pre-reform levels both for the centre and the states. This has enabled governments to step up public investment in infrastructure and other expenditures on agriculture and social sectors. What is clearly on display is that high GDP growth, through improvement in revenues, can facilitate inclusive growth by enabling the governments to undertake the necessary investments in physical and social infrastructure. For a resource constrained economy, high GDP growth is a necessary, though not sufficient, condition for achieving inclusive growth (Rao, 2009a).

(i) Addressing Deficiencies in Infrastructure for Bridging the Regional and Rural Urban Divides

The Indian economy continues to be constrained primarily by the insufficiency of physical and social infrastructure where the government plays a major role (EAC, 2009). At a little over 4% of GDP in the base year of the Eleventh Plan, public investment in infrastructure was seriously deficient. Inadequacy of infrastructure in the less developed regions and rural areas in general is responsible for the inability of such areas to fully benefit from the opportunities opened up by economic reforms including globalization, leading to growing regional and rural-urban disparities.

The Commission on Growth and Development, recently constituted by the World Bank, came out with the assessment that “no country has sustained rapid growth without also keeping up impressive rates of public investment in infrastructure, education and health. Far from crowding out private investment, this spending crowds it in….. Unfortunately, we discovered, infrastructure spending is widely neglected” (The World Bank, 2008). The Commission notes that public investment in infrastructure constitutes 5-7 per cent of GDP in fast growing Asia. Implying, presumably, that there is no sanctity to a particular number in this regard, the Commission specifically observes about India that “now the government is trying to do more, making up for years of underinvestment in public infrastructure”.

The performance of certain infrastructure industries has been far from satisfactory. For example, a basic input like electricity which had registered an annual growth rate of 8-10 per cent in the 1980s, showed a steady decline in its growth rate in the post-reform period reaching a low of about 3% in 2002-03. Since then it has been recovering, its annual growth rate rising to a little over 7% in 2006-07 (RBI, 2008). The Eleventh Plan, therefore, envisages a significant rise in public investment in infrastructure from a little over 4% of GDP in the base year to over 6% at the end of the Plan. Together with private investment, it is expected to rise from 5% of GDP to 9% over this period.
The Eleventh Plan claims to outline “a comprehensive programme for development of infrastructure, especially in rural areas, and in the remote and backward parts of the country consistent with the requirements of inclusive growth at 9% per year....what this plan seeks to do is to target the slower growing regions, and the backward areas within these states, for higher levels of public investment that will enable the backlog in physical and social infrastructure to be addressed” (Planning Commission, 2008). But from the information given in the Plan document, it is not possible to find out how the infrastructure planned is going to be spread over different states, on the one hand, and between agriculture and the non-farm sector including small towns, on the other.

The Tenth Plan, for the first time, specified targets for the growth rate in Gross State Domestic Product (GSDP) for each state in consultation with state governments, without specifying the corresponding investment rates. However, the growth rates actually achieved in the Tenth Plan in the less developed states like Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh fell considerably short of the target, the shortfall ranging from 1.5 (Bihar) to 3.35 (Rajasthan) percentage points. The Eleventh Plan has continued this practice of fixing state-wise growth targets. These targeted growth rates for GSDP show smaller divergence between the richer and poorer states than those achieved in the Tenth Plan. But the absence of targets in respect of investment rates casts doubt on the credibility of these growth targets.

There is no basis to believe that the divergence in the investment rates between the poor and better-off states would come down in the Eleventh Plan period. For one thing, the per capita plan outlays (including central assistance) of the poorer states have been declining relative to those of the richer states in the post-reform period. The poorer states have been handicapped basically by their own weaker resource position. Because of lower tax-GSDP ratios and higher debt-GSDP ratios, their credit-worthiness is lower, and so they have not been able to access borrowing adequately from the market. Private-investment has been flowing basically to the high income states where infrastructure is well developed owing to higher per capita plan outlays (Rao, 2006).

The position has now become worse for the poorer states because of the Centre’s decision to do away with the loan component of the normal central assistance for state plans, following the recommendations of the Twelfth Finance Commission. No alternative mechanism has been put in place so far to enable the poorer states to easily access loans from the market. There is no increase in central assistance in the Eleventh Plan for infrastructure development of the backward regions through Backward Regions Grant Fund, Special Plan for Bihar and Action Plan for the undivided KBK (Kalahandi- Bolangir- Koraput districts of Orissa), which have only been protected at the Tenth Plan level. Such assistance constitutes less than 1% of total 11th Plan outlay for all states. It is not known how the performance of Bharat Nirman - a flagship programme designed to create infrastructure - is tilted in favour of the less developed states.
(ii) **Agriculture**

Public investment in agriculture infrastructure, mainly irrigation, which had declined from 5% of agriculture GDP in the early 1980s to below 2% in 2002-03 has now been stepped up to a little over 3%, with the target of raising it further to 4% by the close of the Eleventh Plan. Together with private investment, the overall capital formation in agriculture is now 12% of agriculture GDP which is the highest in the last 25 years (Planning Commission, 2008). By the end of the Eleventh Plan, this is expected to go up to 16% - necessary for sustaining 4% growth in agriculture GDP. The target of doubling the supply of institutional credit to agriculture in 3 years has been exceeded. There have been concerted policy interventions such as launching of the National Food Security Mission and the Rashtriya Krishi Vikas Yojana.

As a result, there is a clear upturn in agriculture, the growth rate of Agriculture GDP rising to nearly 4%, on an average, in the four years prior to the current drought, with comfortable stocks of food grains – almost comparable to that achieved when the green revolution was in full swing. Needless to say, much more remains to be done towards expanding basic infrastructure like irrigation, strengthening the agricultural research system, regenerating dry land farming, and providing institutional support like credit and extension services to small and marginal farmers and women farmers among them.

In respect of irrigation, for example, nearly 30 per cent of the available irrigation potential from major and medium irrigation projects in the country still remains to be exploited. As many as 388 projects were in the pipeline at various stages during the 11th Plan period. Decline in public investment and thin spread of resources over a large number of projects are responsible for the delay in the completion of these projects. The resource-poor states in the eastern and central regions account for the bulk of the irrigation potential remaining to be exploited. At the current levels of investment, the projects in hand in the country will take over 20 years for completion. Even for bringing it down to 10-15 years, the rate of investment will have to be almost doubled. The exploitation of the remaining potential from minor irrigation sources, consisting primarily of ground water sources, hinges on the availability of electric power for pumping water, especially in the eastern states where nearly three-fourth of their ground water potential still remains unexploited.

The above experience clearly demonstrates that there is considerable under-exploited potential in agriculture crying to be tapped and that a little extra effort can bring forth substantial results within a short period.

(iii) **Non-Farm Sector**

However, even after fully tapping the potential from agriculture, drought-proofing of the vast majority of livelihoods dependent on agriculture can be achieved only with a major augmentation of their earnings from non-agricultural occupations. The studies
on the growth of rural non-farm sector in India show that although output and employment have been growing in this sector, it has not really taken-off so far because of slow growth of agriculture, insufficient development of rural infrastructure and the weak public support systems. Therefore, along with high agricultural growth, there is a need for providing an enabling environment through augmentation of rural infrastructure like roads, power and communications, increasing the institutional credit flow to the small and tiny sector, building of strong public support systems for improving market information and marketing networks, skill and technology upgradation and their dissemination through training, especially for the weaker sections, and for promoting quality consciousness and quality control.

(iv) Social Sectors

Major initiatives have been taken in the last few years to improve social infrastructure like education and health through Sarva Shiksha Abhiyan (SSA) and National Rural Health Mission (NRHM). The allocations for these social sectors have been stepped up substantially in the 11th Plan when compared to the 10th Plan. The allocation of funds to the poorer states from the Centre during 2007-08 for programmes like NRHM, SSA and poverty alleviation was well above their share in population. Even so, in view of the overriding importance of education and skills in the post-globalization era, there has to be a sustained increase in investment in this field with special emphasis on effective implementation through the participation of beneficiaries at the grass root level.

(v) Financial Inclusion

Financial inclusion should be measured not only by the number of bank accounts held by the weaker sections, but also by the amounts borrowed by them, which show a more dismal picture. For example, the share of direct accounts with a credit limit of less than Rs.25,000 in total direct accounts declined from 97% in 1990 to 67% in 2005, while their share in outstanding direct credit declined from 0.66% to 0.23% in the same period (Planning Commission, 2007). The share of small-scale industries in total bank credit declined from 12.5% in 1991 to 5% in 2003: the small and marginal farmers account for only about one third of institutional credit for agriculture, the remaining two-thirds going to the farmers above 2 hectares (Shetty, 2009).

Financial inclusion could no doubt be inhibited by the higher transaction costs of dealing with a large number of small accounts rather than a small number of large accounts. But such costs can be reduced through organizational innovations or, where necessary, met through explicit subsidies to the banks and other institutions. Subsidies can also be extended to make up the losses on account of lower rates of interest charged to the weaker sections. In practice, however, restriction of bank credit to such sections is inhibited not by higher transaction costs or risks but by the financial sector and banking sector reforms implemented in the 1990s which have
also resulted in the emergence of an inequitable interest rate structure. For instance, paradoxically, a small farmer was made to pay an interest rate of 12 per cent while a highly rated corporate entity could raise money from banks at 6 per cent (Mujumdar, 2009).

Therefore, the basic cause for financial exclusion, often missed, is a mindset lacking in social concerns. This has to be faced squarely if appropriate institutional arrangements are to be made for checking the prevailing distortions in bank lending. The experience with the linkages of Banks with Micro Finance Institutions and Self-Help Groups (SHGs) clearly demonstrates that the poor are bankable. Even when margins are low, high volumes can make the business profitable (Joshi, 2008). Innovative institutions and methods for the delivery of credit are called for, such as Group-Lending to small and marginal farmers, and using NGOs, Farmer Clubs, SHGs, etc. for credit delivery.

Conclusion

The Planning Commission notes that over the past several years, the share of public investment in the overall investment has been declining reaching a little over 20% in recent years. Therefore, according to the Commission, there is “a very great limitation on the influence that fiscal quantities, allocations and strategy can directly exert on growth rates, especially at state level. States have, therefore, to focus on providing the necessary policy framework and supporting environment that makes economic activity possible and attractive enough for private sector investments. This would include the entire gamut of services right from maintaining law and order, providing quick and effective dispute resolution through an efficient adjudication system, avoiding an extortionate and distortionary tax system to enabling and empowering the general mass of population to take advantage of economic activity” (Planning Commission, 2008). While many of these measures for ‘good governance’ are desirable, they can not be a substitute for the provision of adequate infrastructure through public investment and through public-private partnerships. There is thus a case for revisiting the whole area of infrastructure development in the less developed regions and the rural areas in general.

References


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When you don’t invest in infrastructure, you are going to pay sooner or later.

- Mike Parker