UNPRODUCTIVE SPENDING

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The government needs to give greater attention to, and provide larger resources for, primary education and primary health. With regard to public funded schools and difference in the quality of healthcare, the Global Competitiveness Report 2000 places India at the 54th and 57th ranks respectively. In the sphere of raising the literacy levels and providing greater access to basic health services, the government is required to play an enlarged role. Much higher levels of literacy could be achieved through creative mobilization of new information technology approaches, better school attendance, and other policies, all with a clear focus on inclusion of girls and other traditionally disadvantaged groups. Evidence from across the world suggests that high levels of literacy have helped raise growth rates and reduced fertility rates over time. Aggressive public health campaigns are required to address major infectious diseases (pneumonia, diarrhoeal diseases, and malaria) and the incipient AIDS epidemic, which now threatens India with tens of millions of cases unless properly addressed.

Rather than providing across-the-board subsidies on food prices which tend to get dissipated in corruption, administrative costs, and lower food prices for the wealthy, in part these programmes could be targeted at school children, by guaranteeing one nutritious meal a day for every school child in every school throughout the country. Schemes such as mid-day meals for school children should be expanded. However, the scheme currently being implemented does not envisage any re-targeting of subsidies as we suggest. Not only would this help to target the aid to needy households, but would also provide a vital economic incentive for poor parents to send their children to school.

Expenditure on educating girls is perhaps one of the most productive expenditures. It helps bring down both fertility and infant mortality rates. The impact on the former is seen to be significant and similar in most Indian states. Besides, female literacy would also be instrumental in greater female labour force participation and raising the status of women in the society. The Centre needs to provide greatly enhanced transfer payments to the states to help support primary health and education. This may be done on a matching-grant basis, so that state governments are given an incentive to increase their own effort in expenditures directed at these areas. In addition, some part of the privatization revenues could also be earmarked for increased expenditures on primary health and education. Briefly put, a reorientation is required in the government's social policy — high priority to human resource development.

India's growth strategy should focus heavily on exports. Export-led growth in services is one of the most interesting developments; and in manufactures, the more traditional textiles and apparel, in electronics and other labour-intensive operations, it remains an area where India could do a lot more than in the past.
India's export environment suffers from several institutional weaknesses. India's labour laws make it very costly to fire workers in enterprises of more than 100 workers (on hiring and firing practices, India ranks 53rd out of 58 countries). The result is that formal-sector firms (those that are registered and that pay their taxes) are loath to take on new employment, and the vast majority of India's employment is informal, in small, tax-evading, inefficient enterprises. India continues to restrict the entry of medium or large firms, or the growth of small firms into medium or large firms, in several areas of potential comparative advantage. Thus toys, shoes and leather products continue to be reserved, to a varying extent, for small-scale producers. The recent decision to remove garments from the list of products reserved for the small-scale sector is a very welcome step.

Such restrictions virtually assure China's dominance in these sectors compared with India. India's tax and tariff structures similarly remain anti-export biased. India's high overall tariff rates, especially tariffs on intermediate products that are used by exporters, impose a heavy indirect tax on export competitiveness. Furthermore, the Union budget for 1998-99 had imposed an additional non-modvatable levy of 8 per cent on imports, which was later reduced to 4 percent. There are duty drawback systems to reduce this anti-export bias, but such programmes are administratively burdensome and often too costly to use effectively. Finally, the regulatory attitude to foreign direct investors, who could be the fuel for India's export drive, continues to be ambivalent. The government promotes FDI on the one hand, but then maintains regulations against full foreign ownership, or insists on lengthy approval processes, on the other hand. The development of industrial parks for exports should be enhanced. Private developers need the freedom to acquire urban and semi-urban land to develop privately financed infrastructure in support of exports. The government must take urgent measures to reduce export costs, including private-sector provision of port services, zero tariff ratings on capital and intermediate goods imports used for export based on an effective duty exemption scheme and enhanced export-oriented infrastructure.

The reservation of labour-intensive sectors to small-scale enterprises should be scrapped. This will give India a chance to provide stiff international competition in labour-intensive exports to countries such as China. The government should encourage inward investment in export-oriented sectors, allowing 100 percent foreign ownership without administrative interference, and with the provision of generous tax holidays as necessary to attract internationally mobile capital from other locations.

China has achieved a lot more in manufactured export production than India and for no particular reason. India has the resource base, it has the entrepreneurship, access to the sea coast, a vast labour force; it has everything that coastal China has had except the interest of the government, which neglected this for a long time and which even today under-emphasizes the role of industrial facilities, infrastructure, of land area and effective port facilities needed to be able to compete with China in this area. But it is, we believe, a place where one could find tens of millions of jobs over the next few years in real, significant foreign exchange earning private-sector activity.
India's growing capacity in service-sector exports based on information technology must be mentioned. Here, as in labour-intensive exports, Indian government policy could do much more to spur export growth. On the plus side has been the government's long-term commitment to the Indian Institutes of Technology. More recently has been the government's support for software technology parks in Chennai, Bangalore, Pune and other cities, which are the IT-industry equivalent of the export processing zones in manufacturing industries.

However, there are serious negatives. India's telephone density is abysmally low, at around 1.3 per hundred in 1995, compared with around 62.6 per hundred in the United States. Charges for domestic long distance and international telephone calls in India are among the highest in the world, largely due to lack of competition.

India is becoming one of the most important players of the world in the IT sector and it is the fastest growing foreign exchange earner for India. The government could do more for this industry, through liberalization of telecom, allowing for lower priced telecommunication services, by allowing new entry of major international players in telecom who would lay down a fibre-optic network in India and increase the bandwidth available for Indian business.

Some of the key areas requiring further reform to attain and sustain higher rates of gross domestic product growth are: greater openness of the economy; dereservation of items from the reservation list of the small-scale sector; deregulation of India's private sector, including liberalization of labour laws and exit policies; demonopolization of infrastructure; and decentralization of economic policy-making. Fiscal deficit remains high. Ominously, the ratio of internal public debt to GDP has continued to rise, and the debt service burden has risen even faster because of rising interest rates.

Quite evidently, expenditure reform has lagged behind tax reform. Hence, the expenditure-GDP ratio needs to be brought down considerably. The composition of government spending is skewed towards unproductive current expenditures and away from basic infrastructure as well as vitally needed spending on human resource development, especially in the areas of primary health and education.

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