



## ECONOMIC REFORM IN INDIA

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### *Task Force Report*

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## EXECUTIVE SUMMARY

The tidal wave of growth carrying India for the past decades following the 1991 reforms has proven to be just that – a wave that is now subsiding, leaving the world’s largest democracy stranded on a barren beach. Time is cheap, poverty is plentiful, and growth has taken leave as the GDP annual growth rate plunged from 10.1 percent in 2010 to just above four percent in 2012. From a fiscal deficit growing alarmingly fast to a population growing even faster, India faces both problems and potential that, if addressed in time, can lead to a new and greater time of growth.

Based on our research and meetings with leaders in business, academia, politics, and social reform movements, we present recommendations in the areas of fiscal policy, infrastructure and resources, education, labor, governance, social inclusion, health, agriculture, monetary policy, trade, and foreign affairs. Ordered in this memo by both importance and political feasibility, these reforms, many of which will take years before all their benefits will be felt, cannot fix every problem India faces. However, they will begin carving out a path so that, what was a single wave of growth, can evolve into a steady current of change.



### *Methods*

This report stems from more than 12 weeks of research and study, including two weeks traveling in India meeting with leaders in the public and private sectors. We analyzed works on India’s economics, politics, culture, and history, met with individuals from the CEO of the Bombay Stock Exchange to teachers and principals, and travelled from Mumbai’s towering financial sector to its slums, from the rural village of Kasar Malai to the factories of Noida.

In addition, we examined best practices in relevant areas from other developing and developed countries, as well as successful policies implemented at the local, state, and federal levels in India. The following document draws on these experiences and research, creating a plan of action addressing some of India’s most urgent problems. The following is a summary of those recommendations.



### *Putting the Nation on Sound Fiscal Footing*

With 15 times more phone subscribers than taxpayers, India is home to a convoluted tax system that is both difficult to enforce and unnecessarily harmful to businesses. From politicians to business owners to academics, there is near total agreement that the best alternative to the current system is the Goods and Services Tax (GST). In addition, direct cash transfers must replace energy, agricultural, and food subsidies, which are both significant burdens on the government as well as highly distortive to the market and often poorly targeted. Finally, unproductive and inefficient state-owned enterprises (SOEs) must be cautiously disinvested. Although perhaps the most politically difficult of the fiscal policy recommendations, scaling back government control in these enterprises will ultimately increase productivity as well as transparency and competition, reducing potential for corruption.

### *Opening the Physical Bottlenecks Slowing Growth*

Sedan-swallowing potholes, unruly traffic, and over-crowded and poorly maintained roads make travelling in much of the country slow to impossible. Although perhaps the most apparent when jolting through the streets of India's urban centers, roads are far from the only infrastructure problems the country currently faces. Land acquisition regulations and water and electricity shortages plague the country, from the very richest as witnessed by power outages in Delhi's five star hotels, to the very poorest as they struggle to access clean water. The use of an electronic database to register land titles, streamlining of urban land sales, improved eminent domain policies, and development of a master plan for urban development will target many of the issues surrounding land use and ownership. Resource issues can be addressed through fostering greater public-private partnerships, while addressing issues of water and sanitation through elected committees, and energy through the subsidization of household and farm power grid separation in rural areas.

### *Leveraging the "Demographic Dividend"*

From professors to CEOs to social workers, nearly every conversation we had featured the term "demographic dividend." But without a robust education system with high quality institutions from primary through higher education, the great advantage of the demographic dividend will be lost.

The government must focus on reducing teacher absenteeism with the use of technology, school visits, and tying salaries to teachers' presence in the classroom. Pedagogical reform, changes to grade advancement regulations, and student and institutional evaluation development will improve primary and secondary school quality. Finally, higher education will be more competitive with the best universities in the world by allowing the expansion of private and foreign schools, as well as improving financial aid allocation mechanisms.



### *Unfettering the Labor Force*

The power of India's demographic dividend cannot be fully levied without addressing harmful labor regulations hobbling the country's workforce and business growth. To make India's manufacturing sector internationally competitive, the Industrial Disputes Act (IDA) must be reformed significantly, including addressing its regulation of disputes between employers and employees, and the hiring disincentives created by Chapter VB. Other crucial reforms include reducing firms' regulatory burden by replacing inspectors with Internet resources and technology, and an overall reduction of inspectors and inspections, instead utilizing spot checks and higher fines. The creation of special economic zones for manufacturing, as well as modernizing the bankruptcy code, will make India far more competitive with such countries as China. Finally, the adverse effects of labor reforms can be blunted with the adoption of retraining programs and unemployment insurance funds.

### *Curbing Corruption*

In many countries, a prison record can get in the way of a career in politics. In India, when considering numbers alone, it is practically a prerequisite. Campaign finance reform and the creation of an independent election commission will target questionable election tactics and

reduce the number of criminals running for office – a move from which many countries would benefit.



*UP CM Mayawati in a wreath of currency notes.*  
Source: “Mayawati-A Biography” The ForthRight

Administrative reform targeting corruption and efficiency must include changing hiring, promotion, and firing practices of government officials, as well as the introduction of public comment periods, industry advisory commissions, and the utilization of outside consultants when developing and promulgating business regulations. In addition, increased use of technology and automation has the potential to significantly reduce corruption and speed up an often frustratingly slow system.

Finally, to address the backlogged and sluggish judiciary system and the insufficient police force, the government should improve incentives for a faster case resolution while minimizing opportunities to stall court dates. Increasing the police force, with an additional initiative in increasing the number of female officers, while improving training can also target urgent issues such as crimes against women and corruption.

### *Diffusing Economic Growth*

In a rural village outside of Mumbai, children play cricket and push broken bicycles – although they appear no more than five, most are eight or older. Nearly half of Indian children are malnourished, resulting in significant growth problems both mentally and physically. The same village is devoid of those who are not children or the elderly, as everyone else has migrated to the city in search of employment. Programs like India’s Public Distribution System (PDS) have attempted to address issues of poverty by redistributing food, but often result in corruption and waste. India should replace PDS with direct cash transfers, utilizing developing technologies to minimize corruption. However, to insure that more remote areas have goods to be purchased with the cash transfers, the government should provide grain to select ration stores.

The National Rural Employment Guarantee Act (NREGA), meant to alleviate unemployment in rural India, has both failed to provide workers with skills and to produce quality outputs. Reforming the allocation of costs for capital versus labor, as well as minimizing corruption by leveraging new IT infrastructure, the government can significantly improve the program.

Ultimately, the greatest benefits will come from the replacement of NREGA with cash transfers and the fostering of public-private partnerships to make rural projects more efficient in both skill development and output.



### *Fostering India's Physical Health*

A young boy sits in a health clinic in a Delhi slum, his face pale and damp with sweat and his boney arms crossed over his thin chest, waiting to receive tuberculosis treatment. Outside, residents are reduced to using the streets and garbage heaps on the outskirts of the slum to relieve themselves. Sanitation, malnutrition, and lack of clean water are only a few problems facing India, detrimental to the country's economic and physical health. Improving grassroots health provision through an overhaul of the Accredited Social Health Activist (ASHA) program could significantly improve health outcomes in India. Pairing this initiative with improved incentives and training of health professionals, as well as programs targeting malnutrition through food fortification, and improved primary care through infrastructure grants and cash transfers will all help in addressing some of India's most pressing health problems. Finally, better advertisement and development of community-based health insurance schemes will increase participation in such programs.

### *Developing a Robust Agricultural Sector*

Although engaging a large percentage of the workforce, India's agricultural sector has seen little growth in recent years.

Land reform targeting murky land titles will improve tenant rights, while substantial increases in productivity will be gained from fostering a second Green Revolution. Encouraging research through the expansion of funding, streamlining food distribution channels, and reforming trade policies will both improve productivity and farmers' standard of living – rare examples of policies that maximize efficiency and the equity of the policies' impact.





### *Beyond the Yellow Bricks – Guiding Monetary Policy*

Indian's affinity for gold is not the only issue facing the banking sector as inflation runs high and savings run low, exacerbated by poor banking regulations. The Reserve Bank of India must focus on reducing and maintaining a realistic inflation target, while also targeting the causes of inflation, such as certain subsidies and defective food distribution systems.

### *Dismantling Destructive Trade Barriers*

India's attempts to pursue Gandhi's philosophy of self-reliance have done the country more harm than good. Although the 1991 reforms included important trade reforms, India still must address such issues as high tariff rates and regulations that keep out foreign firms. In order to minimize the adverse effects of improving international trade, India should first focus on stabilizing its agricultural and manufacturing sectors and improving their productivity. In addition to focusing on the improvement of trade with developed and Western countries, India should bolster regional trade, especially with Pakistan. As highlighted in the Foreign Affairs section, improved trade relations will benefit both countries economically, while fostering improved diplomatic relations and therefore greater regional stability.

### *India on the Global Stage*

Although a relatively young country, attaining independence within the lifetime of its older generation, India is increasingly becoming an important player on the world stage. More than ever, the United States has an interest in developing a strong relationship with India – an interest that India should take advantage of by concluding the Bilateral Investment Treaty (BIT) within the year. In addition to the billions of dollars worth of investment both countries will enjoy from the BIT, India can leverage the improved relations by establishing free trade agreements in selected sectors, and collaborate with the United States to help fuel India's second Green Revolution.

Partnering with the United States is not the only foreign policy initiative that India must pursue – normalizing relations with Pakistan is also a vital action. Improving trade between the countries, expanding visas especially for students, and encouraging Track II diplomacy – non-official

meetings – complementing formal diplomatic engagements are all important steps to creating a more stable and productive region and international relations.



### *India Rising, Again*

A few minutes drive from the Chhatrapati Shivaji International Airport in Mumbai, a broken billboard declares “See you tomorrow.” The words overshadow clusters of crooked huts made of sheet metal and tarps, while stray dogs and feral cats keep watch. The roads, mostly abandoned at 2 AM when international flights arrive and depart, are still populated by dented taxis and auto rickshaws, their drivers leaning against the doors waiting for passengers who will never come. Slums surround dilapidated buildings and streets littered with the world’s refuse. But underneath is a majestic city, still trying to shed the remnants of colonialism. Like much of India, Mumbai grew substantially both economically and demographically since the groundbreaking 1991 reforms, but much of the success and hope so abundant in the past few decades has dissipated. Like the taxi drivers and the billboard, the millions of people wandering the streets, the city is waiting for tomorrow’s wave of reforms, the next leap forward, the next leaders who will have the courage and strength to push forward the necessary changes.

The entire country is waiting.

## **2. Fiscal Policy**

- Replace state and local indirect taxes with a 16 to 20 percent Goods and Services Tax
- Transition from energy, agricultural and food subsidies to direct cash transfers utilizing the national identification system
- Continue disinvestment in state-owned enterprises

## **3. Infrastructure and Resources**

- Ease the process of land acquisition while maintaining accountability by digitizing land titles and amending the new regulations on eminent domain
- Establish local-level committees to manage water and energy resources
- Design incentives for concessionary public-private partnerships that reduce risk
- Create an urban development planning commission, reform land sales, enforce local property taxes

## **4. Education**

- Target teacher absenteeism by providing government-run and government-financed schools with cameras to monitor teacher attendance, having regular and announced visits to schools to establish teacher attendance and quality of teaching, expanding information campaigns to parents and local communities, and tying teachers' salary to classroom attendance
- Reform teacher training and de-emphasize rote learning as the desired pedagogical style
- Increase public spending on primary and secondary education and streamline current funding schemes
- Reform physical amenity regulations and school performance evaluation mechanisms, emphasizing academic outputs and basic infrastructure inputs
- Establish more schools controlled by the Centre rather than by the states and local governing bodies
- Abolish Section 16, Chapter IV of the RTE
- Relax restrictions on the opening of private and foreign institutions
- Expand the financial aid system and reform the allocation mechanisms to make it individual-based rather than institution-based
- Create more vocational schools and programs, and allocate financial aid for individuals to attend these schools
- Reform tenure requirements and grant allocation mechanisms

## **5. Labor**

- Scale down the Industrial Disputes Act (IDA) and 1948 Factories Act
- Utilize successful state-level initiatives to reform the labor inspection process
- Modernize the current bankruptcy code
- Establish a fund for worker retraining and unemployment insurance
- Create special economic zones (SEZs) specific to the manufacturing sector
- Shift labor regulation to the state list

## **6. Governance**

- Increase campaign contribution limits for federal and state elections
- Create a separate arm of the independent election commission designed to crack down on and prosecute law-breaking candidates and politicians
- Change the system of promotion in bureaucracies from seniority to merit
- Compensate workers with higher pay but less job security
- Use industry advisory commissions, outside consultants and public comment periods to limit inconsistent policy outcomes
- Utilize IT and automation to reduce administrative corruption
- Create an ombudsman to listen to appeals of licensing and other regulatory decisions
- Speed up the judicial process for current trials by increasing the system's capacity via the appointment of more judges and creating incentives for faster case resolution
- Minimize stalling tactics by increasing the standards for allowing motions to delay and reschedule court dates

- Create alternative dispute resolution mechanisms at the local and municipal levels (i.e. mediation and panchayat-level community justice systems)
- Limit docket growth by curbing unnecessary appeals from the federal government
- Hire more police officers, particularly in urban areas
- Increase standards for officers' conduct and training at the university level and within police departments
- Prioritize the hiring of more female police officers to increase departments' capacities to address issues related to women's rights and protections
- Break state governments' strangleholds over police appointments and transfers and give police officers protection from the Executive and politicians

## **7. Social Inclusion**

### *Public Distribution System (PDS)*

- Replace provision of grains through the Public Distribution System with targeted, unconditional cash transfers, but only after other subsidies have been successfully transitioned to the cash transfer model
- Ensure residual level of government grain procurement and distribution at ration shops in very remote localities

### *National Rural Employment Guarantee Act (NREGA)*

- Encourage higher capital expenditures by increasing the cap on material costs and covering all capital input costs
- Increase accountability through transparency and IT infrastructure development
- Replace the current NREGA system with a set of public-private partnerships targeted at rural development projects

## **8. Health**

- Redesign ASHA compensation, training, evaluation, and media attention
- Form autonomous, merit-based public health agencies at the state level
- Create mid-level health professional degrees and incentives for rural postings
- Establish a national food fortification program in schools and daycares
- Reform PHC policies and provide conditional cash transfers to women
- Encourage community-based insurance programs while RSBY integrates with IT

## **9. Agriculture**

- Legalize tenancy in all states and create clearer land titles
- Encourage a second Green Revolution
- Promote community-based programs
- Streamline distribution channels
- Adjust export policy

## **10. Monetary Policy**

- Set credible inflation targets and adjust interest rates to achieve them
- Lower required reserve for commercial banks to around 10 percent of deposits, in line with international standards outlined in the Basel III accords
- Encourage a shift away from gold to productive savings like inflation-linked bonds, implement limited gold monetization schemes and expand finances literacy around savings
- Lower directed credit for agriculture and small-scale industries from 40 percent of all credit to 25 percent by 2020, work to eliminate this program altogether by 2040

## **11. Trade**

- Continue to lower tariff rates and reduce the variation of rates
- Keep lowering barriers to FDI
- Strengthen regional trade

## **12. Foreign Affairs**

- Conclude BIT negotiations before 2014 elections
- Move toward sector-specific trade agreements in industries in which there is significant congruence in economic interest
- Leverage American know-how in pursuing a second Green Revolution

## **1. INTRODUCTION: OUR PERSPECTIVE AND PURPOSE**

Until recently, India’s economic potential appeared limitless. Its vibrant democracy is stable and thriving. The nation’s young population abounds with entrepreneurial spirit and persistence. Its companies are expanding globally, and its competent English-speakers are in high demand.

Yet the recent economic downturn has exposed India’s structural weaknesses, and its acclaimed “demographic dividend” may spiral into a demographic burden. The government has proven to be a drain on growth due to complacency and widespread corruption. Factor markets are inefficient and unreliable, and infrastructure cannot support market demands. Chronic poverty remains despite twenty years of rapid economic growth, and human capital is wasting under weak healthcare and education systems. Growth cannot continue at historical rates when chained by foundational failings.

This report aims to put India’s economic structures back on track. It sprouts from ten weeks of intensive study of India’s history, society, and economy, followed by a two-week visit to Mumbai, Delhi, and Ahmedabad to meet with various figures in India’s political, business, academic, and social spheres. We offer actionable, specific policy recommendations that address the following topics in order of priority: fiscal policy, infrastructure, education, labor, governance, social inclusion, health, agriculture, monetary policy, trade, and foreign affairs. Prioritization stems from consideration of short and long-term impact coupled with feasibility. We recognize the difficulties presented by India’s diverse democracy and politics, its federalist structure, and its widespread corruption. Our work remains cognizant of divergent perspectives, and the impact that reforms will have on all socioeconomic and cultural groups.

Despite the challenges, we are certainly optimistic about India’s future, particularly in its rising middle class. As journalist Fareed Zakaria has noted, “We are watching the birth of a new sense of nationhood in India, drawn from the aspiring middle classes in its cities and towns, who are linked together by... a common Indian dream—rising standards of living, good government, and a celebration of India’s diversity.”<sup>ii</sup> India’s young, aspiring generation deserves a government that makes this dream a reality.

### *1.1 Macroeconomic Trends and Relative Progress*

India’s economic development has been both frustrating and admirable. Following independence from Britain in 1947, India languished at what has been termed “the Hindu rate of growth ” — from 1950 to 1980, per capita income growth averaged just 1.3 percent annually, less than half the global average during the period.<sup>ii</sup> Prime Minister Jawaharlal Nehru, who led the country to independence, and his daughter Prime Minister Indira Gandhi “shackled the energies of the Indian people under a mixed economy that combined the worst features of capitalism and

socialism.”<sup>iii</sup> The socialist-inclined leaders implemented strict government controls and led the nation to near-autarky.

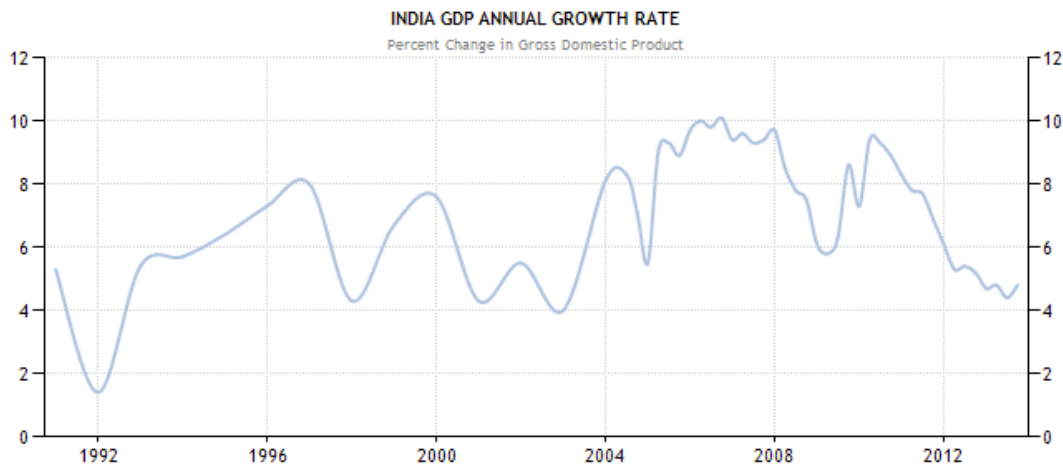
The existence of the “License Raj” primarily explains India’s weak growth throughout this period. In the license-permit-quota system, essentially every economic activity required permission from a government official. Nandan Nilekani, founder of the Indian technology giant Infosys, recalls that importing a single computer took three years and 50 trips to Delhi.<sup>iv</sup> Further, oppressive labor laws and small-scale industry protections effectively neutralized India’s manufacturing sector. While China’s global economy boomed, India stumbled along as an inefficient, insular, and agrarian nation.

While the economy improved under Prime Minister Rajiv Gandhi throughout the 1980s, India faced a crisis in the early 1990s due to tax and tariff reductions and high government spending. Its economy was in a nosedive after years of growing fiscal imbalances. The current account deficit ballooned as exports stagnated and imports and interest payments spiked. By 1990-1991, the Centre’s fiscal deficit was up to 8.4 percent. Foreign private lending dried up, India’s credit rating dropped, overall debt accelerated, and foreign exchange reserves dipped to just two weeks worth of imports.<sup>v</sup>

The crisis presented an opportunity for much-needed reform. Then-finance minister and current Prime Minister Manmohan Singh was the mastermind behind the economic liberalization. Singh ended industrial licensing, lowered tariffs and other trade barriers, opened India to foreign investment, limited currency controls, and bolstered market competition.

Singh’s actions worked. Over the past 20 years, the economy has grown at roughly 7 to 8 percent annually without a recession. Growth peaked at 10.1 percent in 2010, and GDP has risen from \$503 to \$1,265 per capita.<sup>vi</sup> More than 100 Indian companies now have a market capitalization over a billion dollars, and many are becoming competitive global brands.<sup>vii</sup> Most promisingly, swathes of the nation’s poor now have newfound opportunities and are moving into the urban middle class, which now numbers over 250 million.

Figure 1.1: India’s GDP Annual Growth Rate 1992-2012<sup>viii</sup>



However, there is no doubt that this growth has been peculiar. Unlike in other developing countries, services have flourished in India while manufacturing has idled as a share of output. Consumption has dominated investment, and the domestic market has contributed more than exports to overall expansion. Generally, high-tech industry has beaten out the low-skilled. While this has raised productivity, it has left many behind; most people still work informally and are tied to the land. *The Economist* succinctly sums up India's greatest contradictions: "India has world-class information-technology exporters but imports lots of fridges; it has 15 times more phone subscribers than taxpayers; and in the coming years Indians are likelier to be connected to a national, biometric, electronic identity-system than to a sewer."<sup>ix</sup>

And while the aphorism that a rising tide lifts all boats has been broadly true in India, some boats are rising faster than others. Vast economic gains have not led to equal improvements in health, education, and poverty reduction metrics; compared to other developing countries, the elasticity of improvement in social indicators has been low.<sup>x</sup> Primary and secondary public education is still of dismal quality—classrooms are overcrowded, numerous schools lack sanitation facilities, and tenured, well-paid teachers are often absent. Higher education struggles as well: a Gurgaon-based tech company found that not even 3 percent of engineering graduates were employable without extra training.<sup>xi</sup> On the healthcare front, India faces rampant malnutrition. Without making its growth more inclusive, India will be hampered by an unhealthy, uneducated population.

The economy's recent slip proves that India cannot operate on autopilot, and the country is facing its greatest economic crisis since 1991. Within the last three years, India has seen a falling rupee, high inflation, a tumbling stock market, weak private investment, and high fiscal and current account deficits. Growth hovers just 4 or 5 percent and foreign investors are wary of India's future stability.

## *1.2 Bottlenecks*

The recent downturn has laid India's underlying structural issues bare. While India has grown, it has done so *despite* the state, which has fallen behind on needed reforms. Bottlenecks in government regulations, factor markets, and infrastructure have stymied India's business development and are responsible for many of its economic contradictions.

Bureaucratic processes, whether honest or corrupt, are nightmares to work through. The judiciary takes an average of 7 to 8 years to resolve a case; companies can go out of business and witnesses can die before a judge makes a verdict. Errol D'Souza, an economics professor at the Indian Institute of Management, Ahmedabad quipped, "There are two things in India you should never get in the hands of: You should never get in the hands of a heart surgeon or the judicial system; in both cases, your chance of living is very low."<sup>xii</sup> Beyond processes themselves, the Indian bureaucracy lacks coordination. Working with multiple divisions leads to months of delay. Mumbai, for example, is run by 15 different committees that each vie for decision-making power. Without an executive leading the way, the city teeters near disarray: trash litters the streets, overcrowded slums are growing, and urban planning is lacking.

Factor markets like labor, land, and energy are dismally organized and inefficient. Labor regulations, which stem from India's socialist beginnings, put harsh requirements on businesses as their number of employees increases. Companies are effectively barred from laying off workers, making hiring burdensome and eliminating economies of scale. As a result, average employment at an Indian garment factory is 15; in Sri Lanka, it's 3,000.<sup>xiii</sup> Land, which D'Souza deemed the "most murky market in India," similarly puts a chokehold on development. Eighty percent of titles are informal or contentious, leading to high land prices and corruption.<sup>xiv</sup> This makes it difficult to piece together parcels for large projects.

Even if regulations are met or bypassed, decrepit infrastructure slows business down. Driving from Calcutta to Mumbai takes six or seven days by truck; in the United States, the same distance would take less than two. In Mumbai, 500 die each year by simply falling out of overcrowded commuter rails, and driving is hardly safer. As *The Economist* jests, a daily commute on Mumbai's streets should qualify for "post-traumatic stress counseling."<sup>xv</sup> We agree.

Perhaps most damaging, India's regulations are as inconsistent as they are enraging. Investors are wary to put their money in the country when policies are erratic. In one instance, the CEO of a business processing organization (BPO) moved his entire business to a special economic zone (SEZ) after the government promised certain tax breaks for a five-year period. Two years later, the government raised rates retroactively, hurting the business's bottom line. Manish Kejriwal, founder of a Mumbai-based private equity company, argues that archaic and troublesome regulations are surmountable if only they are transparent and reliable for a five-year timeframe.<sup>xvi</sup> Throughout discussions across cities and sectors, entrepreneurs and academics echoed this sentiment.

### *1.3 Corruption*

All policy proposals will be for naught if India cannot defeat the beast of corruption. Since Independence, corruption has been endemic. With roots in the license raj, India's culture of fraud and abuse now manifests itself in the "inspector raj," in which government officials have power to approve or verify certain economic activities.

Battling corruption is a daily struggle for modern Indians. As CEO-turned-author Gucharan Das notes, "Corruption sometimes begins right when you are born — your parents have to bribe someone to get a birth certificate — and ends when you die — your children are forced to 'buy' your death certificate."<sup>xvii</sup> We encountered multiple incidents of corruption in our short visit. A restaurant entrepreneur described how a local politician randomly showed up at his door demanding a \$12,000 payment, or else she "could not guarantee that something bad would not happen." The BPO chief executive revealed that he had been picked out for tax scrutiny one year; to avoid the process, a government official asked for a 50,000-rupee bribe. The CEO paid the bribe, and has since been selected for tax scrutiny every subsequent year.

While bribes have defined day-to-day activities at the individual, local level, they have also marked Singh's time as prime minister. In 2010, accusations emerged that funds had been mishandled at the Commonwealth Games, causing the project to go 18 times over budget. Later,



former telecom minister Andimuthu Raja illegally sold licenses below market value for personal gain, costing the government \$39 billion.<sup>xviii</sup>

Fortunately, Indians are waking up to the perils of corruption. The public has responded to the egregious nationwide scandals with uproar and demands for increased transparency. Activist Anna Hazare vowed a fast unto death unless the government took definitive action against corruption, particularly in the development of a new anticorruption ombudsman to review complaints expeditiously.

Policies that increase transparency, reduce complexity, incorporate technology, and sidestep bureaucratic involvement will go a long way to combat corruption. India is on the right track in this sense — in 2005, the central government passed the Right to Information Act, giving the public access to public records upon request. Even in distant hamlets, villagers are said to routinely submit requests.<sup>xix</sup> India has also developed a biometric identification system to give Indians unique, digital identifications that can then be tied to bank accounts directly. This will allow welfare programs to usurp the greedy bureaucratic hands often found in current in-kind transfer programs. Our recommendations will follow these examples to limit corruption's threat.

#### *1.4 2014 Elections*

The upcoming 2014 Lok Sabha elections put India at a crossroads. Campaign results will have drastic impacts on reform opportunities.



The public is visibly angry at the status quo of the ruling Congress Party, which has controlled the government from 1947 to 1998 and again since 2004. Congress represents India's socialist undertones, and its priorities lie in wealth distribution rather than wealth creation. While this approach may not be best for overall economic growth, it appeals to the underprivileged, who have largely been left out of India's recent prosperity. Soft-spoken and uninspiring Rahul Gandhi (*left<sup>xx</sup>*) will likely be its pick for prime minister, but it is unclear whether he can be a confident, formative voice for needed change.

The Bharatiya Janata Party (BJP) has captured much of Congress's lost support. The BJP calls itself the "Hindu nationalist party," both less secular and more conservative than Congress. The party has painted itself as a voice for reform, focusing on economic growth and a more hands-off government. The controversial Narendra Modi (*right<sup>xxi</sup>*) is the party's clear leader. Modi has emphasized his success leading Gujarat, India's most prosperous and business-friendly state, for four consecutive terms. But his peripheral involvement in a 2002 massacre of over one thousand Muslims puts many on edge about his candidacy, and he may be wise to look toward the ideological center to garner greater support.



But Congress and the BJP will not be alone in the race. Over the last decade, India has developed into a fragmented party system. Regional parties have sprouted throughout the country and pose a significant threat to a majority for either the BJP or Congress. In the 2009 election, 370 different parties ran for a seat, and 39 parties are represented in Parliament. This trend shows no sign of abating.<sup>xxii</sup> The sizeable presence of regional parties in Parliament will likely force either Congress or the BJP to form a coalition government, full of competing regional interests with little cohesion. This will obviously make any consensus difficult, and policy recommendations must be cognizant of the conflicting interests at hand.

While Indian elections have been known to get unruly with expensive gift-giving and corruption, there is hope for rationality in the growing middle class. These voters tend to be young, literate, mobile, and informed. To them, results are more important than election bribes. Recent state elections suggest that this more pragmatic approach is gaining traction. In Delhi, the brand-new, anti-corruption Aam Aadmi Party shocked the country in December 2013 when it won 28 of the state's 70 seats. The party moved beyond traditional vote-banking and focused on reason rather than reward. Whether this same pragmatism can be repeated nationally remains to be seen.

### *1.5 Political Will*

Perhaps the most difficult challenge will be motivating elected officials to make the tough decisions India needs. There have not been any significant reforms since the 1991 economic crisis. Though Singh served as the maverick behind this economic liberalization, he has been timid and feeble as prime minister. No elected official has been able to muster the political courage needed to put the country back on track, and most are consumed with local or caste-based issues. While anti-corruption movements have made progress, they have also made government officials fearful. As *The Economist* notes, “the public is so angry that even honest decisions are sometimes construed as favoring special interests, so *babus* consider it safest to do nothing.”<sup>xxiii</sup>

As D’Souza noted in our meeting, Indian democracy historically “never wanted strong leaders,” out of fear of their unrestrained influence.<sup>xxiv</sup> Now, for the first time, Indians are demanding one. The nation needs an intellectual, forthright executive to explain to the Indian people *why* reform is necessary and expend the needed political capital to make reform happen.

While India’s upcoming economic crisis will hurt, there is a bright side: the impending doom will force bureaucrats to act. As one Indian citizen exclaimed, “I always wish India to be in a crisis. We have benefited from every crisis.”<sup>xxv</sup> With considerate, swift action, this one will be no different.

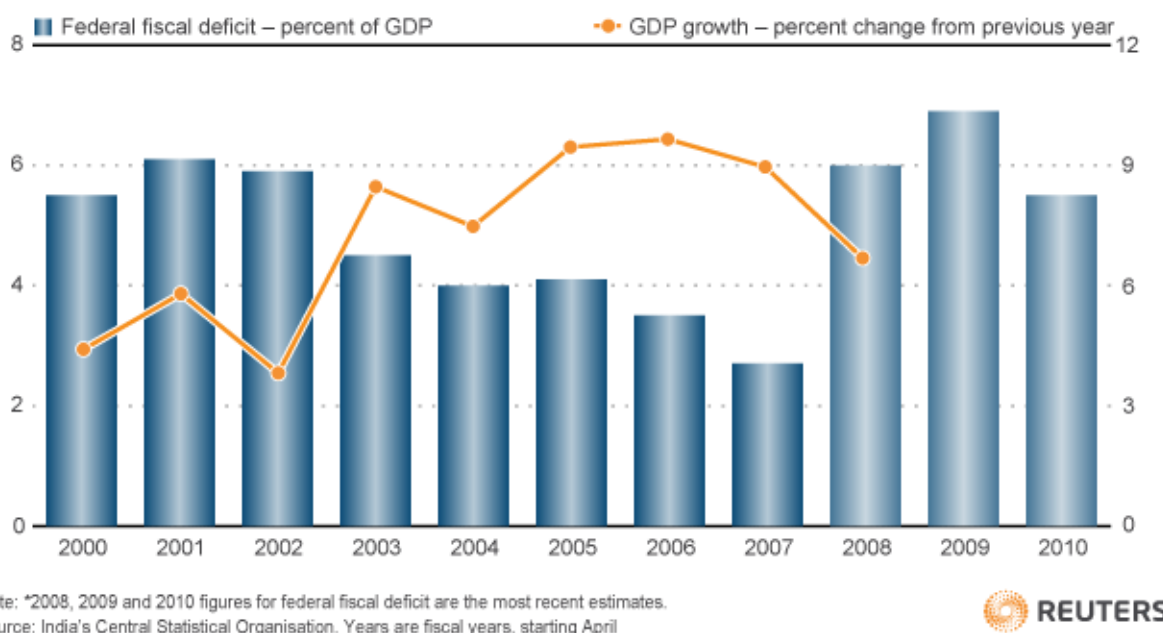
## **2. FISCAL POLICY**

*“India’s first priority must be the fiscal deficit.”*

—Rakesh Mohan, former deputy Governor of the Reserve Bank of India,<sup>xxvi</sup>

India's fiscal health has deteriorated in recent years. Since the 2008 global financial crisis, deficits have expanded to between 5 and 10 percent of GDP annually and government debt has ballooned above 60 percent of GDP.<sup>xxvii</sup> These realities have placed India on an unsustainable path, but the government has yet to take the steps needed to get its fiscal house in order. The International Monetary Fund (IMF) has estimated that India's fiscal deficit will grow to a disturbing 8.5 percent of GDP in fiscal year 2014 as its projected growth rate declines.<sup>xxviii</sup> Moving forward, India should close its fiscal gap by immediately transitioning to a national Goods and Services Tax and reforming subsidies and state-owned enterprises, changes that have the potential to accelerate growth and improve welfare.

Figure 2.1: Federal Fiscal Deficit Versus GDP Growth<sup>xxix</sup>



### Recommendations:

- Replace India's state and local indirect taxes with a 16 to 20 percent Goods and Services Tax
- Transition from food, agricultural, and energy subsidies to direct cash transfers utilizing the national ID system (only once infrastructure is in place to implement this system universally)
- Disinvest or privatize all companies in competitive sectors, and examine monopolistic sectors on a cases by case basis for privatization

### 2.1 Tax Policy

India's central government's tax revenue is about 10 percent of GDP, which is far below that collected by other developing countries.<sup>xxx</sup> Taxation is divided between the states, which can levy taxes on land, agricultural income, alcohol, consumption, and sales, and the Centre, which can levy taxes on customs, personal income, and corporate income, and must share some revenue with the states. This complex system creates a variety of tax rates for similar production across

the country, as well as opportunities for tax avoidance or outright evasion.<sup>xxxii</sup> For example, only 5 percent of India's tax revenue comes from the service industry, even though this sector accounts for over half of India's overall economy.<sup>xxxiii</sup> Because states do not communicate about compliance, companies that operate in multiple states can easily evade paying taxes in each. One business leader we met with compared this issue to Mexico's reaction to a crime committed in California. The different tax structures also prevent India from having a common national market essential to interstate trade. As one analyst noted, "the European Union has lower barriers to trade between its member nations than India has between its states." These issues reduce the government's spending power while creating inefficiencies that favor certain industries.

**India should repeal its inefficient indirect tax systems at both the state and federal level, and replace them with a Goods and Services Tax (GST) of 16 to 20 percent.** The GST is a form of consumption, or value-added tax, that is applied at each level of production. Companies are credited for the value of the good when they purchase it, and are only taxed on the value added to the product after selling it. The tax is simple to assess because it is collected at each step in supply chains, and violators can be easily identified because of discrepancies in value. Producers only receive a credit if all the other companies in their supply chains also pay their taxes. Crucially for India, the GST will bring companies into the formal economy and create a common market across the country, which has the potential to increase tax revenue "multi-fold" and GDP by 2 to 3 percentage points each year.<sup>xxxiii</sup>

A GST rate of 16 to 20 percent is consistent with international standards and will significantly increase overall tax revenue.<sup>xxxiv</sup> However, a constitutional amendment would be required to implement a GST because only states can administer taxes on retail and sales. Many states have already adopted value-added taxes, but are concerned they will lose their autonomy to levy taxes. States are also concerned about losing their ability to levy entry taxes, which raise revenue for individual states but limit interstate trade and growth. We believe these obstacles can be overcome by ensuring states that states will receive at least 5 percent more revenue, distributed by the central government and indexed to inflation, as they had prior to the national GST. The prospects of greater funding and growth due to a common market should persuade most state and national politicians to support a new GST. Much of the political groundwork has already been laid for a GST, and analysts believe it is one of the most viable reforms following the 2014 elections.<sup>xxxv</sup>

## *2.2 Subsidy Reform*

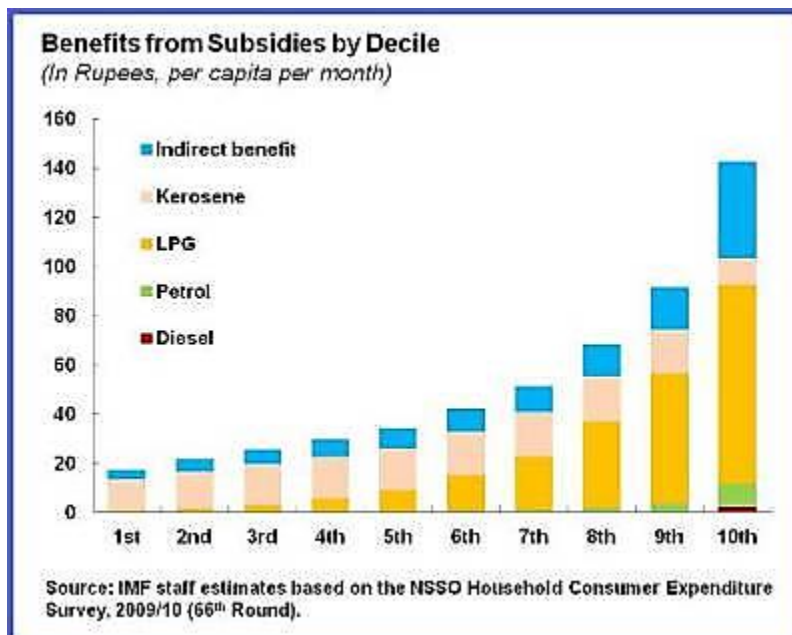
India needs to not only reduce deficits, but also ensure that any deficit spending is productive and necessary. Subsidies currently cost the government over 2 percent of GDP per year, including at least 0.8 percent of GDP in fuel subsidies alone.<sup>xxxvi</sup> Fuel subsidies not only distort the incentives for consumers, but also primarily benefit the wealthy, who are the largest consumers of cheap fuel. Furthermore, they put India's finances at the mercy of global oil prices. In the current fiscal year, for example, India budgeted 650 billion rupees for fuel subsidies, yet is now projected to spend 1.4 trillion rupees because of increased oil prices.<sup>xxxvii</sup> Subsidies for fertilizer, electricity, and water have similarly inefficient and costly records. While millions depend on food subsidies for basic sustenance, they are also subject to considerable inefficiencies and corruption along the way. Rajiv Gandhi famously estimated that less than 15

percent of the spending from government programs actually reached its intended recipients.<sup>xxxviii</sup> This wasteful spending through subsidies increases deficits in the short-term and creates long-term fiscal burdens as interest expenses crowd out productive investments.

**We recommend a gradual process that replaces energy, agricultural, and food subsidies with direct cash transfers utilizing the national ID system.** Cash transfers have the advantage of providing real benefits to those that need them most, while also preventing market distortions created by subsidies. To administer the direct cash transfer system, we recommend leveraging new technology that has made it possible to give each Indian a unique biometric identification card linked to an individual bank account, a process that is supported by The World Bank, Nilekani, and *The Economist*.<sup>xxxix</sup> Benefits could then be provided directly to the accounts, which would be easier to audit and monitor than subsidy programs.<sup>xl</sup>

Achieving this favorable outcome, however, will require the navigation of considerable political obstacles. Opposition will come from bureaucrats and middlemen who benefit from the inefficient subsidies as well as members of the public who do not understand how the policy changes would affect them. Because the median voter is poor, rural, and highly in favor of these costly subsidies, the reduction and elimination of these subsidies need to come with alternative incentives. Reducing subsidies can be made more politically viable by communicating the public health and environmental benefits of reducing the subsidies.<sup>xli</sup> Further, addressing related infrastructure shortcomings like the coal monopoly, which keeps prices artificially high, will lessen the need for the subsidy.<sup>xlii</sup> Cutting the most regressive subsidies first will also help. For example, diesel and LPG subsidies should be eliminated before kerosene subsidies because the poor rely almost entirely on kerosene for energy.<sup>xliii</sup>

Figure 2.2: Regressive Energy Subsidies<sup>xliv</sup>



Gradual implementation is also key for subsidy reform because it will ensure that the most difficult changes, such as removing grain and sugar subsidies, will only be made once citizens already have received cash benefits. We believe that recipients will be more inclined to support reforms to food subsidies once they are able to feel the tangible benefits of a functioning cash transfer system. Therefore, we recommend categorical sequencing for the transition to cash transfers. To begin, existing transfers should be linked to the UID program. Secondly, fuel and fertilizer subsidies should be replaced with cash transfers. The government has begun to reduce fuel subsidies, as petrol subsidies have already been eliminated and small steps to eliminate diesel have been undertaken. A plan outlined by the IMF suggests that further reform of fuel subsidies requires an effective communication campaign to inform the poor that the wealthy are the primary beneficiaries of such policies, and that these costly expenditures could be used instead for better infrastructure, education, and health services. Fuel subsidies should be phased out using an automatic pricing mechanism, as used in Turkey and the Philippines, that minimizes the impact on inflation and allows consumers time to adjust behavior. Additionally, removing fuel subsidies will open the door for consideration of a carbon tax, which is an opportunity to raise revenue, potentially by reducing other taxes, and ameliorate some of the environmental damage that accompanies economic growth; however, this policy is not politically viable right now.

Lastly, food subsidies should be replaced with cash transfers. To administer the program, we recommend following the model developed by Karnataka, which has successfully switched from fuel subsidies to cash transfers.<sup>xlv</sup>

These changes will require substantial improvements in infrastructure, both to administer the cash transfers and to ensure that those receiving cash are able to purchase the goods that used to be subsidized. In particular, food subsidies should not be replaced until the government has the capacity to ensure the availability of food for purchase in all of India's rural villages. However, once implemented, spending could be cut by as much as a third from increased efficiencies while providing enhanced benefits. After reforming fuel subsidies, "the bottom 40 percent of families could be fully compensated for the move to market prices for less than a fifth of what government now spends."<sup>xlvi</sup> Switching to a cash transfer system will reduce government spending while ensuring that the allotted funding reaches its intended recipients, improving both India's fiscal outlook and the welfare of its citizens.

### *2.3 State-Owned Enterprises*

State-owned enterprises (SOEs) are companies in which at least 51 percent of capital is held by the central government or by state governments. As such, they often lack transparency and are insulated from market mechanisms that drive productivity. SOEs exist at all levels of government and span a wide variety of industries. Moreover, government investment in these companies has risen from about \$35 billion in 1993 to over \$100 billion in 2006. In 2008, these firms employed 1.6 million people and accounted for 8.3 percent of GDP.<sup>xlvii</sup>

In some cases, like natural monopolies, SOEs may prevent market distortions on net. In most other cases, they simply lack productivity. While some inefficiency might be tolerated in order to create some stable employment opportunities, the vast scale of SOEs ensures that the less

profitable companies crowd more efficient ones, and consequently, lower GDP growth.<sup>xlviii</sup> For example, Air India continues to lose about \$1 billion a year due to government restrictions that prevent market adaptability. With 70 year-old flight attendants and 80 percent aircraft utilization, Air India is the poster child for the pitfalls of state-owned enterprises.<sup>xlix</sup>

**Disinvestment, or scaled privatization, is the best solution for moving these competitive sector firms away from government control.** These conditions would introduce market discipline, independent corporation boards, and financial disclosure. Additionally, disinvestment not only makes the companies more productive, but also improves India's fiscal health by removing some net losses and adding revenue from sales of stock. Of course, privatization must be pursued with attention to the political feasibility and proper management.<sup>1</sup>

Transparent auctions through competitive sales on the stock market are the route to disinvestment. This will ensure the transfer of ownership with minimal corruption. Otherwise, corruption may lead to sales at below-market value to less productive firms. Furthermore, without labor reform, full privatization may be politically infeasible as workers will be strongly opposed to losing their cushy compensation packages.<sup>li</sup>

As an intermediary step, the government can disinvest only partially, decreasing the share of its holdings in these competitive companies. A study by the Reserve Bank of India (RBI) found that a decrease in the government's shareholdings from 100 percent to 50 percent on former SOEs raises the return on assets by about 24 percent. In the past, India has pushed for disinvestment in its healthiest companies. While any privatization is good for companies in a competitive industry, it is imperative that all such companies move out of the public sphere given the fiscal drag that is created by underperformers.<sup>lii</sup>

The transfer and consequent restructuring process could be painful for low-income employees. Mohan suggested a number of policies to ease the transition. As a buffer, the government should pay redundant workers a lump-sum fraction of their pension depending on their tenure with the company. It should also place safeguards on remaining employees' pensions in the privatization contract and create an unemployment insurance system as a safety net for workers. Such measures not only protect low-income workers, but also soften the political blow among the working classes, as we discuss with labor reform.<sup>liii</sup>

Premature privatization could allow the government to steal money from future taxpayers if the large lump sum transfer is squandered on ineffective programs or slips through the cracks of corruption. For this reason, privatization of large income-generating companies may have to wait until further governance reforms are enacted to reduce corruption and remove poorly functioning programs. However, privatization of poorly performing companies like Air India should be prioritized as these companies create a fiscal burden on India's government.

**Given entrenched political interests and resource concerns, SOE reform in natural monopolies (railroads and extractive industries) must involve transparency and competition.** Perhaps the clearest example of failed reform was the coal scandal of the late 2000s. The Indian government lost \$34 billion in revenue by allotting coalfields too cheaply. Das noted that today, "Mining stands for all that is wrong with unreformed India – the nexus among

politicians, officials, police and big business, a powerful labor mafia, disenfranchisement of local residents, damage to the environment and massive corruption.”<sup>liv</sup>

Das notes a role for privatization in reforming natural monopolies. He suggests that privatization should occur only if characterized by stimulating competition, an open and transparent bidding system that sells rights to the highest bidder via an online system, and a regulator who can evaluate the quantity and quality of the resource and monitor production and operations.<sup>lv</sup>

When requisites of privatization for natural monopolies are not in place, policy should focus on increasing transparency of government activity in the sectors. Some disinvestment to increase outside stakeholder involvement may be beneficial as well.

India’s fiscal policy has been abysmal as of late, but implementing a GST, switching subsidies to cash transfers, and disinvesting SOEs will reduce India’s deficits, improve its citizens’ welfare, and promote growth. Nearly every stakeholder we met with, from businessmen to village farmers, agreed that India’s tax and subsidy policies should be reformed. Similarly, it is widely acknowledged that the government’s influence over major industries should continue to be wound down. We prioritize these three fiscal policy reforms because of their potential to be implemented quickly and have an enormous immediate impact on India’s fiscal outlook as well as its economic growth.

### 3. INFRASTRUCTURE AND RESOURCES

*“India cannot make a great leap forward with her feet tied by a lack of power, transport, and telecommunications.”*

—Vijay Joshi and I.M.D. Little<sup>lvi</sup>

After spending hours caught in Mumbai and Delhi traffic, it is clear to see that infrastructure is one of India’s biggest challenges. Recent public investments have significantly expanded access, but population growth, urban sprawl, and poor governance are rapidly outstripping the capacity of existing systems. It is imperative to speed up infrastructure development, and the Indian government hopes to raise infrastructure spending to ten percent of GDP by 2017.<sup>lvii</sup> However, due to systemic inefficiencies, funding alone is not enough; as it stands, India’s GDP growth is poised to fall by 1.1 percent by 2017 from infrastructure problems alone.<sup>lviii</sup>

#### Recommendations:

- Ease the process of land acquisition while maintaining accountability by digitizing land titles and amending the new regulations on eminent domain
- Establish local-level committees to manage water and energy resources
- Design incentives for concessionary public-private partnerships that reduce risk
- Create an urban development planning commission, reform land sales, enforce local property taxes

Infrastructure developers in India face many fiscal and political constraints that limit service improvement and expansion. High corporate leverage and a shortage of private equity have increased risk aversion, forcing the government to issue procurement contracts, which pay per



completed project but are vulnerable to concerns about moral hazard, speed, quality and corruption.<sup>lix</sup> Moreover, rising land prices, stringent restrictions on eminent domain, conflicting interests amongst local administrative bodies, and legal pressure from organized stakeholders have upped financial and capital requirements for projects. As a result, private investment is stymied, the public is left with unfinished or low-quality infrastructure. Moving forward, India must address both supply-side and demand-side pressures on infrastructure.

### *3.1 Land Acquisition*

When we asked academics, business owners, and politicians about infrastructure their responses were always the same — it is an issue of land acquisition. Time and time again, we were told of communities fighting road expansions in court, of environmental groups opposing the acquisition of forested lands, and of farmers being cheated out of lands and livelihoods. The ultimate cause of these problems is ineffective legislation concerning land title registration and eminent domain.

**In both urban and rural areas, India needs to manually conduct a land ownership survey that registers land titles in an electronic database.** India's traditional deficit of formal land titles in many areas has created a norm of land sale litigation and poor land price tracking. Jairam Ramesh, India's rural development minister, once said, "India is one of the few countries in the world where the record of rights on land is presumptive... We are presumed to be owners of land unless proved otherwise."<sup>lx</sup> Thus, it is unsurprising that 70 to 80 percent of land cases involve title disputes and that 69 major infrastructure projects are currently in limbo.<sup>lxi</sup> In June 2013, the Indian cabinet made an important first step to overhaul India's outdated 1908 Registration Act, calling for land transaction documents to be made publically available, for land registration offices to be able to accept digital documents, and for short-term land leases to be registered as well. However, because paper records from past registrations are often missing or severely faded, India needs to send out public officials to manually survey households across the country. These can be the same employees who carried out the 2011 census or local officials. Investment of resources in requirements for IT, public information campaigns and worker logistics would reap enormous returns.

**Revised eminent domain policies can foster responsible public and private land purchases.** The government has lost the public's trust by using colonial-era laws to collect cheap land, then botched its development, enabling squatters to move in.<sup>lxii</sup> Meanwhile, environmental groups and scheduled tribes have opposed eminent domain on similar grounds. They have blocked forest clearance projects and prevented the formation of a National Investment Board (NIB), which would have had the authority to authorize and fast-track infrastructure projects costing over \$190 million.<sup>lxiii</sup> Yet eminent domain is crucial for public-private partnerships (PPPs). With land acquisition costs comprising 50 to 60 percent of the costs of starting a business, most firms cannot afford to develop infrastructure without getting land from the government.<sup>lxiv</sup>

Unfortunately, the government has gone too far in trying to regulate eminent domain. To replace the antiquated Land Acquisition Act, the Indian Parliament in September 2013 passed the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation, and Resettlement (LARR) bill, which will take effect in January 2014.<sup>lxv</sup> LARR sets extremely high compensation

benchmarks for most government land acquisitions, with additional compensation requirements if scheduled castes or tribes owned the land, if other affected households file claims, and if the land is sold prior to being developed.<sup>lxvi</sup> This essentially debilitates the government, giving excessive leverage to the less than ten percent of the population who are landowners and making investments very difficult to recover.

To reform LARR, displaced households and other affected claimants should receive land bonds, whose values are linked to the success of development in the area, and be accepted into centrally administered employment training programs and government schools instead of being guaranteed employment or pensions. Rather than requiring housing, which may be distant or poor-quality, the package should subsidize the costs of rent based on the financial situation of the household. There also needs to be a compensation limit on the number of successful claimants per instance of eminent domain. Lastly, since large private land acquisitions also fall under LARR, consent requirements should be lowered for any projects in public infrastructure. To reduce the legal burden on infrastructure projects, the plans for an NIB should be pushed through, and to make all of these changes politically palatable, the government must make land acquisition information publically available and guarantee that acquired land is returned to the original owner if not used for development within five years.

### *3.2 Community-Level Resource Management*

The Swades Foundation, a nonprofit focused on rural empowerment who sponsored our village stay, has set up an extremely sustainable system for water resource management and sanitation development through village-level and panchayat-level financial and administrative support. This same mindset of fostering community-based pricing and financing structures can be applied to all types of resource management and infrastructure development across India to provide customized solutions that the public can take ownership of.

**The government should establish water and sanitation committees to collect and reinvest user fees.** By some estimates, inadequate sanitation cost the Indian economy 6.4 percent of its potential GDP in 2006.<sup>lxvii</sup> Despite recent improvements, sanitation infrastructure varies significantly between states, ranging from 15 to 88 percent coverage.<sup>lxviii</sup> Sadly, 74 percent of the rural population still practices open defecation, and 55 percent of all Indians lack access to any type of toilet.<sup>lxix</sup> With regards to water, 88 percent of people have access to improved sources of water, but only 25 percent have that source near their house, and 67 percent of households do not treat their water.<sup>lxx</sup> Another major challenge in rural areas is a rapidly falling water table due to flood irrigation, borewells, and lack of knowledge on aquifer recharge. In the case of a harsh dry season, agricultural livelihoods are at stake given the poor water infrastructure.

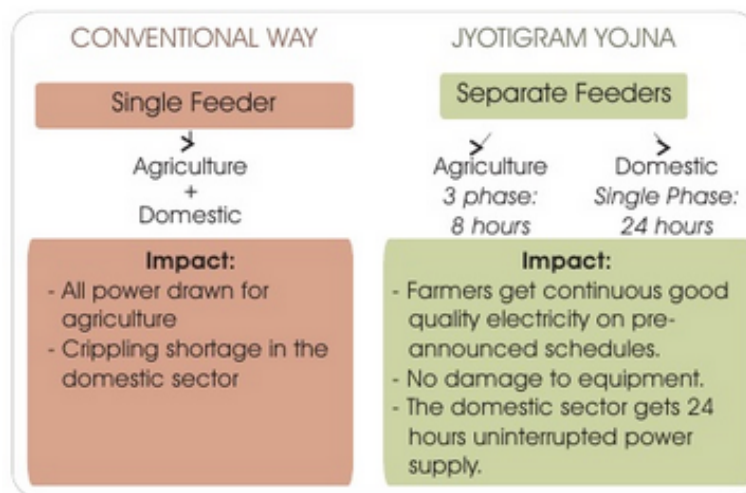
By electing villagers to water and sanitation committees, panchayats can organize collective funds that go toward the materials for latrine construction, water harvesting, water storage, and drip irrigation. Each village would pay either fixed or variable fees for water usage, to be collected by village leaders from households, and panchayats can decide upon public infrastructure investments, using the labor of the villagers who benefit from the water supply or latrines. One innovative option for household toilets is the two-pit pour-flush toilet, which costs 500 rupees to build and can take a family of five more than four years to fill.<sup>lxxi</sup> Innovative, low-

cost, and low-skill options for water infrastructure include building trenches to slow water runoff, building simple gravity piping structures, and building simple water storage and rainwater collection tanks.

**The government should subsidize the separation of household and agricultural power grids on the condition that panchayat-level power committees are established to combat power theft and collect fees for agricultural power usage.** Gujarat’s Jyotigram Yojana scheme, in which power was separated between households and farms, was successful in making energy reliable and making the public willing to pay utilization fees for electricity. As a result of a guaranteed eight-hours of 440-volt power, Gujarat’s agricultural output grew by 9.6 percent versus 2.6 percent across the country.<sup>lxxii</sup> Challenges to expanding this program nationwide have included increased power theft, lack of state electricity board funds to invest upfront, and initial backlash from farmers against charges for agricultural power. The government could push the effort forward by subsidizing the physical construction needed to build a parallel grid and install smart electricity meters.

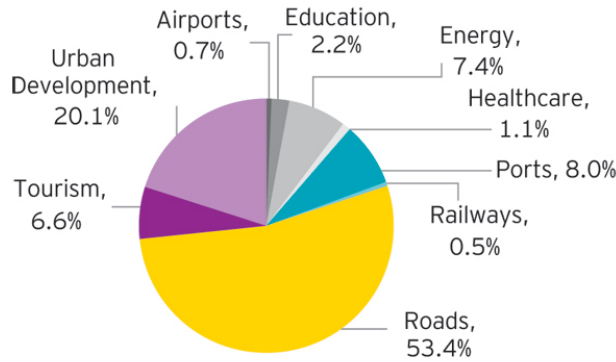
Panchayat-level power committees would receive financial incentives for minimizing power theft as monitored by the smart meters. The committees could also collect user fees for household power on a customized basis to encourage energy conservation. The agricultural usage fees are necessary to discourage borewells, which deplete the water the table, and encourage drip irrigation investments.

Figure 3.1: Comparison of Power Schemes<sup>lxxiii</sup>



### 3.3 Public-Private Partnerships

Figure 3.2: Public-Private Partnerships By Sector<sup>lxxiv</sup>



**Public-private partnerships should be maximized to encourage investment in India’s roads, railways, and alternative energy infrastructure.** India’s 3.3 million kilometers of roads account for 65 percent of India’s freight transport.<sup>lxxv</sup> However, as recently as 2007, a quarter of highways were congested at any one time. Auctioning concessionary contracts would lead to sustainable development, providing some revenue for the government for future land acquisitions. India should focus on attracting foreign construction companies, too. This can be done by offering grants of land near the road or highway in addition to build-operate-transfer toll rights. While this requires the government to utilize eminent domain to a greater extent, it also links the profit of construction companies to the quality and maintenance of the roads and highways. The government would retain the responsibility of paying land bonds to the original landowners. To reduce the risks that companies face, the government should provide safety nets of partially compensating firms for initial losses in the first few years and reimbursing repairs needed due to natural disasters. The ultimate focus of these PPPs should be on building more overpasses and road dividers to control pedestrian crossings.

India also boasts the fourth longest railway network in the world, and ranks fourth globally in freight distribution over those rails. However, overcrowding, non-ticketed passengers, poor coordination with road development, theft and violence, and severe delays have reduced the profitability and efficiency of the railway industry.<sup>lxxvi</sup> Passenger and freight trains operate on the same lines, and the rail network is heavily concentrated in the north and west, relying on the colonial layouts but lacking connectivity through the central and eastern parts of the country.

As a public industry, the railways have had the responsibility to set concessionary ticket prices for vulnerable populations, increase access to rural areas, and meet safety standards. Because private operators are not bound by these responsibilities, India has not allowed private train operation even though it has allowed unlimited foreign direct investment in tracks and other physical infrastructure. For cargo rails, India needs an entirely separate cargo corridor, which will require heavy capital investment. Because issues of equity and safety are not as relevant for cargo, full privatization is a viable option. Railway distribution is still heavily used by Indian businesses, so safety nets and cargo train operation rights should attract substantial private sector investment in PPPs for freight corridor construction.

PPPs can also be used to revitalize the energy infrastructure. India has one of the biggest coal reserves in the world but is incapable of mining it at full capacity due to poor labor structures. Additionally, poor transportation connectivity leads to certain stocks of mined coal being unable

to reach power plants in other areas of the country. The best solution is to gradually disinvest the coal mining industry while working out compromises with environmental groups, private firms, and other stakeholders to ensure efficient mining operations and strong cleanup and land restoration measures. In the meantime, the government needs to invest in renewable energy infrastructure, with nuclear power as the most viable option. With the U.S.-India civil nuclear development agreement stuck in Parliament, the government should strive to push that along and open up the path to generating nuclear energy.

### *3.4 Urban Development and Land Sales*

Urban infrastructure development is key to attract and support businesses and workers in cities' high productivity sectors. India has 25 of the world's 100-fastest growing urban areas and is expected to add ten million people a year between 2000 and 2030 to its 5,161 cities. Infrastructure development in water, sewage, transportation, and electricity has failed to keep up with population growth. A lack of urban development inhibits the reallocation of labor to more productive, urban sectors of the economy.<sup>lxxvii</sup>

At best, a lack of infrastructure leads to unsustainable growth, as has happened in Gurgaon, a city just outside of Delhi. Although Gurgaon has largely developed privately from the will of determined citizens and the motivations of developers, the city does not have a functioning sewage or draining system, reliable electricity, public sidewalks, decent roads, or public transport.<sup>lxxviii</sup> At worst, lack of infrastructure strongly inhibits economic growth and public health efforts. The city of Lucknow is characterized by overflowing sewage pipes and streets choked by gridlock. It has not completed any major new sewage projects since India's independence in 1947 and as many as 70 percent of residents lack sewage service. The annual infrastructure budget of \$139 million falls well short of the estimated \$960 million Lucknow needs to invest in roads, water and other critical projects.<sup>lxxix</sup>

**Supply can meet demand with the streamlining of urban land and property sales.** Excess regulation in land use change should be removed. Fortunately, the Urban Land Ceiling Act has been lifted in most states, but this repeal must become uniform.<sup>lxxx</sup> While some regulation is needed to ensure proper safeguards, in excess, the regulations prevent the building of factories and other such buildings, which provide more productive and higher paying, jobs. For example, Kejriwaal showed us an expanse of prime real estate in Mumbai's financial district that has failed to be developed due to regulations and subsequent litigation.<sup>lxxxii</sup> Changing the default policy to allow factories and buildings to be built unless told otherwise within a certain time limit can help India move in this direction.

**India needs a master plan for urban land development with proper sequencing so that initial safeguards can gradually be lifted.** Master plans can create designated areas for expedited factory processing. Urban planning is also critical for creating room for and building necessary infrastructure such as roads, public transportation, water lines, and sewage lines.

In most municipalities, the responsibility for infrastructure development is split between general municipal administrative bodies as well as industry-specific organizations like the Railway Ministry, which leads to massive inefficiency. Indeed, Saugata Bhattacharya of Axis Bank spoke to us about how Mumbai has only one city planner for a population of 13 million on top of fifteen other authorities involved in the city's governance, making general city planning a challenge.<sup>lxxxii</sup> Abhay Mangaldas of The House of Mangaldas Girdhardas described how the city of Ahmedabad creates ten-year master plans that are difficult to adjust and lead to very inorganic planning. As a result, he finds it difficult to work with the city to expand his business. An Urban Development Planning Commission should be tasked with reaching agreements between organizations for development priorities, organizing simultaneous joint development projects (i.e. building power and piping infrastructure while roads are expanded), and setting fair charging structures for each types of infrastructure. Centre and state support can help cities build capacity using best practices in their plans.<sup>lxxxiii</sup> Higher-level support from the state and Centre can also provide carrots and sticks for effective planning in terms of corruption mitigation, land use change processing, and infrastructure development.

**Local taxes such as property taxes will be critical for developing much of the needed infrastructure.** Even absent corruption and improper allocation, urban planners and infrastructure developers will require much more funding to complete necessary projects. Local taxes should be easy to implement, transparent, and easy to collect. Delhi's property tax system, which is based on square footage and reports payment amounts online, is a good standard. The capital city is expanding its tax system using information technology to enhance accuracy by tagging each property with photos and a unique number. Informal squatters will not be captured in the tax, but these individuals are likely very poor and would not be able to contribute much to tax revenue regardless.

The property tax should be the main revenue generator for localities. Entry taxes are highly distortionary and hinder overall economic growth by limiting the movement of goods. Very high sales taxes may simply encourage people to work and shop outside of city limits, which would lead to lower tax revenue and economic disturbance.<sup>lxxxiv</sup> State and Centre financial support might also be useful as these bodies can collect revenue on a scale that is infeasible at the local level. However, municipalities should not solely rely on this funding since the political economy of resource allocation is fraught with distribution concerns. The median voter is rural and as such will not vote for increased spending in urban infrastructure. Centre or state matching grants based on the quantity and quality of projects in place might make the revenue sharing more desirable, encourage more infrastructure development, and be less prone to corruption than a program based on municipal spending.

#### 4. EDUCATION

*“In India today, demand is not really a constraint for education — it's the supply.”*

— Karthik Muralidharan<sup>lxxxv</sup>

On a relatively cold winter morning in Delhi, more than half a dozen children squeeze into an auto rickshaw, sitting on each other's laps and clutching book bags to their chests. Farther south, in a rural part of Maharashtra, students wake at 4:30 a.m. to make the 10-kilometer trek through unbearable heat and over hilly roads to reach the closest school. Although separated by half the

country, the students share two characteristics — an impoverished background and a burning desire to receive a high quality education that will raise them out of poverty and help them attain their dreams.

Figure 4.1: Primary School In Maharashtra



Cited as India's great advantage over an aging world, the country's demographic dividend holds both promise and apprehension. As the youth population increases, so does the demand for education, but the supply and quality of schools do not meet the country's growing appetite for education. The Right to Education Act of 2010 (RTE) attempted to address the equity issues surrounding education by establishing education for children aged 6 to 14 as a fundamental right, but failed to address, and in some cases exacerbated, the most urgent educational challenges. Issues of public funding, teacher absenteeism, poor pedagogy, and outdated curriculums and evaluation systems plague the education system from the primary to the university levels. In order to achieve India's goals of universal education laid out in the RTE, these issues must be addressed.

#### *4.1 Teacher Absenteeism and Pedagogical Reform*

##### Recommendations:

- Target teacher absenteeism by providing government-run and government financed schools cameras to monitor teacher attendance, having regular and announced visits to

schools to establish teacher attendance and quality of teaching, expanding information campaigns to parents and local communities, and tying teachers' salary to classroom attendance

- Reform teacher training and de-emphasize rote learning as the desired pedagogical style

When asked about whether teachers are present in the classrooms when they should be, a panel of teachers at a rural, government-funded school in Maharashtra laughs. Even they are ready to admit that teachers are frequently not at work, that the current incentive system creates too much job security. A 2005 study found that as many as a quarter of all teachers were not present during unannounced school visits conducted by the researchers, while half of the teachers were not actually teaching.<sup>lxxxvi</sup> Approximately four percent of the absences were because of official nonteaching duties, meaning that in the vast majority of cases, teachers simply did not show up to class.<sup>lxxxvii</sup> The first and most important reforms to the education system must address teacher absenteeism, as well as the current pedagogical style that focuses on rote learning rather than critical thinking, creativity, and analysis.

**Leveraging inexpensive technologies, paired with regular and unannounced school visits, will create strong incentives for teachers to show up, particularly if their salaries are tied to these conditions.** The NGO Seva Mandir partnered with 57 education centers in Rajasthan, providing schools with cameras. The teacher was instructed to have a student take a picture of the teacher in the classroom, which was then automatically time-stamped.<sup>lxxxviii</sup> Teachers also received a financial bonus for each day they were in school after a certain number of days, while teachers could receive reduced pay if they failed to be in class for a certain number of days. Teacher absenteeism was reduced by 21 percent as compared to the control group, which had a 42 percent absenteeism rate. Even four years after the experiment had ended, the rate of teacher attendance in the experimental group remained significantly higher than in the control group.<sup>lxxxix</sup> The increased rate of teacher attendance also translated into significant educational improvements in both the short and long term.

Implementation and enforcement would need to occur with as little corruption as possible, and might require partnering with an NGO like Seva Mandir, or creating the necessary reporting system in a central location at the federal level to roll out such a program. This system may face political difficulties since government-employed educators are politically powerful, but the large, low-cost improvements to educational outcomes should also garner considerable support.

Transparent efforts at accountability via public information have been successful in other countries. Uganda faced high rates of teacher absenteeism, but implemented a highly successful newspaper information campaign that resulted in significant decreases in rates of teacher absence. The campaign provided communities — and most importantly, parents — with information as to what resources the local schools should be receiving, and how often teachers should be in their classrooms. These communities followed through on the information by utilizing streamlined reporting methods for supply shortages and instances of absenteeism.<sup>xc</sup>

India can adopt a similar information campaign through media outreach, community gatherings and local governance structures. High readership makes newspapers a good means of information distribution, especially in urban areas, but rural areas will require additional



campaigns such as distribution of information through panchayats and other community organizations such as women's self-help groups.

**Reforming teacher training and encouraging a more engaging and student-centered pedagogical style will improve the educational quality overall.** The current teaching style, even in the best of India's primary and secondary schools, emphasizes rote learning rather than critical thinking and creativity. Part of the problem stems from the cultural norm of respecting elders, which translates in the classroom to students being unable to engage with and challenge the teachers. Teacher training should emphasize engaging students rather than lecturing to them alone, while curriculum reforms should include greater emphasis on writing and in-class discussion.

#### *4.2 Primary and Secondary Education*

Recent educational reforms, including the RTE, have increased school attendance and literacy rates considerably, moving India toward its goal of universal primary education. However, issues of quality, as well as the regulations and evaluation systems established in the RTE are significant problems that must be addressed in order to achieve a more efficient and equitable education system.

##### Recommendations:

- Increase public spending on primary and secondary education and streamline current funding schemes
- Reform physical amenity regulations and school performance evaluation mechanisms, emphasizing academic outputs and basic infrastructure inputs
- Establish more schools controlled by the Centre rather than by the states and local governing bodies
- Abolish Section 16, Chapter IV of the RTE

**India must increase spending on primary and secondary education in order to meet its goal of spending six percent of GNP on these areas, as well as to provide the necessary support to open schools and invest in basic infrastructure and teacher training.** Although public expenditure on primary and secondary education increased over the past several decades, recent years has seen a stagnation of funding, especially at the state level.<sup>xci</sup> India ranks low in terms of public funding of education among both developed and developing countries. Ultimately, we do not believe that creating better access to already existing high quality institutions (namely private schools) is the solution. School voucher systems and reservations may make some changes at the margins, but will do little to address incredibly low quality of government-run and funded schools. Instead, the government can create greater equity and improve quality by focusing on its own schools. The central government should also streamline its funding schemes so as to create more efficiency and reduce the potential for corruption. The government should maintain and expand funding schemes that have proven to be successful, such as the midday meal plan, while reducing funding for less successful programs, such as state or locally-run schools that are centrally funded. The curriculum established by the Centre, as well as funding schemes and institutional developments have made schools controlled by the Centre rather than the state or local governing bodies more successful.<sup>xcii</sup> Therefore, in allocating funds to establishing more

schools, the government should focus on financing schools run by the Centre rather than other governing bodies.

**The increased budget should have a significant portion allocated to supporting schools without basic infrastructure such as drinking water and toilets, as well as teacher training.**

Under the RTE, schools are assessed by their physical amenities rather than student achievement, and what standards the schools are supposed to meet are often impracticable.<sup>xciii</sup> When schools cannot meet these requirements, they face steep fines and closure. Such a system invites corruption as schools bribe inspectors in order to avoid being closed. In order to reduce corruption and increase support for schools to develop their infrastructure, the government should allocate the necessary funding to these schools, provided that the schools then use the funding to establish the necessary changes within a set period of time. Moreover, some requirements, such as the size of the school kitchen, existence of a school wall, and size of the playground should factor very little, if at all, into school quality. Greater focus should be placed on certain infrastructure such as sanitation and drinking water, while other academic indicators such as student attendance, literacy rates, test results, as well as rates of teacher attendance can be used to evaluate schools and establish whether or not they need additional assistance.

**Finally, students should not be automatically advanced to the next grade without considering their performance through the course of the year and on end of term examinations.**

Section 16, Chapter IV of the RTE establishes that no child at the elementary school level may be held back a grade, even if he or she performs very poorly on examinations and are not considered ready to advance to the next grade. This not only hurts the child by forcing him or her into a new grade without enough preparation, but also increases the likelihood that the child will drop out of school, both because they are unprepared for the next year and because his parents may be fined for his poor performance. The government should establish an evaluation system that monitors students' progress throughout the course of the year. When a student performs poorly, he or she should receive additional attention and tutoring free of charge from the teachers. If at the end of the year the student still fails to pass final examinations, they may be held back a grade. Fines should be abolished or set to punish parents who remove students from the education system.

### *4.3 Higher Education*

India houses esteemed institutions such as the Indian Institute of Technology and the Indian Institute of Management, but the majority of universities and colleges are poor quality institutions, especially by international standards. No Indian higher education institution ranks in the top 200 universities and colleges in the world. Although India has the third largest higher education system in the world, and has recently implemented new funding schemes to expand financial aid and open new schools, it is still far from creating an equitable system that can meet current educational demands.

#### Recommendations:

- Relax restrictions on the opening of private and foreign institutions
- Expand the financial aid system and reform the allocation mechanisms to make it individual-based rather than institution-based

- Create more vocational schools and programs, and allocate financial aid for individuals to attend these schools
- Reform tenure requirements and grant allocation mechanisms

**Reforming the accreditation system for higher education institutions and allowing more private and foreign institutions to open will improve capacity and quality.** The University Grants Commission (UGC) holds a monopoly over the accreditation system. This limits the expansion of private institutions and is strongly biased toward a small number of public, national universities. The national universities also develop the curriculum and standards to which the schools are held, imposing these standards on the smaller, private institutions. While quality is crucial, the current approach is overly stringent and does not foster competition, and thus fails to address quality and supply issues. Allowing private universities greater say in curriculum requirements and accreditation schemes, while also permitting the entrance of more private and foreign institutions, will increase the supply and diversity of higher education offerings.

Recent estimates indicate that the Centre accounts for approximately 10 percent of all expenditures on higher education — well below the 30 percent spent in the United States. Moreover, financial aid in India is distributed on an institutional rather than individual basis. In order to create both a more equitable and efficient system, the central and state governments should reform the distribution mechanisms, making them individual-based while also reserving a significant share of the aid for students facing financial barriers to pursuing higher education.

**As India attempts to expand its manufacturing and services sectors, the country will need to increase its skilled labor force by expanding and developing available vocational and technical programs.** Not only are these institutions needed to prepare the workforce, but also to replace a changing educational system in which child labor laws keep children out of the factories and therefore also from learning the technical and craft skills that used to be passed from parent to child through work experience. Vocational programs will preserve these skills while also allowing children to continue their educations. In addition, to encourage students to attend such programs, which have suffered from low attendance rates in the past because of social stigma surrounding such training and work, the government should allocate a significant portion of financial aid for individuals attending vocational and technical schools

**Indian higher education also contributes little in the way of high quality research and academic work, in part due to underfunding of grants and to the incentives created by the current tenure requirements.** This not only diminishes the prestige of the institutions, but also limits students' opportunities to engage in, contribute to, and gain from the greater academic world. Much of the problem stems from the lack of incentives provided through public grants to individuals and institutions. Although the central and state governments do offer grants, institutional requirements established by the UGC severely limits the number of schools eligible for public funding. The central and state governments should both invest more funds in expanding their grants programs, as well as loosen the current limitations so as to foster greater competition among the public and private universities. In addition, tenure requirements should be reformed both to encourage more research and use of these grants by making tenure more difficult to attain without significant prior academic work.

All Indians recognize that education is both vital and in dire need of reform in India. Now is the time to push forward on reforms, expanding on recent legislation so as to maximize the demographic dividend and use the considerable political capital surrounding education.

## 5. LABOR POLICY

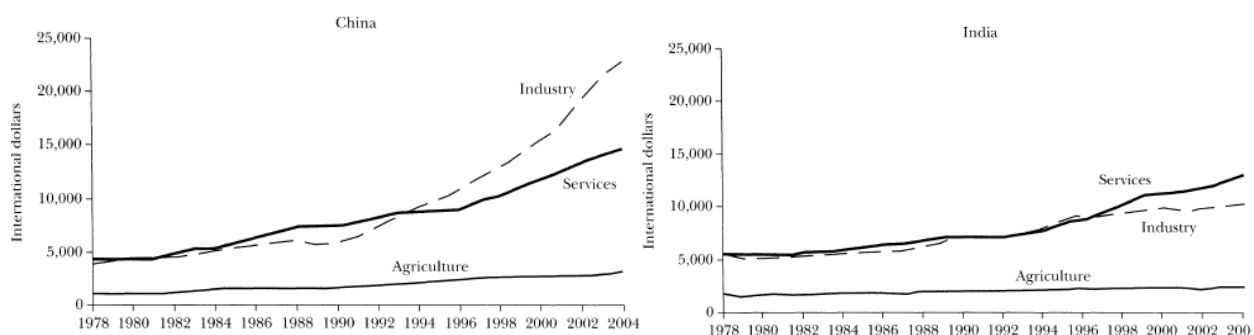
India's manufacturing sector lags behind its East Asian peers due to overly restrictive labor laws. Owners are afraid of hiring because firing a worker is nearly impossible, keeping firm size small. Factories are forced to comply with antiquated yet costly regulation or face the hordes of inspectors ready to shake them down for even the slightest infraction. Struggling firms and their creditors are both at the mercy of an archaic bankruptcy code, which somehow manages to favor the worker over everyone else. Reforms are nigh impossible given the culture of Nehruvian favoritism for labor and must be accompanied by significant concessions to workers.

### Recommendations:

- Scale down the Industrial Disputes Act (IDA) and 1948 Factories Act
- Utilize successful state-level initiatives to reform the labor inspection process
- Modernize the current bankruptcy code
- Establish a fund for worker retraining and unemployment insurance
- Create Special Economic Zones (SEZs) specific to the manufacturing sector
- Shift labor regulation to the state list

India has demonstrated positive growth in making its workforce more urban, formal and concentrated in industry and services, but in order to show the same sustainable expansion as the East Asian tigers, the country must rapidly make reforms to drastically improve its manufacturing sector.<sup>xciv</sup> While the number of Indians in the agriculture workforce has dropped from 60 percent in 1991 to 53 percent in 2008, that drop is incredibly small compared to the 24 percent reduction seen in China, which is further compounded by the fact that India's agriculture growth rate is at an anemic 2.5 percent.<sup>xcv</sup>

Figure 5.1: Comparative Growth Rates of the Chinese and Indian Economies<sup>xcvi</sup>

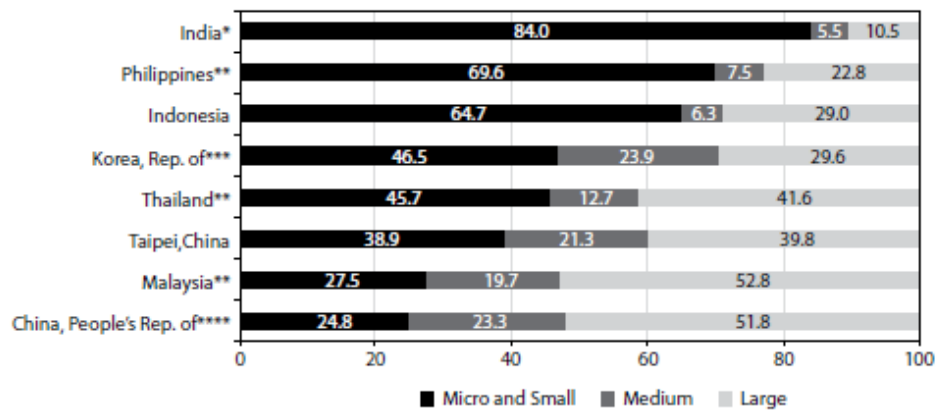


Meanwhile, only 1 percent of establishments and 19 percent of workers employed in manufacturing were in the organized sector, which is magnified by the fact that the unorganized sector has become a cultural and business norm — the percentage of workers employed in the organized sector is essentially unchanged since 1989.<sup>xcvii</sup> And while Indians have been migrating

to urban areas with larger frequency — the proportion of the population living in urban areas increased from 17 percent to 31 percent (1951 to 2008) — that trend pales in comparison to countries like China (19 percent to 45 percent from 1980 to 2008).

India’s manufacturing firms remain small, which prevents them from exploiting economies of scale. One study found that 84 percent of Indian workers are employed by firms with 50 or fewer workers, and firms with 200 or more workers have only 10.5 percent of the labor force. The same study also found that this distribution is skewed further when only analyzing labor-intensive industries — 92.4 percent of workers are employed by firms with less than 50 workers.<sup>xcviii</sup> These trends are particularly alarming given the purportedly imminent arrival of India’s demographic dividend.

Figure 5.2: Comparative Sizes of Manufacturing Firms in East Asia<sup>xcix</sup>



Ultimately, India’s plethora of labor laws explains the small average firm size. There are over 52 independent central labor laws, most of which are over 40 years old, along with over 150 state level laws.<sup>c</sup> As the saying goes “you cannot implement Indian labor laws 100 percent without violating 20 percent of them”.<sup>ci</sup> Many of the labor laws are incredibly detailed, redundant, and antiquated, making compliance extremely difficult for firms. For example, companies must keep six attendance logs and 10 separate accounts for overtime wages, and file five types of annual returns. There are at least 11 definitions of the word "wage." Finally, there are very restrictive laws relating to limiting hours of operation for shops and limiting hours for female employment.<sup>cii</sup> One study found that restrictive labor laws have cost the Indian economy 2.8 million jobs in the last 7 years.<sup>ciii</sup>

Ideally, India needs to completely overhaul its labor regulation apparatus, but labor legislation is among the toughest to manage politically. Therefore, reform must be incremental and focus on the worst laws. It should learn from the experience of the IT sector, where employment waivers have enabled massive, industry-wide growth. Furthermore, reforms must be coupled with unemployment insurance and job retraining so that displaced workers are adequately compensated.

**Scaling down the Industrial Disputes Act (IDA) and 1948 Factories Act will significantly improve flexibility for manufacturing firms.** The most pernicious labor law on the books in the Industrial Disputes Act (IDA), which regulates all disputes between employer and employee,

regardless of firm size. The IDA stacks the deck disproportionately against employers by conferring the power to regulate employer-worker decisions on the state labor department. It requires employers to give three weeks' notice to workers of any change in their working conditions in all companies with more than 50 employees, massively reducing flexibility for firms. Most importantly, Chapter VB of the IDA effectively makes it impossible for an industrial establishment with 100 or more workers to lay off or retrench workers, even if the firm is unprofitable. This restriction removes an owner's ability to respond to market demands or remove poorly performing workers, creating a massive disincentive around hiring.

The IDA should serve to make Indian manufacturing firms competitive in the global market. First, the legislation should clearly define retrenchment to prevent arbitrary, worker-friendly judgments by labor courts. Second, the national government should create a politically isolated, Independent Labor Commission (ILC) that is responsible for adjudicating employer-worker decisions, with a maximum time limit of 30 days for ruling on a dispute after submission and a presumption toward the employer if that deadline is not met. Third, the required time window for informing workers about changes to working conditions should be reduced from three weeks to one to provide firms with more market flexibility.

Most crucially, Chapter VB should be repealed, as it creates a massive disincentive to hire workers. This will be politically fraught and should be accompanied by several alternative, mitigating changes — increasing the firm-size requirement of 100 or more workers; lifting Chapter VB for certain labor-intensive industries; and more clearly segregating layoff, retrenchment and firing provisions. Layoffs and retrenchment are more acceptable to trade unions and political parties than closure. If compensation is increased from 30 days pay per year worked to 45 days, political resistance should diminish. Opposition will drop even further if existing contracts are grandfathered and the new provisions apply only to new labor contracts.

Next, the 1948 Factories Act needs to be revisited. Many of its requirements, such as the height of urinals and the frequency of whitewashing are antiquated, add very little protection for workers, allow opportunities for corrupt labor inspectors to shakedown owners and massively increase the costs of compliance for firms. Parts of the act identified by the RBI commission on labor reform should be completely removed. Furthermore, firms should be allowed to gain exemptions on a case-by-case basis from the newly created ILC for some of the remaining restrictions that either are not relevant to their business or are overly restrictive.

**Utilizing successful state-level initiatives to reform the labor inspection process is an effective way to reduce the regulatory burden on firms.** Firms with over 100 workers face an average of 17 different labor inspectors, all of whom are looking for their slice of the profits. There are several possible solutions to solve the inspector problem. Beyond improvements to the IDA, many inspections can be replaced with online forms and other IT solutions that involve infrequent spot checks and higher penalties for fraud. States can also drastically reduce the number of inspectors and inspections. In Uttar Pradesh, labor inspectors can carry out inspections only after consent has been obtained from higher-ranking officials and advance information about the inspection has been provided. Rajasthan and Andhra Pradesh have exempted certain kinds of enterprises from the ambit of labor inspections. A combination of these strategies will reduce the regulatory burden on manufacturing firms.

**Modernizing the current bankruptcy code will create more efficiency in the marketplace.** The process for bankruptcy in India is an absolute mess. Currently, bankruptcy is governed by a set of debt recovery tribunals. These tribunals are antiquated, slow, and known for arbitrary judgments. This spurs risk-aversion, which makes it very difficult to find start-up capital or future rounds of financing. It also encourages failing state-owned enterprises to stay afloat rather than restructure or liquidate, creating massive market distortions and widening the growing fiscal deficit. To encourage debt financing, India must modernize its bankruptcy code, following the US models for liquidation, restructuring, and individual entrepreneurs.

**Creating a worker retraining and unemployment insurance fund to protect workers from looser labor regulations will make the earlier labor reforms more feasible.** Given political constraints, any attempt at labor reform must involve significant compensation for labor. First, the government needs to institute a formalized retraining program for workers that are displaced as a result of a potential scale back to the IDA. The retraining program should be well funded, with a widespread presence that partners with vocational training programs at technical institutes. More significantly, the government needs to set up an unemployment insurance fund, modeled after the National Renewal Fund proposed several times in the 1990s and early 2000s. This fund charged a 4 percent wage premium of which 2 percent was paid by the employer, 1 percent by the employee and 1 percent by the government. There would be no payout of the fund for the first 7 years while the federal government covered the difference to build up a sufficient trust to make the fund sustainable. Workers should be paid according to their length of service at the firm. This would provide adequate protection to workers in light of the more flexible labor laws if companies chose to downsize and modernize.<sup>civ</sup>

**Creating special economic zones specifically for manufacturing, similar to that of China and other East Asian tigers, is a second best solution for the manufacturing sector.** These special economic zones should have several features — a simple tax code with a low rate, without the addition of an alternative minimum tax; robust infrastructure investment by the government in roads, power, water and housing for workers through PPPs; loose labor regulations including the recommendations listed above as well as modifications to the Trade Unions Act and Contract Law Act; and relative proximity to large ports. While India has attempted to set up SEZs in the past, both for manufacturing and services, many of them have been plagued by an inconsistent regulatory policy. This time around, the government must set the conditions outlined above for a long period of time, without modification, to assure the business community that relocation will be profitable. Furthermore, successful implementation of the SEZs can be used to demonstrate that a looser taxation and labor regime can breed incredible growth for India's manufacturing, which could provide leverage for further labor reforms.

**A third-best solution is to amend the Constitution to move labor issues entirely to the state list.** This recommendation should be the relatively straightforward, given that even in a weak coalition, partners are usually regional parties who nearly always prefer to gain more power for their states. This will mean that any state wishing to have flexible labor laws will be able to legislate accordingly and not have to wait on Delhi. While many states will continue to foster restrictive labor conditions, progressive leaders in states like Kerala, Tamil Nadu and Gujarat may be able to gain traction on labor reforms in the next several years.

Inefficient labor laws hurt both employers and workers — the former must rely on the informal economy given high formal labor costs, while the latter become excluded from basic protections. Formalization of the labor force would significantly improve receipts since income and payroll tax revenues would expand exponentially. On the expenditure side, a shift to efficient regulatory institutions would significantly lower bureaucratic costs. India is positioned to become a manufacturing hub, especially as wages grow rapidly in China, and labor market reform would be an economy-wide boon.<sup>cv</sup> But small countries like Bangladesh and Vietnam will surpass India in industry if nothing changes. Without bigger, efficient firms, foreign investors will be deterred and growth will continue to stagnate.

## 6. GOVERNANCE

### 6.1 Political Reform

*“When he decided to run for a parliamentary seat from this impoverished, and mainly low-caste constituency in northeast India, Kameshwar Baitha made no effort to sugarcoat his criminal record. Obediently, he cataloged the serious charges pending against him, all of which he says are false. There were 17 for murder, 22 for attempted murder, six for assault with a dangerous weapon, five for theft, two for extortion, and so on, a legacy from Mr. Baitha’s previous career as a leader of the local Maoist insurgency. On top of that was the fact that he was in jail. But this did not hurt him with voters here.”*

— Ellen Barry<sup>cvi</sup>

#### Recommendations:

- Increase campaign contribution limits for federal and state elections
- Create a separate arm of the independent election commission designed to crack down on and prosecute law-breaking candidates and politicians

As Adam Roberts, South Asia correspondent for *The Economist*, told us over dinner one night in Delhi, political corruption is a way of life in India. For example, a simple labor inspector, assigned to the middle of Maharashtra, who found a trivial deficiency in one of the five quarterly tax return filings of a small sandal manufacturing factory. After receiving several threats to shut down the factory, the owner slipped the inspector a large bribe. While 30 percent of the bribe went directly into the inspector’s pocket, the remaining 70 percent went to his supervisor. The supervisor pocketed a percentage of the profits, then passed the rest up to the district labor magistrate. In turn, he skimmed some off the top and handed the remaining amount, along with the bribes from all of the other supervisors in his district, up to the state minister of labor. The labor minister took a chunk of that as well, and then donated the rest to his political party, which redistributed his contribution, along with the contribution of the other ministers, in the form of free televisions to key voter blocks in the state. Several weeks later, the owner of the sandal factory received a flat-screen television in the mail, along with several notices to file another tax return.<sup>cvii</sup>



This type of corruption is not driven simply by the petty greed of the lowly labor inspector — it starts from pressure handed down by politicians who need the funds for reelection. India’s politicians rely on “money men” to influence voters and get swept into office.<sup>cviii</sup> But corruption is not the only widespread crime of which many Indian politicians are guilty. Thirty percent of officeholders face criminal charges in national and regional elections. In 2004, out of the 128 elected MPs charged with crimes, 84 were for murder.<sup>cxix</sup> Politicians like the infamous Lalu Prasad Yadav ran the state of Bihar from the back of a jail cell. Clearly, politics in India is in dire need of a cleanup.<sup>cx</sup>

**Increasing the contribution limits for campaign donations is likely to bring more transparency and accountability to the election process.** Current contribution limits for state and national elections are incredibly low, which forces any politician who is serious about winning to seek “alternative financing” for his campaign.<sup>cx1</sup> Significantly increasing these donation limits, along with strengthening reporting requirements, will likely reduce dependence on illicit funding. Moreover, bringing donations out into the open will allow voters to make more educated decisions about the character and legitimacy of individual candidates.

**Creating a separate arm of the independent election commission to crack down on and prosecute law-breaking candidates and politicians would help sweep criminals out of politics.** Even though strict laws have been passed against electing candidates with criminal convictions, many politicians have been able to avoid conviction by manipulating the judicial outcomes. A separate, well-funded arm of the independent election commission dedicated solely to investigating and prosecuting illegal activity by elected officials is likely to put heavy pressure on dirty politicians. However, this body must be created in conjunction with a law allowing for the fast tracking of all cases against elected MPs and MLAs. With this law in place, politicians will find it much harder to stack the deck in their favor.

## 6.2 Administrative Reform

*“Opening a business in India isn’t easy, and running it doesn’t get any easier.”*

— Anonymous Mumbai restaurant owner

After four years, 25 licenses, over 100 denied applications and countless payments of “facilitation fees,” the current owner of a Mumbai restaurant was relieved to find that his liquor license application was finally approved. But only a week after opening, a local politician threatened to close down the restaurant. The only way he could keep it open was to pay a \$12,000 bribe. These are the conditions under which entrepreneurs in India do business.

### Recommendations:

- Change the system of promotion in bureaucracies from seniority to merit
- Compensate workers with higher pay but less job security
- Utilize industry advisory commissions, outside consultants and public comment periods to limit inconsistent policy outcomes
- Utilize IT and automation to reduce administrative corruption
- Create an ombudsman to listen to appeals of licensing and other regulatory decisions

It takes 89 days to start a business in India. The same process takes two days in Scandinavia, the U.S., Canada or Singapore<sup>cxii</sup>. Licensing requirements and bribery discourage even the most inspired entrepreneurs. Even after the business is open, an average of 17 inspectors are constantly hounding owners for kickbacks, laced with an implicit threat of closure.<sup>cxiii</sup> Foreign companies are dissuaded by perceptions of corruption and crony capitalism. Out of sheer frustration, many Indians turn to the public sector for jobs — where high salaries, solid pensions and job security are guaranteed, provided you pay the bribe to get the position in the first place.

Some government insiders are criticizing bureaucracy's dishonesty — we heard of a bureaucrat-turned-whistleblower who was reassigned 47 times as he consistently revealed his coworkers' corrupt behavior.<sup>cxiv</sup> Even when regulatory decisions are not corrupt, they are often incredibly detrimental to economic growth. A CEO of a BPO firm recounted a time when he received approval to open an office in a newly created SEZ outside of Ahmedabad. Not even six months after opening the office, the government slapped an alternative minimum tax on any service sector firms in the zone, which sucked up all of the firms free cash flows that were to be reinvested into the business. Out of the nine massive office buildings constructed in the SEZ, only two house active businesses today.

**The hiring, promotion and firing of government officials should be adjusted to conform to standard private sector practices, replacing the current policy of seniority and guaranteed employment.** Merit-based evaluation will immediately lead to better regulatory outcomes, as the smarter employees will rise to the top and impose stricter, more efficient discipline. However, in order to move to a merit-based promotion scheme, assessment systems need to be improved. Currently, eight out of 10 government officers are rated “very good” or “outstanding,” which is absurd given the current performance of the bureaucracy. Mandating that a certain percentage of employees to be rated in each qualitative category should solve this issue, along with the use of more frequent performance reviews. Finally, the administration needs a mechanism to get rid of the useless employees. Creating a policy similar to the Voluntary Retirement Fund — where workers were given the option to retire in exchange for a lump-sum payment based on years worked — would clean out the worst workers. Increasing pay across the board and creating automatic firing mechanisms for the worst 5 percent of workers is another option. Grandfathering in these provisions policy changes will significantly reduce any employee opposition.

**Bureaucracies can decrease the promulgation of inconsistent and burdensome regulations on business by instituting public comment periods, industry advisory commissions, and hiring of outside consultants.** Kejriwal nicely summed up business's biggest complaint: “All we want as a business community is consistent regulation. I don't mind if the regulation is unfavorable, as long as it is consistent.”<sup>cxv</sup> Bureaucratic agencies can easily reduce the chance of creating inconsistent regulation by simply consulting outside sources before making a final decision. Before implementing a regulation, a public comment period of one to two months should be established and feedback from all interested parties should be gathered. Furthermore, advisory committees for all large industries should be created and staffed with executives from large firms who can flag potentially detrimental regulation. For large changes in policy, agencies should hire outside consultants to conduct risk and impact analysis before promulgating any regulation.

**Administrative reforms to encourage whistleblowers, use technology and automation, and create an ombudsman can significantly reduce corruption.** Exposure from within is the easiest way to curb corruption, but given norms about corruption and perverse incentives, few bureaucrats report abuses. Enhanced protection for whistleblowers — a moratorium against transferring the official, harsh penalties for harassment or intimidation, and significant bonuses as a result of a successful conviction — would be good first steps. Furthermore, corruption cases should be fast-tracked through the court system to improve the efficiency of outcomes. The government can leverage information technology to keep reducing face-to-face corruption in areas like land certificates, passports, pensions, birth certificates and tax filings. Licensing decisions should face a 30-day deadline, with an automatic approval if the time limit expires, in the interest of cutting down on “speed money” payments. Lastly, states should create an ombudsman to regulate licensing and other regulatory decisions. If a ruling goes against a business owner because he failed to pay a bribe, he ought to be able to appeal the decision to an objective, transparent decision-making apparatus.

### 6.3 The Judiciary and Police Force

*“L.N. Mishra, Cabinet minister of railways and right-hand man of Indira Gandhi, was murdered in 1975. The case against the accused dragged on for 37 years; he had been 27 years old at the time of the murder and he was 64 and ailing in 2012. Meanwhile, 31 of the 39 witnesses for the defense had died, gravely prejudicing the case against him. No less than 22 different judges had head the case over the years. The trial was still going on in 2012. If this happened in the case of Cabinet ministers, where was the hope of justice for an ordinary person?”*

— Gurcharan Das, *India Grows at Night*<sup>cxvi</sup>

#### Recommendations:

- Speed up the judicial process for current trials by increasing the system’s capacity via the appointment of more judges and creating incentives for faster case resolution
- Minimize stalling tactics by increasing the standards for allowing motions to delay and reschedule court dates
- Create alternative dispute resolution mechanisms at the local and municipal levels (i.e. mediation and panchayat-level community justice systems)
- Limit docket growth by curbing unnecessary appeals from the federal government
- Hire more police officers, particularly in urban areas
- Increase standards for officers’ conduct and training at the university level and within police departments
- Prioritize the hiring of more female police officers to increase departments’ capacities to address issues related to women’s rights and protections
- Break state governments’ strangleholds over police appointments and transfers and give police officers protection from the Executive and politicians

If you were to describe the Indian judicial process in a single word, that word would be “slow.” As of 2012, 25 million cases were pending in various levels of the legal system; at the current rate, it would take 324 years to clear these cases.<sup>cxvii</sup> Justice does not speed up for the most

serious crimes; out of the 477 criminals on death row, only three have been executed in the last 18 years.<sup>cxviii</sup> Judges are happy to give adjournments and delays if it means avoiding unpopular decisions. Finally, one study estimates that less than 50 percent of the judicial outcomes actually result in justice<sup>cxix</sup>.

The two primary areas in need of reform are the police force and the judicial process. While much of the focus of judicial reforms rests with the courts, the police play a vital investigative role that is often overlooked in India. Unfortunately, the police are understaffed, underfunded and are prone to corruption and abuse, which contributes to many of the problems downstream in the court system.

**With more judges and incentives for speedier case resolution, the judicial system can tackle its vast backlog.** India simply needs to recruit and appoint more judges. At present, the judge to citizen ratio is just 15 percent of the global average, which means hiring five new judges for every existing judge. Even marginal progress will help unburden judges whose dockets are filled with hundreds of trials at one time. Furthermore, judges need to encourage more cases to be settled out of court, either through arbitration, mediation, standard settlements or plea bargains. Some recognition for judges who hit certain thresholds for cases settled out of court will introduce a tangible incentive for mutually agreeable outcomes, rather than letting trials fester.

**Minimize stalling tactics by increasing the standards for allowing motions to delay and reschedule court dates.** New legislation should make it more difficult for judges to grant delays. If such legislation is not politically feasible, posting a publicized list online about individual judge statistics (average length of trials, number of delay motions granted per trial, etc.) should provide some public pressure on judges to reform their practices. At the individual level, enacting a schedule of penalties (i.e., fines) for excessive delays or failure to appear in court could also encourage private defendants and plaintiffs to afford the court calendar greater respect.

**Create alternative dispute resolution mechanisms at the local and municipal levels (i.e. mediation and panchayat-level community justice systems).** Utilizing the panchayat-level quasi-judicial systems to settle low-level crimes in villages is quicker, less costly, more accountable and more likely to deliver a just outcome than the traditional trial system for village disputes. Diverting low-level offenses into alternative dispute resolution mechanisms such as mediation, drivers' education, community service, youth tribunals (for juvenile crime), and automatically levied fines is a simple way to reduce volume at the urban level. The mediation model has specifically been implemented to great success in Bangalore, where the Kanataka High Court has diverted disputes into the Bangalore Mediation Centre (BMC) since the Centre's establishment in 2007.<sup>cxx</sup>

**Limit docket growth by reversing the government's appeal policy.** Much of the court clog in the courts as a whole, but especially the appellate courts, exists because the federal government insists upon automatically appealing every lawsuit they lose. Replacing that policy with a more flexible case-by-case policy will reduce court clog and litigation costs for the government. Second, the government's decision to initially litigate a case is made at the lowest level of

bureaucracy but the decision not to litigate was made at the highest level. If this process is simply reversed, government-initiated litigation would decrease significantly.

**Hire more police officers, particularly in urban areas, to improve coverage and capacity.** Police departments' capacities are currently insufficient, and the police presence in large cities is inadequate. Currently, India has 130 police officers for every 100,000 citizens; this is less than half of the global average.<sup>cxxi</sup> Remediating this problem by hiring more police officers, particularly in urban areas where alternative and community-based justice structures are weak to nonexistent, should be a priority for the establishment of rule of law.

**Increase standards and infrastructure for officers' conduct and training.** The current officer corps lacks standards for conduct. An alarmingly high percentage of prisoners die in police custody, suggesting widespread negligence.<sup>cxxii</sup> Setting clear standards for individuals' treatment while in police custody, tracking officers' individual records and institutionalizing consequences for abusive officers are important reforms in this area. Even when citizens have contact with the police, incompetency is rampant. Officers are without proper forensic skills or awareness of police procedure (i.e., collection of witness statements, chain of evidence and appropriate interview procedures). With this in mind, the Centre should invest more heavily in investigative training; this will improve the quality of expert testimony in court.

**Prioritize the hiring of more female police officers to increase departments' capacities to address issues related to women's rights and protections.** Women are discouraged from reporting crimes given officers' unwillingness to register complaints, sub-standard investigative procedures, and low conviction rates. Victims might be more likely to report cases of rape, violence, and harassment to other women. However, there were only 84,479 female police personnel in India in November 2013, constituting only 5.33 percent of the total police force.

**Break state governments' strangleholds over police appointments and transfers and give police officers protections from Executives and politicians.** In 2006, the Supreme Court ruled in *Prakash Singh v. Union* that the police force should be granted immunity from the Executive and politicians.<sup>cxxiii</sup> This has been strongly opposed by state governments, particularly in Maharashtra, Uttar Pradesh and Andhra Pradesh. These states understand that granting the police immunity would restore the rule of law in states — such as Maharashtra and Uttar Pradesh in particular — where the law has yielded to the influence of power.

## 7. WELFARE AND SOCIAL INCLUSION

### 7.1 Public Distribution System

On a sweltering December afternoon, we discussed India's Public Distribution System (PDS), a food handout scheme, with residents in a remote Maharashtra village. The PDS seems to work well at the local level — eligible residents have had little difficulty procuring their ration cards and the food comes in on time — yet most of the villagers still favor a move toward a direct cash transfer system. Despite its effectiveness, the villagers seem to acknowledge the shortcomings of the program around the country, where waste, fraud and abuse mean that many of India's neediest continue to go hungry. Yet the Lok Sabha recently passed the Food Security Bill, a

measure intended to expand the PDS to cover 67 percent of the population at a cost of 3 percent of GDP.<sup>cxxiv</sup> Ultimately, we recommend a reform of the PDS from in-kind transfers of food to direct cash handouts.

#### Recommendations:

- Replace provision of grains through Public Distribution System with targeted, unconditional cash transfers, but only after other subsidies have been successfully transitioned to the cash transfer model
- Ensure residual level of government grain procurement and distribution at ration shops in very remote localities

India's food distribution system is a nightmare. Today, India "grows so much food that it has a bigger grain stockpile than any country except China, and it exports some of it to countries like Saudi Arabia and Australia."<sup>cxxv</sup> But a land of plenty is also home to some of the worst levels of child malnutrition in the world. A 2012 report indicated that in some states, 42 percent of all children under the age of 5 were malnourished.<sup>cxxvi</sup> Much of the grain lies rotting on India's roadsides, as an inefficient and corrupt administration prevents the yields from one of India's most costly social welfare programs from reaching the country's most needy. Under the Food Security Bill, enacted in August 2013, the PDS is supposed to reach 800 million Indians, providing each with a monthly allowance of five kilograms of rice or wheat at subsidized rates.<sup>cxxvii</sup> The expanded food subsidy program is projected to cost \$18 billion.<sup>cxxviii</sup>

Meanwhile, much of the new funds will be used to procure additional stockpiles of wheat and rice, despite the extent of waste and fraud — 40 percent of existing rations disappearing over their long journey between producers, bureaucrats, ration shops and distributors.<sup>cxxix</sup> Yet many Indians cannot purchase the food that does make it to the ration shops, because acquiring the necessary ration card entails procedures that discriminate against the most needy. Proving eligibility often requires that applicants prove their residence and income, which many lack documentation to do.<sup>cxxx</sup> In other cases, it requires bribes. The dismal state of India's food distribution system clearly necessitates a significant change in policy.

**The government should replace PDS with a system of direct cash transfers to cut out corruption, increase financial access and give purpose to India's UID system.** The cash transfer system offers clear advantages over PDS. First, it all but eliminates opportunities for corruption in the distribution process. With a click of a button, India's poor can receive their monthly allotment directly to their bank accounts, without having to bribe officials along the way. Second, it offers advantages that extend beyond quelling hunger. Rolling out the system will require that transfer recipients have formal bank accounts, which will bring them into contact with the formal financial sector. This enables the poor to more easily secure small loans and avoid steep fees for cashing checks.<sup>cxxxi</sup> Finally, movement toward direct transfers will speed up India's efforts to enroll its citizenry in a massive identification scheme, which will provide each citizen with identity numbers tied to unique biometric markers. The system will mean that no Indian will have to bribe a local official to prove his/her identity while corrupt middlemen will find themselves bereft of opportunities to pay "ghost laborers" as they pocket funds for public-work schemes.

As one of the most expensive and politically sensitive welfare programs, policymakers should ensure that the PDS is among the *last* in transitioning to a direct transfer system. Government should sequence reforms so that first, existing pension and scholarship transfers are linked to the biometric scheme.<sup>cxxxii</sup> Following this, fertilizer and fuel subsidies should be replaced with the transfers. Only then should policymakers pursue reform of sensitive programs like the National Rural Employment Guarantee Act (NREGA) and PDS.

To be most effective, a new cash transfer model must include several key components. The government should mandate that wholesalers and retailers offer fortified grains to ensure that the poor have access to high-quality, nutritious food with their cash transfers.<sup>cxxxiii</sup> While most commentators acknowledge the need to fix waste and corruption in the PDS, few acknowledge the “supply-side” of the PDS — the need to ensure that grains the poor successfully access fill the nutritional deficiencies that are rampant among India’s poorest. Additionally, the program should target women as the prime recipients of direct transfer funds. It is widely proven through trans-national development studies that women are more likely than men to spend funds on food to benefit their families.<sup>cxxxiv</sup> Lastly, policymakers should resist the temptation to place any conditions on the transfers, as such measures open the door for abuse and corruption. As Jagdish Bhagwati argues, “If enforcement is weak and corruption endemic, as is the case in India, fake invoices can be obtained inexpensively as proof of having met conditionality.”<sup>cxxxv</sup>

**While most of the PDS should transition to cash transfers, the government should continue grain procurement and distribution at ration shops in very remote areas.** Further study is required to determine the precise threshold for village size. However, we acknowledge that very small localities may lack market access or be subject to exploitative pricing due to lack of competition.<sup>cxxxvi</sup> To reduce corruption in these areas in which government continues to operate, the PDS should follow the example of Tamil Nadu’s accountability efforts. Among other things, its PDS system benefits from a robust tracking system that follows grain shipments from warehouses to ration shops. In addition, local councils rather than private owners run ration shops, which reduces incidences of corruption.

Enacting a cash transfer model, in tandem with policies to ensure the poor can access high-quality food, will allow India to feed more with less. Policymakers should seize the opportunity provided by the UID program and advances in mobile banking to reform the PDS to bring India closer to eliminating hunger and malnutrition.

## *7.2 National Rural Employment Guarantee Act*

When NREGA was first introduced in 2005, it was touted as *the* solution to rural poverty in India. Eight years later, young villagers continue to migrate to the cities in droves, starved by the lack of consistent employment. Changes to its implementation in the short-term and structure in the long-term are necessary to develop into a successful, sustainable program.

### Recommendations:

- Encourage higher capital expenditures by increasing the cap on material costs and covering all capital input costs
- Increase accountability through transparency and IT infrastructure development

- Replace the current NREGA system with a set of public-private partnerships targeted at rural development projects

NREGA has been cited in the political community and academic literature as the premier welfare program for rural India. But in Kasar Malai, the villagers saw NREGA as an afterthought: “A couple people are listed on the muster rolls, but no one really uses it for regular work.” Others were more bullish about NREGA’s potential but heavily qualified their position with regards to its implementation. “In theory, the program is well-designed, self-selecting, and has the potential to significantly increase rural development while lifting many out of poverty,” said a leading economist for the World Bank in India “but implementation across the states has been incredibly sporadic.” A recent study found that while outcomes across states were highly variable, four positive outcomes were visible — agricultural wages have increased; distress migration has declined; area cultivation has increased in some states; and water conservation structures have been built and revived. While there are some success stories in each state, Andhra Pradesh stands out for the systematic and transparent manner with which it has implemented NREGA.<sup>cxxxvii</sup>

However, several leading economists have voiced several concerns of the program: low limits for capital inputs means the assets being created are often shoddy, ineffective and need to be repaired frequently; the focus on manual labor leaves workers with no skills or training; the program takes time away from workers; and leakages due to corruption are eating up one-third to one-half of stipulated wages.<sup>cxxxviii</sup> Thus, NREGA is good at providing wage-earning opportunities, but not so good at producing quality assets and providing workers with skills.

**An improved NREGA program should reform the allocation of costs for capital versus labor.** Currently, the total cost of material components of projects including skilled/semiskilled workers is capped at 40 percent of total costs. In practice, only 35 percent of the average project’s costs are used on skilled workers and material. There are detailed restrictions within the law for use of medium and high tech machinery and other capital inputs. Moreover, the Centre covers all of the unskilled rural workers’ wage costs, but only 75 percent of the material costs, which skews the projects toward even less capital input.<sup>cxxxix</sup>

Utilizing capital for production is key not only for the quality of assets created, but also the skills gained by the unskilled workers who are exposed to new construction methods. Thus, the Indian government should make three modifications to material requirements to encourage capital usage. Instead of covering the wage costs in full and 75 percent of the material costs, the government should cover material costs in full and about 80 percent of wage costs, which will encourage states and local panchayats to spend the full allotted amount on capital inputs. Meanwhile, the cap for material costs should be increased to 50 percent, which will also bring more capital into production and increase the durability and overall quality of the assets created. Lastly, linking NREGA with other rural infrastructure programs like the Rashtriya Krishi Vikas Yojana (water scheme) and the National Horticulture Mission (agriculture productivity) would provide additional funding for material inputs to free up NREGA funding for wages.<sup>cxli</sup>

**Transparency and IT infrastructure can help increase program accountability.** NREGA is among a host of government schemes laden with corruption and inefficiency. Delayed payments, fake muster rolls, and leakages in funding are all commonplace in many states.<sup>cxli</sup> However, the development of information technology has the potential to solve several implementation issues



associate with NREGA. First, as the UID scheme expands to cover all rural areas, payment for work can be linked to an individual's unique identity number, which avoids duplication of muster rolls and creates a transparent payment system. Second, states should replicate Andhra Pradesh's transparency mechanism, which tracks project funds from the Centre all the way down to the panchayat level and allows any villager to access the information at any time. Third, states who do not already do so should delegate project selection and implementation to the local Gram panchayats, who are more likely to have the right mix of knowledge and accountability.

**NREGA should ultimately be replaced with a small cash transfer and public-private partnership system for rural projects.** Private sector competition for NREGA projects will generate efficiency gains that can never be achieved by an all-encompassing government program. Instead of directly paying all costs, the government should transition the money allocated for NREGA into an infrastructural development fund. Gram Panchayats will then be encouraged to post a list of projects in order of priority on a central website managed by the government. Private firms and NGOs will then be allowed to bid on those projects through a transparent, electronic auction. To incentivize private firms, the Centre should provide a tax exemption for profits gained from the completion of the projects and a qualification for a firm's corporate social responsibility requirement based on a percentage of the project costs. Finally, projects will require employment of local workers, with certain exceptions for technicians, engineers and other skilled workers. If a local worker requests work and is unable to be staffed on a project, they will receive a small cash transfer similar to the current cash transfer amount.

The main political barrier to the restructuring of NREGA will come from Scheduled Tribes (STs), Scheduled Castes (SCs) and Other Backward Classes (OBCs), as they disproportionately benefit from NREGA in its current form. At just 25 percent of India's population, they comprise of 52 percent of the day's work and receive 2.2 times the average sum for a rural worker.<sup>cxlii</sup> There are several politically smart ways that the reformed NREGA program can compensate STs, SCs and OBCs — by reserving a percentage of funds for projects that directly benefit those communities; blocking off a percentage of employment spaces; and/or providing a higher cash transfer for them in case there is not enough work.

## 8. HEALTH

*“At government health centers, meanwhile, 40 percent of doctors and a third of nurses are absent at any given time. According to a study by Jishnu Das and Jeffrey Hammer, of the World Bank, there is a 50 percent chance that a doctor at such a center will recommend a positively harmful therapy.”*

— Gurcharan Das, “The India Model”<sup>cxliii</sup>

For India's poor, health problems and expenditures generate a poverty trap that limits the productivity of a significant share of India's labor force. Obstructions to healthcare are barriers to education and employment, distortions to private savings and consumer spending, and limitations to the life expectancy and empowerment of women. In fact, Savita Verma from USA Today writes that “malnutrition is eating up as much as four per cent of the country's gross domestic product,” and a study from London's Global University found that acute and chronic illnesses cut GDP by about 12.5 percent each.<sup>cxliv,cxlv</sup> India has consistently ranked among the

countries with the worst health outcomes, even when compared to poorer countries in Sub-Saharan Africa and Southeast Asia.<sup>cxlvi</sup> Despite the 2002 National Health Policy and the 2005 National Rural Health Mission, the Indian government still only invests 1.2 percent of GDP in health compared to 2.9 percent in Sub-Saharan Africa and 6.5 percent as a world average.<sup>cxlvii</sup> Shortages of funding and poor incentives for primary care have pushed the Indian public toward unchecked private expenditure. India desperately needs to refocus its health system on community-level preventative care, nutrition, rural healthcare, environmental health, and health financing.

#### Recommendations:

- Redesign ASHA compensation, training, evaluation, and media attention
- Form autonomous, merit-based public health agencies at the state level
- Create mid-level health professional degrees and incentives for rural postings
- Establish a national food fortification program in schools and daycares
- Reform PHC policies and provide conditional cash transfers to women
- Encourage community-based insurance programs while RSBY integrates with IT

#### *8.1 Accredited Social Health Activists*

**Community health workers worldwide have been shown to be the most cost-effective way to improve health indicators in developing countries, so India needs to make substantial investments into its Accredited Social Health Activist (ASHA) program.** The ASHA program, started in 2005 as part of the National Rural Health Mission (NHRM), sought to deal with health issues at the grassroots level to reduce health expenditures as a whole. The country's 820,000 ASHAs are selected at the panchayat level, and should have at least eight standards of education. The program has not yet reached all states, but the NHRM sets the goal of hiring one ASHA per 1000 people in the rural population.<sup>cxlviii</sup> Provided that they understand their role — a recent study found that 78 percent of the ASHAs in Bihar could not delineate their responsibilities, and most ASHAs have not completed the full 23 days of training<sup>cxlix</sup> — ASHAs are incentivized to only perform tasks with direct financial compensation given that they themselves are mostly poor.<sup>cl</sup> However, compensation is much too low for the knowledge expectations and travel time associated with the “volunteering” role. Additionally, ASHAs often lack the supplies needed for their work, experience delays in payment, and face the usual challenges with administrative bribes.

While the program has been successful in many states, the government should strengthen the financial and status-based incentives for ASHAs, ensure effective local-level ASHA supervision and evaluation, provide ASHAs with periodic training and toolsets for the promotion of hygiene, environmental health, family planning, and neonatal health, and establish media channels dedicated to increasing awareness of the best practices in community health. Ideally, ASHAs can become full-time, salaried health workers like auxiliary nurse midwives and anganwadi workers. Lastly, the government should finance a national ASHA radio program modeled off of the one in Assam to spread awareness of best practices in community health.<sup>cli</sup>

#### *8.2 State-Level Public Health Agencies*

**Public health agencies must be given autonomy once again, with merit-based career tracks and comparable pay to other health ministry positions.** The National Health Policy of 2002 largely cast away responsibility for environmental health. In 2002, states spent 40 percent of their budget on secondary and tertiary care but only 8 percent on public health.<sup>clii</sup> Instead, India should, by national policy, follow Sri Lanka and Kerala in rewarding public health career paths and establishing public health agencies that can oversee environmental health, epidemic monitoring, and community health workers. Increased institutional autonomy will be crucial to motivate training and investment in public health experts.<sup>cliii</sup> India's focus has been on specialized clinical services and single-issue programs, and although these initiatives are important, they are neither cost-effective nor self-sustainable. Guaranteeing a basic level of care provision and health education will do much more for India's welfare and economic productivity.

### *8.3 Mid-Level Medical College Education*

**The Indian government needs to establish professional community health and midwifery degrees, remove licensing barriers for rural medical colleges, and incentivize both medical teaching and rural medical practice.** The World Health Organization (WHO) recommends one doctor per 600 people, yet India has only one MBBS (bachelor of surgery) per 1,800 people.<sup>cliv</sup> But the country's greatest need is for mid-level, specialized public health professionals. In 2001, Chhattisgarh instituted a 3-year community health education program, which produced Rural Medical Assistants (RMAs) that have been in service since 2008.<sup>clv</sup> The RMAs perform just as well as MBBS doctors in primary care settings. Plans for more diverse and quality education have been opposed by the Indian Medical Association, which argues that only MBBS doctors are qualified to run PHCs and other health facilities.<sup>clvi</sup>

To overcome this problem, the government must organize community health programs at the best medical colleges and set up systems of evaluation and standardization. The Medical Council of India should be pressured to invest in these programs and relax medical college licensing restrictions for new medical colleges in rural areas. To incentivize rural health practice and medical teaching, the government should start programs of tuition reimbursement for doctors and other health professionals who choose to work in underserved rural PHCs for at least the number of years of education reimbursed.<sup>clvii</sup> Eventually, rural doctors mid-level health staff should be paid more than their counterparts in urban areas. These salaries can be partially funded by public health agencies, once they are formed and strengthened.

### *8.4 Fortified Foods*

**The government should create a national food fortification program that provides fortification mix packets, along with midday school meals and preschooling initiatives.** Compared to China, sub-Saharan Africa, and the other developing countries in Southeast Asia, India has the highest proportion of preschool-age children with anemia and Vitamin-A deficiency, at 74 percent and 62 percent, respectively. Thus, targeting children is most effective way to achieve the maximal effects of nutritional supplementation. A study in Gujarat found that vitamin A deficiency fell by 34 percent when children were given fortified midday meals and 74 percent in preschools run by the Integrated Child Development Services program.<sup>clviii</sup> In 2006, the cost of iron and folic acid fortification was only ten rupees per metric ton of wheat.<sup>clix</sup>

Providing government schools and daycares with packets of fortification powder has been shown to reduce diversion of the meals and instill public knowledge of the importance of fortification and nutrition.<sup>clx</sup> Lastly, public schools and daycares should also undergo twice-yearly deworming campaigns that include a day of education on diet and proper nutrition. If hygiene and sanitation programs are weak, diarrheal diseases will counteract all the benefits of ingesting nutrients.

Figure 8.1: WHO Recommendations for Food Fortification<sup>clxi</sup>

Table 1. Average levels of nutrients to consider adding to fortified wheat flour based on extraction, fortificant compound, and estimated *per capita* flour availability

Nutrient	Flour Extraction Rate	Compound	Level of nutrient to be added in parts per million (ppm) by estimated average per capita wheat flour availability (g/day) <sup>1</sup>			
			<75 <sup>2</sup> g/day	75-149 g/day	150-300 g/day	>300 g/day
Iron	Low	NaFeEDTA	40	40	20	15
		Ferrous Sulfate	60	60	30	20
		Ferrous Fumarate	60	60	30	20
		Electrolytic Iron	NR <sup>3</sup>	NR <sup>3</sup>	60	40
	High	NaFeEDTA	40	40	20	15
Folic Acid	Low or High	Folic Acid	5.0	2.6	1.3	1.0
Vitamin B <sub>12</sub>	Low or High	Cyanocobalamin	0.04	0.02	0.01	0.008
Vitamin A	Low or High	Vitamin A Palmitate	5.9	3	1.5	1
Zinc <sup>4</sup>	Low	Zinc Oxide	95	55	40	30
	High	Zinc Oxide	100	100	80	70

<sup>1</sup> These estimated levels consider only wheat flour as main fortification vehicle in a public health program. If other mass-fortification programs with other food vehicles are implemented effectively, these suggested fortification levels may need to be adjusted downwards as needed.

<sup>2</sup> Estimated per capita consumption of <75 g/day does not allow for addition of sufficient level of fortificant to cover micronutrients needs for women of childbearing age. Fortification of additional food vehicles and other interventions should be considered.

<sup>3</sup> NR = Not Recommended because very high levels of electrolytic iron needed could negatively affect sensory properties of fortified flour.

<sup>4</sup> These amounts of zinc fortification assume 5 mg zinc intake and no additional phytate intake from other dietary sources.

### 8.5 Primary Care

**The government should give infrastructure grants and performance-based bonuses to primary health centers (PHCs), give cash transfers to women who achieve specific maternal health and child health benchmarks, and provide free medication on a directly observed treatment (DOTS) basis through ASHAs.** A walk around any rural PHC will show you firsthand how bad government-run primary care is in India. When we visited a PHC in Raiga District of Maharashtra, there were no patients because the center lacked toilets and running water. On average, only 69 percent of PHCs have at least one bed, 20 percent have a telephone, and 12 percent undergo regular maintenance.<sup>clxii</sup> It is no surprise, then, that 81 percent of urban

patients and 78 percent of rural patients in 2004 sought out private providers, paying out of pocket for care even when government services were low-cost or free.<sup>clxiii</sup>

Investment in basic PHC infrastructure is ultimately crucial. Without running water and electricity, PHCs are incapable of conducting many maternal health diagnostics and treatments. To ensure quality control, PHCs should receive government bonuses based on district-level or state-level health outcomes. The worst performing areas should have their PHCs evaluated by health ministry officials to identify major problems. Conditional cash transfers can be provided to women who show up for the recommended prenatal and antenatal checkups. The government should subsidize all basic medication on the condition that an ASHA manages the stocks and monitors dosages. This prevents medication theft, encourages people to get diagnosed at PHCs, and confers a greater degree of drug adherence.

### *8.6 Community-Based Insurance*

**Community-based health insurance schemes can buffer catastrophic health spending and link underserved populations to better care providers.** While the Rashtriya Swasthya Bima Yojana (RSBY) program’s guarantees for below poverty line (BPL) households are great in theory, very few people know of the scheme, and there is no coverage for private expenses in primary care and even some causes of hospitalization.<sup>clxiv</sup> This reflects the government’s failure to advertise the scheme and fully develop the insurance package, and even when BPL families do experience an acute health problem and learn about the scheme, they don’t have the time to file the paperwork necessary to register for the biometrically linked insurance card. Until the national ID system or another form of BPL registration can be automatically linked to the insurance, the government should subsidize BPL household participation in community-based insurance schemes. While most premiums are at least Rs. 100 per person per year, people in rural areas are generally only willing to pay premiums of Rs. 20-60.<sup>clxv</sup> The government can also work with NGOs or community-based organizations (CBOs) to publicize insurance. Linkage of credible insurance companies to a credible CBO or NGO is crucial to building trust. Ultimately, these efforts will lay the groundwork for BPL households to understand how a national health insurance system will work.

## **9. AGRICULTURE**

*“Over the last ten years, India's economy as a whole may have grown at more than 6 percent per annum, but agriculture, which still supports, fully or in part, around 60 percent of the country's population, has grown at a mere 2.2 percent annually.”*

*— Foreign Affairs<sup>clxvi</sup>*

With such a large percent of India’s workforce in agriculture, higher agricultural returns have the potential to boost GDP and increase the wellbeing of many Indians.<sup>clxvii</sup>

### Recommendations:

- Legalize tenancy in all states and create clearer land titles
- Encourage a second Green Revolution
- Promote community-based programs
- Streamline distribution channels

- Adjust export policy

**Land reform should allow for tenancy and creates clear land titles.** One study found that land reforms to give tenants more secure rights increased productivity in West Bengal as compared to East Bengal.<sup>clxviii</sup> In some states, however, tenancy itself is illegal. By establishing rights for tenants, land reform can increase productivity. Additionally, allowing for tenancy may make larger scale farming more feasible without changing land rights.<sup>clxix</sup>

Land reform that expedites land sales by removing red tape can also aid in creating larger scale farming. Currently, the widespread lack of clear titles to land also inhibits streamlined land sales. D'Souza stated that because rural land is often familial and passed down to various family members, the determination of rightful ownership is often difficult. His findings match our experience in Kasar Malai, where locals explained that only they knew who owned each parcel of land. A comprehensive land titling program is the first-best solution, but it is very expensive and can be highly disruptive if corruption skews who receives the title. A second-best current policy is to remove current barriers that prevent easy titling, such as panchayat stamp duties, which require individuals to pay a fee to register their titles.<sup>clxx</sup>

States should take the initiative on these fronts, but involvement from the Centre to create incentives, like infrastructure grants for adopting tenancy reform, might be necessary in areas where capacity is low.

**One of the clearest ways to increase returns on agriculture is to increase the productivity of agriculture.** The first Green Revolution increased as the yield per unit of farmland by 30 percent and established India as a major agriculture producer. However, high-yield value seeds did not spread to all crops or regions. This first wave also led to large-scale groundwater depletion, difficult power dynamics with international seed providers, pesticide pollution, and ecosystem vulnerability in areas where it was adopted.<sup>clxxi</sup>

Consequently, the second Green Revolution must differ from the first. It should instead be based on integrated approaches that focus on the entire farming system. Government should invest in the research and development in crop variety, management, planning, warehousing, and food processing. Officials should also monitor groundwater and safeguards should put in place safeguards that kick in at certain levels of depletion. The second Green Revolution can also focus on genetically improved seed varieties, but will have to examine how the modified crops influence larger practices and the system as a whole to determine their viability.<sup>clxxii</sup>

Figure 9.1: Villagers Process Rice in Kasar Malai



**Another key reform is to encourage community-based programs through research and funding for expansion.** During our meeting with Swades Foundation founder Zarina Mehta and a visit to the Kasar Malai, we saw a clear need for community-based education. By educating farmers about how to plant new crop varieties and adopt certain water management techniques, the Swades Foundation has been able to enhance the livelihoods of thousands of farmers. Government intervention can learn from the best practices of NGOs like Swades and replicate its work to address rural livelihood challenges.<sup>clxxiii</sup>

The Jeevika project can also serve as a model program to build on. Supported by the World Bank and the state of Bihar, the project has piloted, customized, and scaled-up several innovative livelihood interventions in Bihar. The project involves institutional change that brings the program directly to small and marginal farmers. As result, farmers demand better services from the public sector, access credit from commercial banks, and experiment and customize various technologies.<sup>clxxiv</sup>

**Streamlining food distribution channels will help ensure that farmers receive higher payments for their crops and that less food is wasted.** Currently, farmers only see about 20 percent of the retail price of fruits and vegetables, which is far less than what their counterparts in the United States get. As noted in our discussion of PDS, eliminating middlemen and improving infrastructure can help farmers see higher returns.<sup>clxxv</sup>

**Adjusting trade policy can help farmers receive higher returns on their labor.** When we visited the Indira Gandhi Institute of Development Research, various faculty members stated that thus far India has liberalized agricultural trade, particularly by reducing import tariffs and quotas.<sup>clxxvi</sup> However, some unpredictable export restrictions continue to exist and should be reduced. For example, in 2012, India banned the export of cotton due to high domestic prices.<sup>clxxvii</sup> Reductions in export restrictions will expose farmers to more volatile global prices but also enable them to command higher returns from higher world prices.<sup>clxxviii</sup>

In order to mitigate the disruptive effects of reducing trade barriers, the Indian government should gradually reduce the barriers while supplementing with policies that raise land productivity like investments in a second Green Revolution. For the first year or two, India can also allow the export only of high-quality, high-priced varieties of such commodities as cotton and rice, to limit upward pressures on domestic prices of lower quality varieties, which are important to consumption in low-income Indian households. Lastly, the export reductions can happen in concert with a strengthened safety net that can catch families who experience temporary disruption due to the export barrier reductions.<sup>clxxxix</sup>

## 10. MONETARY POLICY

*“India’s financial system is like a ramshackle engine lovingly maintained by a sect of oil-spattered engineers and wearily tolerated by most people who depend on it.”*

— *The Economist*<sup>clxxx</sup>

Over the last two decades, India has made tremendous progress in liberalizing its banking sector and freeing up credit, but rising inflation, persistent current account deficits and demanding banking sector regulations on reserves and credit are slowing India’s growth prospects.<sup>clxxxxi</sup> India’s central bank, the RBI, needs to spearhead policies that rein in inflation, free the flow of credit, and encourage productive savings. The central bank can also play a role in expanding financial literacy and fast tracking the rollout of new technology like mobile banking. Finally, the RBI needs to continue opening India’s banking sector to competition through liberalizing state banks and lowering barriers to foreign entry.

Although the central bank has been described as an “honourable guardian of the status quo,” there is hope that its role is changing.<sup>clxxxii</sup> The recent selection of former International Monetary Fund chief economist Raghuram Rajan to lead the RBI is an optimistic sign that that these goals might be achievable within the next five to ten years. Rajan has stated that reducing inflation and increasing banking sector competition will be his main priorities, and he is already acting to achieve them.<sup>clxxxiii</sup>

### Recommendations:

- Set credible inflation targets and adjust interest rates to achieve them
- Lower required reserves for commercial banks to around 10 percent of deposits, in line with international standards outlined in the Basel III accords
- Encourage a shift from gold to productive savings like inflation-linked bonds, implement limited gold monetization schemes and expand financial literacy around savings
- Lower directed credit for agriculture and small-scale industries from 40 percent of all credit to 25 percent by 2020, work to eliminate this program altogether by 2040

### *10.1 Inflation*

Still reeling from the global financial crisis and with GDP falling fast, the Indian economy is also plagued by inflationary dynamics. While some inflation is necessary for economic growth, India’s unpredictable currency swings are costing stakeholders that range from large manufacturers to street vendors. Moreover, India cannot benefit from export-led growth (as



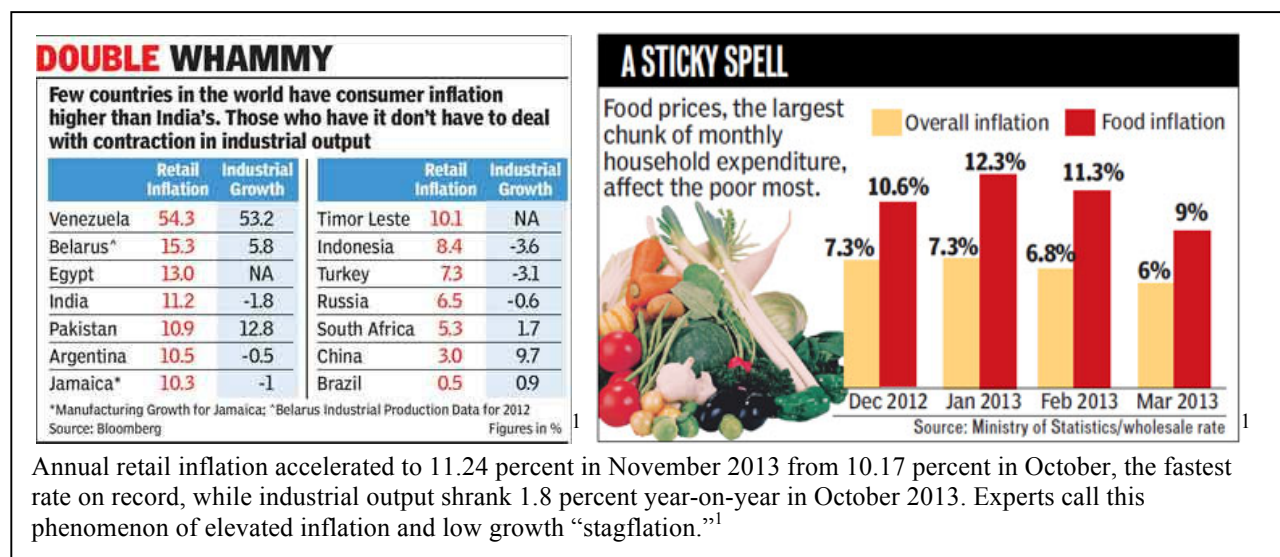
China and Japan have through expansionary monetary policy and weak currencies) because its economy is services-driven and lacks large manufacturing hubs.

Pressed to choose between curbing inflation and slowing short-term growth and employment, Rajan announced in September 2013 that the country’s central bank would impose a slight increase to the repo rate, the rate at which it loans to commercial banks overnight. Although only a modest, quarter-percentage point increase to 7.5 percent, it was the first rate increase since 2011 and helped stabilize the rupee in international markets.<sup>clxxxiv</sup>

**Looking forward, the RBI needs to remain vigilant to rein in inflation and set a credible inflation target of around 5 to 6 percent.** While the repo rate should remain between 7 and 8 percent in the near future in order to keep down the cost of borrowing and avoid triggering unemployment with too much monetary tightening, the bank needs to be ready to exert future rate increases to make its inflation target credible. Recent news of a pick-up in retail inflation prompted experts to speculate that Rajan will again raise interest rates by a quarter percentage point on December 18.<sup>clxxxv</sup>

**The RBI should also work with the Centre to identify and quell root causes of inflation like inefficient subsidy spending and broken food distribution systems.**<sup>clxxxvi</sup> If the Centre cannot do this, rate increases will raise its cost to borrow and service fiscal deficits. Rajan runs some risk of jolting India’s economic system in a negative direction, but his pledge to reform the banking sector through “a hundred small steps” suggests he will be careful and transparent as he executes changes at the RBI.<sup>clxxxvii</sup>

Figure 10.1: Retail Inflation and Rising Food Prices<sup>clxxxviii</sup>



## 10.2 Credit

India’s fastest GDP growth since Independence, the period between 2003 and 2008, was marked by low inflation, price stability, and high domestic savings and investment. Today, inflation and

prices are trending in the opposite direction, and India's gross domestic savings as a proportion of GDP has fallen from 36.8 percent in FY2008 to 30.8 percent for FY2003. This decrease was mostly due to a steep decline in households' financial savings, which dropped from 11.6 percent to 8 percent in the same time period.<sup>clxxxix</sup>

Regulations in India's banking sector have only worsened the problem. The country requires commercial banks to maintain 23 percent of all deposits as statutory liquidity reserves (SLR) – reserves in the form of government securities, gold or cash and held at the central bank – as well as an additional 4 percent as cash reserves (CRR).<sup>cxcc</sup> Together SLR and CRR ensure that over a quarter of all deposits are never lent out by banks for productive investment. Instead, they subsidize the Centre's fiscal deficits and earn depositors lower than market rate returns.<sup>cxci</sup> D'Souza refers India's system as a "tax on savers," a disincentive to growing savings and investment critical to long term growth in India.<sup>cxcii</sup>

**India's RBI should take steps to reduce SLR to 10 percent of all deposits, in line with reserve ratios suggested in the 2010 Basel III rules for international banking.** India's SLR has fallen considerably since the 1990s, when it averaged 35 percent of bank deposits, but it has stalled around 23 percent for much of the 2000s.<sup>cxci</sup> Continuing to lower SLR will likely be viewed positively by banks and industry leaders and disinterestedly by the bulk of the country's populace. The Centre, however, will have reason to worry, as it will need to make up revenue lost by unwinding the mandated bond-buying program or face rising costs to run budget deficits. The RBI must be careful not to shock bond markets as it implements such a policy change, and the Centre must look for smart revenue-generating sources like adopting a GST tax.

### *10.3 Productive Savings*

Gold is everywhere in India, from clinking bangles on the wrists of hip, young urban women to nose and ear piercings worn by elderly rural women in remote villages.<sup>cxci</sup> Especially during December, billboards in the country's metropolises are plastered with gold jewelry advertisements for the nuptial season. While the Centre announced new regulations in August 2013 to limit gold imports, evasion is rampant. A recent article in *The Economic Times* described how smuggling gold has become more lucrative than drugs, and not dissimilar in methodology; "From travelers laden head-to-toe in jewelry to passengers who conceal carbon-wrapped gold pieces in their bodies — in the mistaken belief that metal detectors will not be set off — Indians are smuggling in more bullion than ever."<sup>cxcv</sup>

India's gold demand is both a symptom of domestic unease about the country's economic trajectory as well as a cultural phenomenon. Indians' preference to amass large amounts of an unproductive asset, however, is hurting its economy in multiple ways. Jewelry or gold pieces are typically kept in the home and are not loaned out for investment like deposits at a bank would be, creating a missed opportunity for households to earn interest on their savings. Savings in gold also limit funds available for investment in the country. Finally, because India has very little domestic gold, imports are a significant driver of the country's persistent current account deficits.<sup>cxv</sup>

**In order to appeal to investors who prefer extremely safe, inflation-protected assets, the RBI needs to scale up inflation-linked bond offerings as well as better publicize the benefits to savings in this form.** The central bank needs to continue to roll out further variations of this product in order to appeal to consumers at different price points in the market and organize better education about the benefits to reducing savings in gold. The central bank should also try limited experiments with gold monetization schemes where consumers can deposit their gold at a bank and receive a coupon in return, essentially converting gold into fiat money. The depositor cannot be assured that he will get back the same gold that he deposits, however, making it an unpopular option for assets like gold jewelry. Encouraging productive savings and lowering the country's current account deficits are mutual goals shared by the RBI and the Centre, but these goals are not necessarily understood or supported by the nation's public.

#### 10.4 "Directed Credit"

India's central bank has a stated goal to pursue development initiatives in the country, which includes mandating that Indian banks provide credit to specific "priority sectors" such as agriculture and small-scale industries (SSIs). Currently, directed credit must make up 40 percent of all credit outlays by private and public banks, an enormous distortion in the market for loans. The object of this credit program is to increase funds available to socially desirable recipients.<sup>cxcvii</sup>

But evidence on the success of India's directed credit suggests that it fails on multiple fronts. Instead of alleviating poverty, the Centre is pumping funds into banks serving medium and large size farmers and industries and generating high default rates.<sup>cxcviii</sup>

Figure 10.2: Indian Loan Advances and Credit Intensity In Agriculture<sup>cxcix, cc</sup>

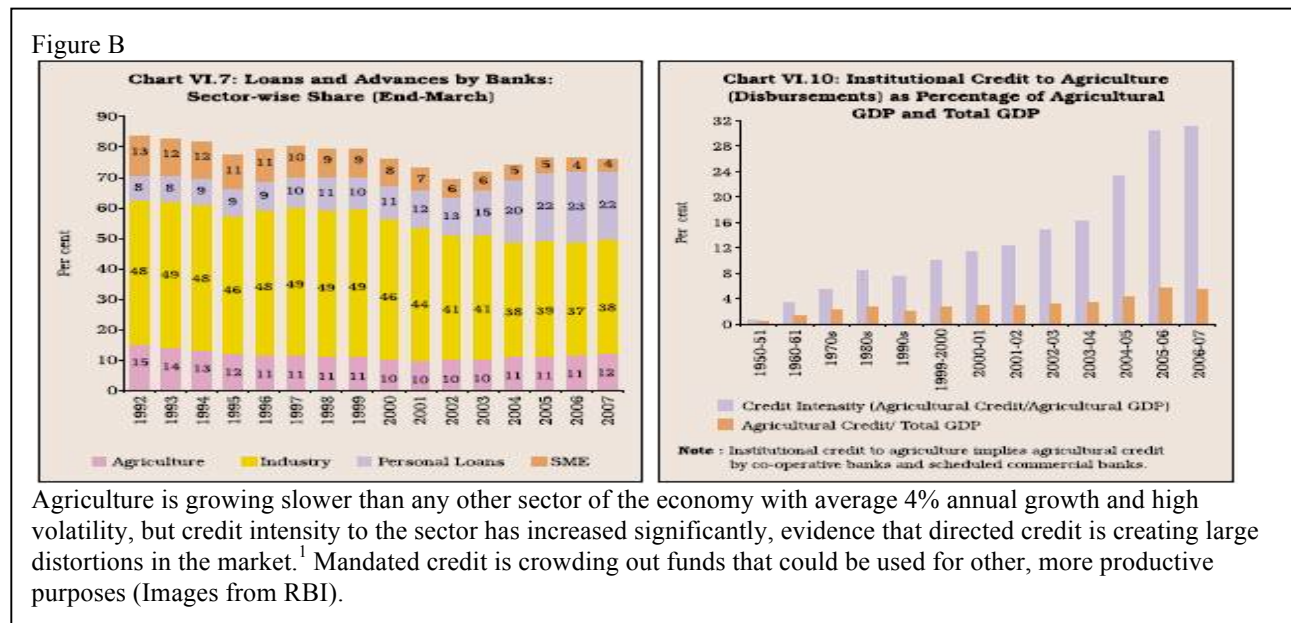
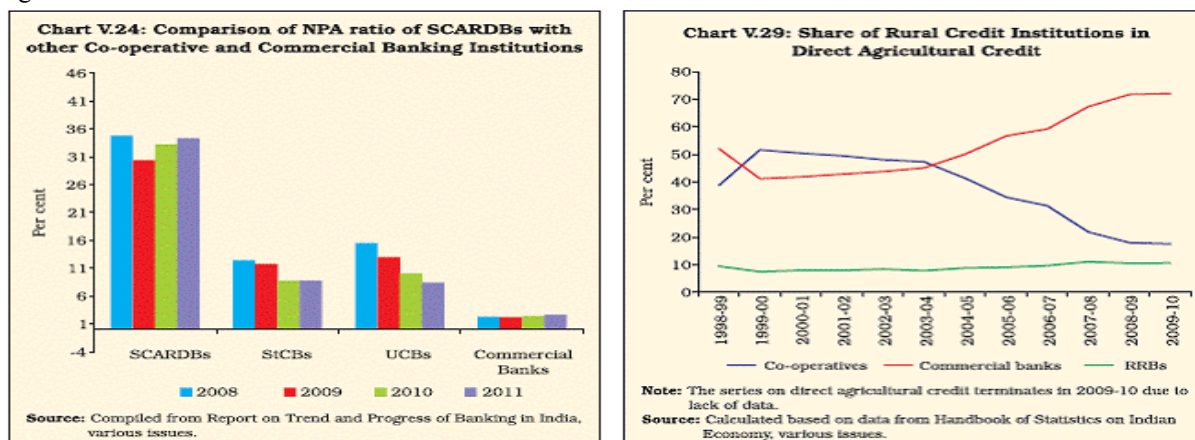


Figure 10.3: Banks' Non-Performing Assets and Lenders To Agriculture<sup>cci, ccii</sup>

Figure C



Commercial banks have exhibited the lowest ratio of non-performing assets as well as the highest disbursements to agriculture. State Cooperative Agriculture and Rural Development Banks (supported by the Centre) have had the highest ratio of non-performing assets, followed by State Cooperative banks and Urban Cooperative banks.

**India's central bank needs to unwind the 45-year old program in order to free resources for productive investment purposes.** In order to make this politically feasible, the bank should target lowering directed credit 15 percentage points by 2020 and plan to eliminate it altogether by 2040. The RBI and Centre will need a multi-faceted campaign that spreads information about the failures and abuses of directed credit, encourages entry by private lenders like mutual savings and loans organizations, and promotes small savings through other schemes such as mandating banks not charge individuals to open bank accounts and matching pension savings similar to 401K plans in the United States. The Centre can increase inclusion in the formal banking sector through other means like UID, and can promote better-targeted market-based anti-poverty programs like pay-for-work schemes such as NREGA instead.

**In conjunction, the RBI needs to scale up its programs to lower underlying barriers keeping the poor from accessing credit.** Barriers include transportation costs to travel to banks, language barriers and illiteracy, fear of written contracts and knowledge gaps about advantages to savings. The RBI already organizes bank correspondent programs and financial literacy programs, and should work with regional partners to compare best practices. The RBI can also expand the types of collateral that it accepts from low-income earners, which it most recently began to do by accepting grain as collateral in 2008.<sup>cciii</sup> Finally, the bank should spread information to private banks about the promises of group lending schemes, which have been shown in some research to increase repayment rates among low-income borrowers.<sup>cciv</sup>

**The most significant way in which the RBI can promote financial inclusion and equity is through encouraging attempts to bring mobile banking to India.** From the low cost of telecom in India, wide dispersion of mobile phones and success of African countries to embrace this technology, the RBI should quickly move forward with this political and economic win-win proposal to boost India's economy.<sup>ccv</sup> As Indians from villagers in remote communities to day laborers in urban slums seem to have at least access to mobile phones with text message capabilities, implementation should have low costs to deliver.

India has made huge improvements to its monetary and banking policy, but the RBI needs to act decisively to rein in inflation, promote savings and increase the independence of the banking sector from the political processes through lower SLR and directed credit targets. As a recent article in *The Economist* described, “confronting vested interests and ingrained thinking will be a slog but the rewards could be immense.”<sup>ccvi</sup> The RBI’s strong record as an institution and clear-sighted leadership under Rajan are positive signs. Overall India’s banks are much healthier with far fewer non-performing assets and market-based interest rates, but continued competition in the banking sector and greater liberalization from the Centre will be necessary going forward.

## 11. TRADE

*“In June 1991 India was the most autarkic non-communist country in the world.”*

— Vijay Joshi and I.M.D. Little<sup>ccx</sup>

Before India’s reforms of the 1990s, the country subscribed to unyielding Gandhian self-reliance: trade with other countries was extremely limited. Quotas on imports and high tariffs abounded. India’s policies toward imports and FDI have since opened the country to the global economy. Continuing this trend can support India’s faltering economy and set the foundation for high and persistent growth. In addition, India must not neglect trade with its neighbors, especially Pakistan.

### Recommendations:

- Continue to lower tariff rates and reduce the variation of rates
- Keep lowering barriers to FDI
- Strengthen regional trade, especially with Pakistan

### *11.1 Tariffs*

After India suffered its balance of payments crisis in 1991, the country vowed to steer away from its import-substitution model. With Singh’s reforms of the early 1990s, the top tariff rate declined from 355 percent in 1985 to 85 percent in 1993. Concurrently, India replaced quantitative restrictions on imports with tariffs and reduced the number of tariff rates.<sup>ccxi</sup> These tariff reforms allowed businesses such as Vanilla Moon, a Delhi-based shoe company, to purchase much-needed foreign raw materials and scale up operations. Since then, the top rate has continued to decline and tariff rates have continued to consolidate. As a result, India’s trade to GDP ratio increased from 15 percent to 35 percent of GDP between 1990 and 2005.<sup>ccxii</sup>

**India has made significant strides in trade reform, but it must continue to lower tariff rates and further consolidate the number of tariff rates.** Today, the average industrial tariff of 12 percent is still high by international standards<sup>ccxiii</sup> while agricultural tariffs are even higher at 30 to 40 percent.<sup>ccxiv</sup> Lowering these tariff rates would bring down domestic prices of goods and thereby raise real incomes. In this way, reducing tariffs can also help alleviate one of India’s chronic problems — inflation. The key component of food price inflation from 2008 to 2011 was milk. Reducing the tariff on powdered milk could have greatly reduced the shortage of this item.<sup>ccxv</sup> Further consolidation of tariff rates can also leave less room for corruption and rent

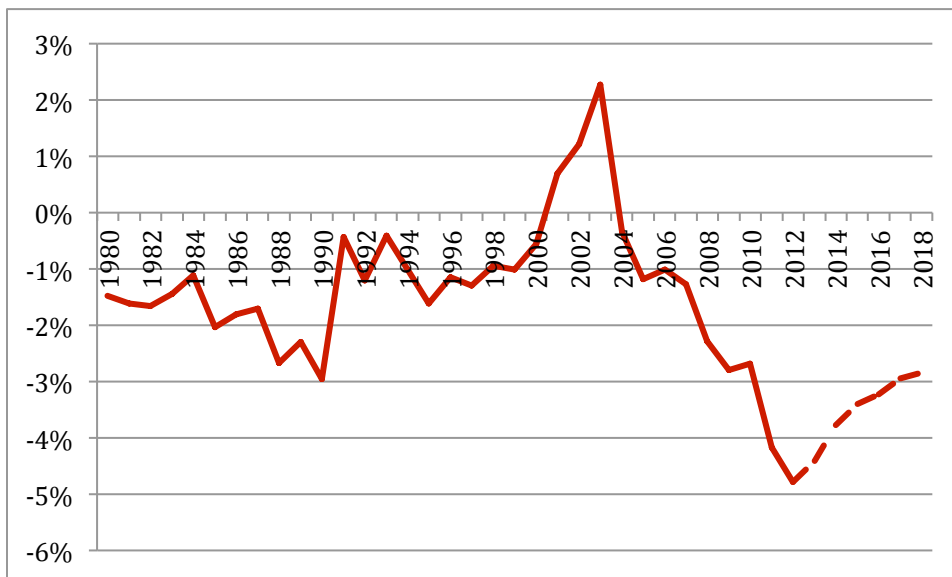
seeking.<sup>ccxvi</sup> India's high variance in tariff rates creates uncertainties for businesses, thus deterring investment.<sup>ccxvii</sup>

However, tariff reduction is not without tradeoffs, as lowering tariffs would adversely impact producers that have to compete with lower-priced imports. In the long run, increased competition and trade would ensure efficiency and direct India's scarce resources toward fields in which the country has a comparative advantage. But in the short run, reducing agricultural tariffs could be especially detrimental to the India's poor and rural segment. More than 60 percent of Indians depend on agriculture for a living.<sup>ccxviii</sup> Thus, these reforms should only be implemented after agricultural and industrial reforms have lifted productivity and shifted employment to areas that are internationally competitive.

With the budget deficit and public debt hovering around 5 percent and 70 percent of GDP, respectively, India may be reluctant to enact any reforms that would result in forgone revenues.<sup>ccxix</sup> There is no question that India's fiscal situation needs attention, but it is unclear what the net revenue impact of lower tariffs would be. After all, customs duties make up roughly 1.6 percent of GDP today — revenues that were nearly non-existent before 1991.<sup>ccxx</sup>

Finally, reducing tariffs has the potential to exacerbate India's ballooning current account deficit. Since the global financial crisis, India's current account deficit has ballooned to nearly 5 percent of GDP — even higher than the levels leading up to the 1991 balance of payments crisis.<sup>ccxxi</sup> While India's foreign exchange reserves are much more robust than they were in 1991, India's high current account deficits still threaten to further destabilize the falling rupee. With reforms in input markets such as land and labor, export growth in manufacturing and services can help close the current account gap. This is one more reason that India must continue to lower tariff rates after reforms in other sectors have revitalized India's businesses.

Figure 11.1: Current Account Balance as Percentage of GDP<sup>ccxxii</sup>



## 11.2 Foreign Direct Investment

According to the United Nations Conference on Trade & Development, foreign direct investment into India was \$27.3 billion in 2012.<sup>ccxxiii</sup> This is in stark contrast with the mere \$150 million of FDI inflows in 1991.<sup>ccxxiv</sup> Since the 1990s, India has made significant progress toward opening up to FDI. In fall 2012, India raised the FDI maximum limit in single-brand retail to 100 percent and the limit in multi-brand retail to 51 percent. It similarly raised FDI caps in aviation and power trading exchanges.<sup>ccxxv</sup> In July 2013, India decided to allow full foreign ownership of telecommunication companies. In addition, the country decided to scrap the requirement of government approval for certain levels of investment in certain sectors such as petroleum refining and single-brand retail.<sup>ccxxvi</sup>

**Although the easing up of FDI rules in retail in 2012 was heralded as a major step forward, India still needs to make it easier for foreign firms to set up shop.** In October 2013, Wal-Mart announced that it would end its retail partnership with Bharti Enterprises, a Delhi-based business conglomerate. Wal-Mart's chief executive for Asia, Scott Price, remarked that regulations requiring foreign retailers to buy 30 percent of products from local small and midsize businesses were the "critical stumbling block" to its retail endeavors. Indian retailers are not subject to these requirements.<sup>ccxxvii</sup> Evidently, barriers to FDI still inhibit foreign entrants.

There are several reasons to advocate for continued liberalization of FDI. First, foreign entry can bring foreign technologies to India and help induce competition, which together can increase efficiency in key sectors such as retail and develop India's supply chains. Second, it has the potential to expand employment and increase government tax revenues. Third, FDI inflows can help finance India's huge and growing current account deficit, which is mostly financed through portfolio investment.<sup>ccxxviii</sup> FDI tends to be more stable and long-term than portfolio investment and is therefore less likely to heighten volatility of markets and exacerbate a crisis. Lastly, FDI has the potential to improve governance and regulation. India can leverage the arrival of American firms and the US Foreign Corrupt Practices Act, which strictly prohibits bribery of foreign officials, to crack down on graft.

Overall, India has made substantial progress in the areas of FDI and tariff reform. Continuing this progress will not be politically easy, as these reforms primarily benefit Indians broadly and in indirect ways. Meanwhile, these reforms can have large and tangible adverse consequences for small segments of society. Mamata Banerjee, the chief minister of West Bengal, "makes a sport of blocking any reforms she considers bad for the poor."<sup>ccxxix</sup> In 2012, Banerjee withdrew her party's support of the UPA in response to the 2012 reforms of FDI in retail, among other Congress-backed policies. FDI reform will take time and come in small steps. To work around populist backlash, India should begin further liberalization of FDI in less consumer-facing and sensitive sectors such as infrastructure and commercial development. As other trade and industrial reforms bring India deeper into the global market, consumer awareness of global brands will likely increase and FDI reforms will become more politically feasible.

### *11.3 Regional Trade*

South Asia's trade profile is one of "inverse regionalism." In 2004, South Asia was the only developing region in the world in which regional trade was less than 5 percent of its world

trade.<sup>ccxxx</sup> Even as it has focused on entering global markets — particularly North America, the EU, and increasingly China — India has not developed strong trade relationships with its neighbors. Trade with Pakistan is meager and has shown little growth, amounting to just \$3 billion in 2011. Investment flows between the two countries are nonexistent; India did not even permit Pakistani investments until 2012.<sup>ccxxxii</sup> Both India and Pakistan have been a part of the South Asian Association for Regional Cooperation (SAARC) since its inception in 1985 and are parties to the South Asia Free Trade Agreement (SAFTA) of 2004. Nonetheless, SAFTA “remains an agreement on paper only” and the increase in trade since these dates has been abysmally low.<sup>ccxxxii</sup>

### **India must develop trade within the South Asia region, and particularly with Pakistan.**

Fortunately, trade is one aspect of the India-Pakistan conundrum that has auspicious prospects for progress. Goods such as cloth, livestock, cosmetics, jewelry, and medicine are already smuggled from India to Pakistan. Estimates for the value of these illegal exports range from \$200 million to \$10 billion.<sup>ccxxxiii</sup> Business leaders in both countries have recognized the missed gains from trade and have pushed government leaders to loosen regional trade barriers. One analyst argued that the yield of normalized trade relations between the two would result in a 405 percent increase in bilateral trade.<sup>ccxxxiv</sup> Some steps in the right direction have already been taken. In 2012, after Pakistan offered India most-favored-nation status and shifted from a positive list of allowed imports to a negative list of 1,209 items that cannot be imported from India, India promised to scale back its “sensitive list” of Pakistani imports, which attract high duties.<sup>ccxxxv</sup>

To sustain the recent progress on trade normalization, Indian policymakers should advance a bilateral economic agenda that falls within the following three parameters. First, trade negotiations should focus on liberalization in areas in which there is “high complementarity in potential good provisions.”<sup>ccxxxvi</sup> For example, India’s ferrochrome industry faces huge potential gains from securing access to Pakistan’s vast chromite endowment. Second, the central government must involve state governments in any trade-related dialogue with Pakistan. The increasing decentralization of India’s democratic politics necessitates that states are involved in discussions over normalization with Pakistan. High-level Indian delegations negotiating with Pakistan should include chief ministers from key states in the country who can generate buy-in for trade normalization efforts and establish common ground with Pakistani counterparts over key issues such as water security and agriculture.<sup>ccxxxvii</sup> Finally, because Pakistan’s armed forces need to be part of any normalization agreement, Indian policymakers should prioritize trade liberalization in industries in which its military plays a large role. Given the growing apprehension toward the economic mismanagement of the military within the Pakistani public, the military may welcome the opportunity to deliver a quick jolt to the local economy.<sup>ccxxxviii</sup>

## **12. FOREIGN AFFAIRS**

*“What keeps people apart? Their inability to get together.”*

— Richard J. Daley, Former Mayor of Chicago<sup>ccxxxix</sup>

As we departed from our Delhi hotel en route to our next meeting, the lobby was bustling. Businessmen from all over the world, speaking dozens of languages, mingled in the hotel lounge. We boarded our bus and drove along one of Delhi’s magnificent boulevards, dotted with the



grandiose office towers of prominent foreign multinationals. The world's eyes are on Delhi, and for these two weeks, so are ours. But it was not always so. Two decades ago, one would be hard pressed to find observers of India, both domestic or foreign, describing any substantive role for that country on the global stage. Today, however, India's economic rise has prompted countless foreign policy observers refer to India as a "global swing state," a set of rapidly developing countries with the capacity to radically transform the international order. India, as the world's largest democracy, has the capacity to become a leading member of the "political West," and in turn, to wield substantial influence on key issues including stability in Asia, political developments in the Middle East and the sustained expansion of globalization.<sup>ccxi</sup> To fully leverage this potential influence, Indian policymakers should focus on managing its bilateral relations with two key players: the United States and Pakistan.

### 12.1 The U.S. and India

*"Strobe Talbott, the former American diplomat, told an audience of Indian business leaders that he had learned a valuable lesson about India: Do not hyphenate it. As in Indo-Pak. (Or, in a close cousin of a hyphen, as in Chindia.) The audience smiled at his epiphany: India matters because it is India..."*

— *The New York Times*<sup>ccxli</sup>

U.S.-India relations reached a new zenith when in July 2005, U.S. President George W. Bush and Indian Prime Minister Manmohan Singh signed the historic U.S.-India Civil Nuclear Agreement, providing India with access to American support for its civilian nuclear energy program. India's economic rise accounts for only part of Washington's newfound infatuation with Delhi. The rest can be explained by China's rise, which has galvanized American efforts to consolidate relations with a strong, like-minded regional player willing to help manage Beijing's growing military and economic prominence. The strategic importance of India in America's strategic 'pivot' to Asia means that India has a powerful hand to play vis-à-vis its American partners. We argue that Indian policymakers should use this leverage to pursue closer economic ties, namely by wrapping up negotiations on the proposed Bilateral Investment Treaty (BIT).

#### Recommendations:

- Conclude BIT negotiations before 2014 elections
- Move toward sector-specific trade agreements in industries in which there is significant congruence in economic interest
- Leverage American know-how in pursuing second Green Revolution

Since its independence in 1947, India's relations with the United States have matured by leaps and bounds. Until the late nineties, a variety of intractable issues – including India's leadership in the non-aligned movement, its poor economic performance, and its pursuit of nuclear weapons – prevented the fruition of a close alliance.<sup>ccxlii</sup> But as Evan Feigenbaum argues, all this has changed: the Cold War is over, the first wave of reforms have propelled India to nearly unparalleled heights of growth, and the recent nuclear deal with the U.S. portends tens of billions of dollars in trade. Once an afterthought, India has become the object of Washington's strategic desire.

For all the talk of fundamental disagreements that both Indians and Americans claim dominate the current bilateral agenda, there is more commonality between both countries' national interests than ever before. Leaders agree on the need for robust regional counterterrorism efforts, stability in Afghanistan, managing China's military rise and intensifying the bilateral economic relationship.<sup>ccxliii</sup> Some of the specific policies within each area may be contested, but the fundamentals that encompass them are strongly shared.

For these reasons, India is in an advantageous position to pursue deeper economic relations with the United States, relations that have already helped propel India's economic ascent most notably in IT.

**We argue that India should focus on concluding existing negotiations on the Bilateral Investment Treaty (BIT), which promises billions of dollars in foreign investment for both nations.** American investors are desperate for a speedy conclusion of the current negotiations as other nations close on their own bilateral trade deals with India, including the Association of Southeast Asian Nations, Japan, South Korea and most recently, the European Union.<sup>ccxliv</sup> These recent deals provide India with the leverage to conclude an advantageous agreement with the United States. To ensure this, three specific steps should be taken.

To help advance efforts to conclude a BIT before the 2014 elections, Indian policymakers should take three specific steps. First, the government should continue to build a coalition of support by deploying nationwide public diplomacy and outreach campaigns. In India, "businesses have not been sufficiently engaged on the issue and industry groups are only now beginning to develop their positions."<sup>ccxlv</sup> Strong efforts to convince the Indian public of the benefits of a treaty could stymie the political opposition, which met efforts to allow multi-brand retail into the country. Second, India must accept "investor-state arbitration" — a provision to allow investors to initiate dispute settlement proceedings against a foreign government — as a fundamental of any investment treaty.<sup>ccxlv</sup> Such a provision is positive for India as any BIT without "a credible enforcement mechanism will deliver no benefits."<sup>ccxlvii</sup> Indeed, the principal goal of such a treaty is to increase investor confidence. Finally, India should look to recent trade deals with Japan, South Korea and the EU to inspire the creativity to overcome technical disagreements surrounding a BIT with the United States.

**Following a speedy conclusion of BIT negotiations, Indian policymakers should move toward targeted free trade agreements in specific industries.** While most analysts agree that a comprehensive free-trade agreement between India and the United States remains too ambitious, both governments can take small steps to work toward this goal. Notably, India and the United States should begin negotiations on FTAs in specific sectors that would provide clear benefits for both sides. Possible sectors include IT and chemicals, areas in which the economic relationship between the two countries is already deep.<sup>ccxlviii</sup>

**Finally, Indian policymakers should leverage American know-how in agriculture to assist in its pursuit of a second Green Revolution.** As Armitage et al. argue, "Comprehensive reform of Indian agriculture will require research into methods for increasing yields."<sup>ccxlix</sup> America's land-grant universities can play a huge role in helping generate innovative solutions for pursuing the second Green Revolution. Such collaboration could include establishing satellite campuses of

U.S. universities in India and other forms of collaboration on higher education, which will necessitate further liberalization in India's education policy.

Above all, these recommendations require substantial political and diplomatic investment if they are to bear fruit. Shared interests do not *naturally* lead to stronger alliances. But shared interests do make the U.S. and India *natural* allies.

While pursuing these recommendations would mark tremendous progress for the U.S.-India relationship, Indian policymakers should recognize the unparalleled importance of domestic economic growth in fulfilling their international ambitions. As Feigenbaum argues, "choices about economic, infrastructure, and human capital, in turn, will largely determine India's capacity for global influence and thus the potential scope of U.S.-Indian cooperation."<sup>cc1</sup>

### *12.2 India-Pakistan Relations*

*"If there were only two men in the world, how would they get on? They would help one another, harm one another, flatter one another, slander one another, fight one another, make it up; they could neither live together nor do without one another."*

— Voltaire<sup>cc1i</sup>

In the nearly 70-year history of the nuclear bomb, only once have two nuclear powers ever gone to war. That was in 1999, when India and Pakistan nearly brought South Asia to the brink of destruction. Today, the India-Pakistan border remains the only region on earth considered a "nuclear flashpoint," a region in which the outset of conventional hostilities could lead to nuclear miscalculation, and deleterious consequences for both the region and the world. It is within this context that we can establish the first of many mutual interests that compel both countries to work toward normalization. Others abound.

#### Recommendations:

- Use trade talks as a starting point for normalization between India and Pakistan
- Expand visa regimes to allow for greater person-to-person exchanges between the two countries
- Continue pursuit of Track II diplomatic efforts to promote efforts to generate creative solutions to India-Pakistan diplomatic challenges

For years, many leading foreign policy thinkers in India advocated a wait-it-out strategy toward Islamabad: allow Pakistan's faltering political and economic institutions to further weaken its ability to project power outside its borders. Thankfully, most Indian policymakers now agree that a weak Pakistan is, in fact, highly incongruous with India's national interests. A failed state in Pakistan could entail a flow of millions of refugees over India's borders, the potential for the transfer of unsecured nuclear weapons and would likely invite great power competition in the region as nations compete for influence in a post-Pakistan environment.<sup>cc1ii</sup> None of these outcomes are favorable for India.

**The alignment of economic interests in both India and Pakistan makes trade relations the obvious starting point for normalization between the two countries.** Focusing on economic

integration between India and Pakistan can also lay the groundwork for broader structural and political evolutions in the bilateral relationship. As Stephen Cohen argues in *Shooting for a Century*, expanding bilateral trade could create a domino effect, creating lobbies in both countries that make it easier to facilitate further economic ties and move on to other more difficult issues in the political and security realm. Meanwhile, as developing countries, both India and Pakistan advance complementary economic agendas at the international level. Stronger economic integration can allow both countries to support one another in such forums as the current Doha Round of the WTO. In addition to stronger trade relations, Indian policymakers should also consider two related measures to further abet the process of economic integration, and in turn, normalization.

**The Centre should gradually expand visa regimes with Pakistan.** Current visa regulations exclude virtually all Indians and Pakistanis barring the elderly and businessmen. An obvious area for expansion is in student visas for those studying at recognized Pakistani and Indian universities.<sup>ccliii</sup> Such expansion would pose minimal security risks to both countries and provide useful diplomatic capital to continue normalization efforts.

**Second, Indian policymakers should continue pursuing Track II diplomacy with Pakistan.** Track II diplomacy, encompassing non-official person-to-person engagements between two countries, constitutes a powerful tool for facilitating improved communication between Pakistan and India. These efforts can complement high-level diplomacy between political leaders by helping generate understanding between publics in both countries, which provide leaders with the political will to pursue more ambitious normalization policies. They also serve as forums for generating creative ideas (particularly on highly technical issues) to resolve areas of disagreement, when appropriately timed.<sup>ccliv</sup>

India's ascent to global power status was long restrained by two factors – its brand of socialism, which required India to insulate itself from the global community, and its conflict with Pakistan, which forced India to focus on regional security and alienated many potential partners. Today, India has rejected its socialist past. In turn, a normalized India-Pakistan relationship could radically enhance India's ability to play an even larger role on the global stage.

### 13. CONCLUSION

India's recent economic growth has been astonishing, but this widespread progress cannot become an excuse for complacency in policy. Though it has weathered the global financial crisis better than most, the country's problems are manifold: the government must learn to spend and raise revenue with greater efficiency; invest in infrastructure so that markets can truly function; fix a broken education system; remove rigidity from labor markets; work to crush corruption at all levels; revise the social safety net to make welfare affordable; engage more fully with public health schemes; facilitate agricultural productivity; combat inflation and widen credit access; keep the economy open to trade and foreign investment; and look outward for mutually beneficial partnerships. If this reads like a laundry list, that is because India today is like the college student who has been letting his dirty clothes pile up all semester. The big difference is that while the college student can probably foist his laundry load onto his mother when he goes

home on break, India is on her own. Only smart policy and tough political compromises can bail India out of its current mess and help the country build for the future.

The path ahead for India should take up the mantra of economic reform 2.0. Though the sweeping changes enacted in the early 1990s were effective and are still reverberating throughout the economy, the time has come for a fresh round of government action that focuses on growing the pie rather than just redistributing it. India's vast poor population will undoubtedly continue to require assistance, but the government must make more room for wealth creation if it wants to dole out greater resources to those that the market has left behind. This means stepping back from enterprising roles in nonstrategic industries like banking, waiving regulations that obstruct turnover in the labor market, and encouraging the entrance of foreign firms and capital, among other things. India can still grow at 7 or 8 percent annually if the government would merely get out of the economy's way.

With the 2014 elections looming, what average Indians seem to want, now more so than ever, is a strong leader. This would ideally be someone with the political acumen to lead a coalition and the policy background to enact the right reforms, but in the short term, India may have to make do with figures like Modi or Rahul Gandhi. Given the fractious nature of Indian politics, the changes we advocate will be neither as quick nor as large as we might hope. Yet if politicians must know one thing, it is that the clock will only keep ticking on India's demographic dividend, and they hold the keys to unlocking it.

This memo has outlined both the challenges that India faces and the host of actionable solutions that are on the table. Our recommendations give priority to policies that possess clear political economy, from the introduction of a national Goods and Services Tax to emphasis on community-based models of healthcare. We saw firsthand that there is almost boundless will, whether in the business community or among rural villagers, to see India fulfill its incredible potential. The looming question is whether politicians, bureaucrats, and voters can find their way together.

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