



India: Improving the Development Effectiveness of Assistance

Because more than a quarter of the world's poor—300 million—live in India, its economic and social performance are critical to achieving the Millennium Development Goal of halving world poverty by 2015. India, which has become more open to the world economy and more receptive to external policy advice than in the past, has built strong foundations for development, but a large, unfinished agenda of federal and state reform remains a substantial challenge.

India was one of the World Bank's founding members and remains one of its largest and most influential borrowers. The Bank, India's largest source of external long-term capital, has provided important nonlending assistance and financed a sizable share of India's public investment. Cumulative lending from 1950 to June 2000 totaled \$53.8 billion for 412 projects, equally split between the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD).

Bank commitments to India averaged about \$1.6 billion annually during FY1997–00, with a 54–46 percent IDA/IBRD blend. In the absence of sanctions and with satisfactory country policy performance, however, IBRD lending in recent years would have been substantially higher and the blend would have been harder.

In a recent assessment of the development effectiveness of Bank assistance to India during the 1990s, OED found that the Bank had a positive impact, but could have done better. With a greater focus on rural poverty reduction, state reforms, and participation in recent years, the Bank has moved in the right direction.

India's Development Record

During the 1970s, when the average annual per capita income growth rate was below 1 percent, the proportion of the Indian population living in poverty fluctuated around 50 percent. The higher per capita growth of the 1980s, estimated at 3.5 percent, reduced poverty to around 34 percent, but this rate proved unsustainable, as it relied on excessive public spending and financing of the fiscal deficit at commercial rates. The 1990s were characterized by the tension between India's substantial economic and



social achievements and its closed trade and investment regimes, fiscal imbalances, and unwieldy public sector. Although India has seen a rise in life expectancy, a reduction in infant mortality, moderated population growth, and increased primary school enrollment, it has trailed China and other low-income countries in such key social indicators.

A balance of payments crisis, the demise of the Soviet Union and its development model, and China's example of reform and economic success created an opportunity for reformers to take over policymaking in 1991 and to deregulate trade and investment. The new approach aimed to boost international competitiveness and give the private sector a greater role in India's development by improving the business and tax environment for domestic and foreign investors, opening infrastructure to private participation, reforming public enterprises and the financial sector, and reducing price controls. The government also expanded its poverty alleviation program.

Economic growth rebounded quickly and proved resilient, even during the East Asian crisis in 1997. Social indicators also improved. But India failed to sustain fiscal reform and to extend structural reform to other areas. And with low growth in the poorer northern and eastern states and no effective strategy for agricultural and rural development, India made little progress in reducing rural poverty.

A few states initiated substantial policy and institutional changes in the second half of the decade, but India still has a large unfinished reform agenda at both the state and federal levels to reduce the fiscal deficit, streamline the public bureaucracy, broaden the tax base and improve tax administration, strengthen governance, relax overly protective labor laws, reform archaic bankruptcy and liquidation laws, correct the still substantial anti-export bias, reform agriculture, enforce environmental protection, improve social services, and reduce the exclusion of castes and women from the benefits of economic development.

India and the Bank: An Evolving Relationship

After a harmonious start in the 1950s, the Bank's relationship with India was marred by India's resentment of what was perceived as excessive Bank interference and the Bank's alternating activism and reticence in advocating policy change. By the end of the 1970s, the positions of the two parties began to converge. The Bank had adopted the essence of India's outlook on development priorities, and India had started to cut its tangle of red tape.

Throughout the 1980s, the Bank was more concerned with the transfer of resources than with whether those resources were put to effective use. Despite widespread recognition that India needed to adopt a new model of economic management, Bank management did not address India's disappointing policy record for fear of

Box 1: Best Practice Economic Work: Linking Analysis with Policy Dialogue

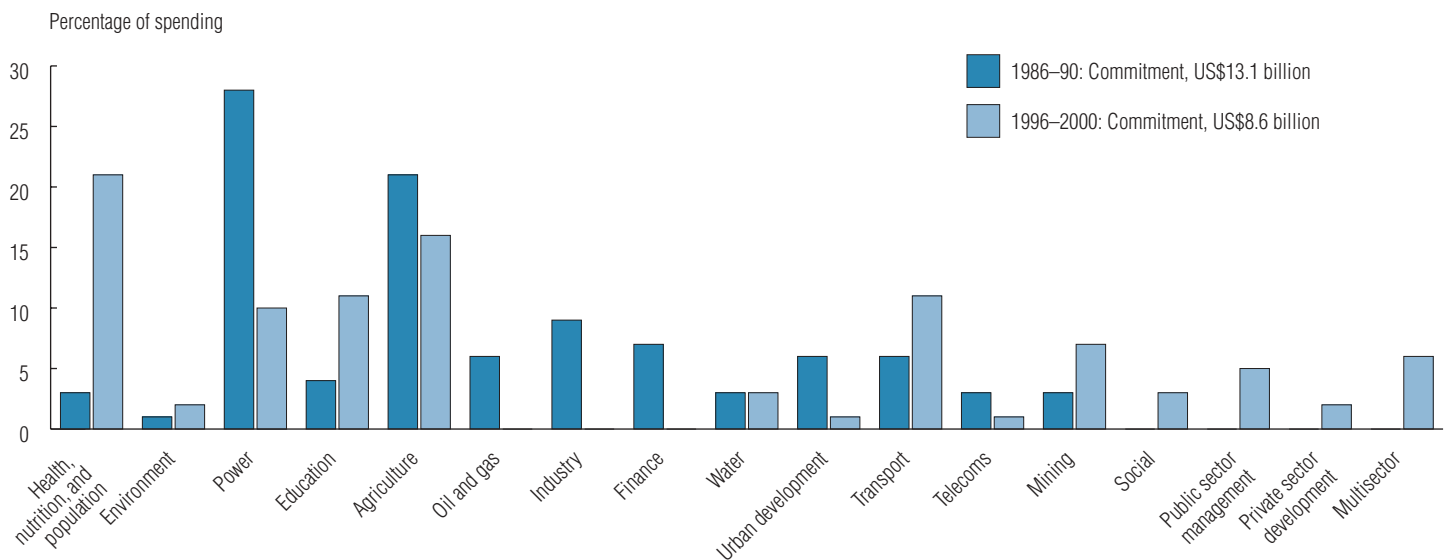
A Quality Assurance Group (QAG) review panel cited the report *Uttar Pradesh: From Fiscal Crisis to Renewed Growth* (World Bank 1998) as best practice (for relevance, internal quality, presentation, and likely impact) for a number of reasons:

- The state government initiated the study request with no prodding from Bank staff.
- The Bank assembled a high-caliber team with an appropriate skill mix.
- Bank staff and state officials undertook the study jointly, as equal partners.
- Co-management of tasks was useful in interactions with the client in Delhi and the sector specialists in Washington.
- The country director provided strong leadership and support in the dialogue with the client, adequately resourced the task, and steered the report internally.
- The study's context, objectives, and scope were clear in the minds of Bank management and task team leaders and were shared by the state officials.
- The report integrated sector knowledge and perspective into the macroeconomic and fiscal framework consistently and coherently, yet tailored them to the state's circumstances.
- The recommendations were tested for political feasibility by involving politicians.
- The strategy for report dissemination respected political sensitivities, but also ensured outreach beyond bureaucratic circles. The state published and circulated the recommendations in a suitable fashion, which muted opposition to the recommendations "as being pushed by the Bank."

jeopardizing a strong lending relationship with a sensitive client. Often, Bank-supported projects were inconsistent with its economic and sector analyses and advice. For example, the Bank continued to lend to public sector enterprises making steel, cement, and fertilizer; to unsound rural credit institutions; and to inefficient state electricity boards that did not charge for the power they produced, and hence contributed to serious state financial problems (see figure 1 for sectoral lending trends).

The Bank's Assistance in the 1990s

Against the backdrop of a new government's commitment to structural adjustment, Bank assistance became markedly more relevant during the macroeconomic crisis of 1990–91. Changing the mindset of the principal counterparts in India's core ministries was no longer the issue. Instead, the challenge was to help the newly elected, reform-minded

Figure 1: Net Lending Commitments by Sector, 1986–90 and 1996–2000

Source: Bank data.

government implement its programs, a challenge the Bank substantially met.

The Bank provided strong support for the reforms of the early 1990s, beginning with three adjustment loans. It expanded assistance to the social sectors and increased its efforts to improve participation. Where sector policy and development results had been unsatisfactory, it reduced lending (to virtually zero in the power sector) and embarked on comprehensive sector work (for example, in irrigation and rural development). It did not pay enough attention, however, to inadequate agricultural incentives, the landless rural poor, rain-fed agriculture, and the structural constraints on rural development. It also missed opportunities to reform safety nets and better target projects and public spending to women and the poor.

In the second half of the decade, and especially after 1997, the Bank paid more attention to poverty reduction. After the mid-1990s, the Bank also focused assistance on states committed to reform (see box 1 for best practice analytical services). It paid more attention to sector reform, offered to help establish a framework conducive to efficient private investment in infrastructure, and offered support for restructuring social programs and providing poor people with the skills needed to participate in a more competitive economy. But insufficient emphasis was given to fiscal management, public sector and judicial reform, gender equity, and the improvement of agricultural policies and rural development.

The Outcome of Bank Assistance

Although the Bank neglected rural poverty in the first half of the 1990s, it provided timely support to structural

adjustment for the resumption of economic growth, which was the most pressing priority. It also showed increased concern for the adequacy of the policy and institutional framework in the energy sector and gave considerable attention to human development. The relevance of Bank assistance continued to be substantial in the second half of the 1990s, as concern for the adequacy of the policy and institutional framework expanded to other sectors (particularly water resources) and to the states, and as a consequence of the Bank's in-depth study of India's rural development strategy and its heightened attention in the lending program to social development and rural poverty. Relevance has continued to improve in the past three years, as the Bank has recognized the importance and urgency of comprehensive fiscal adjustment, sharpened and operationalized its state focus, and intensified its decentralized and participatory interventions.

The achievements of the Bank's strategic objectives in the 1990s are undeniable. Creditworthiness, stabilization, and faster growth on the heels of the fiscal and structural reforms of the early 1990s were already in hand by the mid-1990s. Some progress has also been made in more rational pricing and institutions for power and, to a limited extent, water. Social indicators have continued to improve. Urban poverty has declined. With the support of the Bank and other external partners, India has come to rely more on markets and the private sector. From a closed and controlled economy, India has indeed moved markedly toward integration in the global economy.

Nonetheless, excellent results of Bank assistance in power and good results in increasing competition,

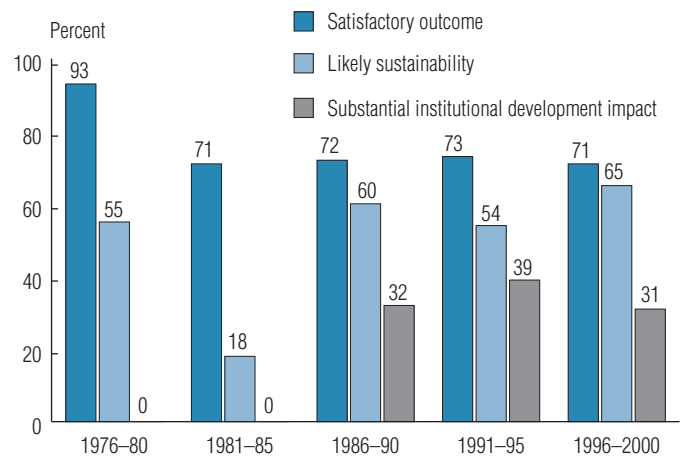
openness, and the role of the private sector in health and in education must be balanced against modest impacts in rural and urban development, financial sector development, public sector management, environmental protection, and gender; the limited outreach of its high-quality analytical services; and the mediocre performance of completed projects (see figure 2). Moreover, macroeconomic stability has been at risk since 1997 because of the fiscal deficit. Economic growth declined to between 5 and 6 percent beginning in 1997, partly as a result of the slowdown in the pace of structural reform, and partly because of the ripples in Indian export competitiveness brought about by the East Asia crisis. Poverty reduction has been limited, with high levels of poverty in rural areas associated with inadequate social and infrastructural services. A large reform agenda remains, a decade after India broke away from the old development model.

The Bank's assistance strategy became substantially more relevant after 1997 through a sharper focus on poverty reduction, a more selective approach to state assistance, and greater attention to institutions and governance—but it is too early to gauge the efficacy of these recent initiatives, as the sanctions imposed in the wake of nuclear testing undermined the implementation of key aspects of the assistance strategy. In particular, they blurred the linkage between the overall volume of lending and the country's macro and sectoral performance, infrastructure reforms, and the quality of its public investment. Thus, OED judged the efficacy of Bank assistance as modest.

On balance, in light of *substantial* relevance but only *modest* efficacy, OED rated the overall outcome of Bank assistance for the past decade as moderately satisfactory. The institutional development impact achieved by past Bank assistance was also assessed as modest. The higher relevance and promising steps taken following the strategic shift in Bank assistance of 1997, including the attention given to governance issues at the state level; the heightened linkage of lending to overall policy and institutional performance; and the mainstreaming of participation in project design, implementation, and monitoring promise better results ahead.

Today there is a broader appreciation in the country of the need for continuing reforms and the fruits of increased interstate competition for private investment and for economic and social progress (see box 2). But the economy remains vulnerable to macroeconomic shocks, which may cause reversal of structural reforms. Moreover, the economy's ability to sustain investment and current growth rates and to further reduce poverty is threatened by the continuing large fiscal imbalances and new military spending pressures, environmental damage, populist approaches to subsidies and trade, and poor governance. Hence, the sustainability of the benefits from past and ongoing Bank assistance remains uncertain.

Figure 2: OED Project Evaluation Ratings by Commitment, FY76–00



Note: Of the 40 projects evaluated by OED for FY76–80 exit, only 2 were rated for institutional development impact. Of the 44 projects evaluated for FY81–85, only 12 were rated for institutional development impact.

Source: OED database, December 2000.

Next Steps

India has built strong foundations for development. As it has become more open to the world economy, the country has also become more receptive to external contributions to its development policies. The Bank's capacity and credibility remain high and its new emphasis on knowledge transfer is welcome in India. Resource transfer, however, remains critical to the Bank's capacity to engage the Indian authorities in a dialogue about policy and institutional reforms and to influence their design and implementation. In such an environment, the comparative advantage of the Bank lies in the combination of money and knowledge transfer—that is, policy and technical analyses and advice—targeted to high-impact development issues.

The Bank's main challenge is to support far-reaching state and central government reforms with policy-based sector and program loans and strong, widely disseminated economic and sector work. OED endorsed the five pillars (as well as the lending triggers) of the 1997 Country Assistance Strategy and recommended their full application:

- Support for policy reform in key areas, including power, rural development, urban management, and urban water supply and sanitation
- More focus on poverty alleviation, including a large social lending program and new initiatives for community participation and demand-driven small investments in the poorest districts
- Greater priority to the social and environmental impacts of Bank operations

Box 2: Stakeholder Response

The Country Assistance Evaluation (CAE) team conducted field work in April/May 1999 and extensive consultations a year later in New Delhi. These included one synthesis and ten sectoral workshops with stakeholders from NGOs, academia, state and central governments, and parastatals, and with the India-based CAE advisers. The comments clustered around the following issues:

- *Focus on Reforming States.* Concentration of assistance on states with sound economic and social reform programs was widely supported. But some participants asked if this approach is unfair to the poor, many of whom reside in non-reforming states, and many criticized the lack of transparency regarding state eligibility criteria and emphasized the need for engagement with non-reforming states through policy dialogue, analytical work, and lending for “islands of excellence.” CAE advisers stressed improved fiscal discipline, whether at the state or central government level, as a precondition for Bank lending assistance.
- *Infrastructure versus Social Sectors.* Most participants agreed with the current balance of Bank lending (with equal weight to core infrastructure, social, and rural sectors). Some attendees, however, argued that the Bank should have stayed with core infrastructure projects (such as power sector development) because of its comparative advantage, rather than expanding lending in the “softer” areas of human and social development. Others preferred a focus on the 125 poorest districts and on health, education, and other social services.
- *Rural Development and Poverty.* While there was strong overall support for the CAE recommendation to strengthen the focus on rural development and poverty, some officials disagreed with the CAE faulting the Bank for not addressing policy and institutional constraints for rural development and agricultural marketing until the late 1990s. These officials also suggested that published poverty data painted a misleading picture and did not reflect current—but unpublished—data suggesting a decline in rural poverty.
- *Development Impact.* Many acknowledged the positive impact of the Bank’s advisory and analytical work on policy discussions in India, especially when focused on the Bank’s international experience, although its dissemination to a broader audience was thought inadequate. Some argued that Bank analysis on trade policy in the late 1980s was useful in technical implementation, but discounted its influence on the government’s path-breaking policy decisions in the area in the early 1990s. CAE advisers stressed that Bank analysis had supported the policy change, rather than causing it, and that any effort at the latter would have been futile—and possibly counterproductive. All concurred that project monitoring and evaluation had been weak, rendering poverty-reduction impact difficult to evaluate.
- *Bank Processes.* While NGO representatives applauded Bank policies for the environment and resettlement, some officials found that Bank-imposed safeguards on a number of projects were overbearing and blindly applied. Officials and CAE advisers also criticized the Bank’s “zeal for participation,” which undermines elected panchayat leaders and engenders a reluctance to borrow from the Bank for energy-related and road construction projects. The long lead times required for project preparation and appraisal were also criticized.

Source: In-country consultations, March-April, 2000.

- Development of the private sector, including the financial sector
- A concentration of assistance on states and programs strongly committed to reform.

The Bank should link overall lending volumes to the central government's fiscal discipline as well as to progress in structural reforms in agriculture and in implementation of an effective rural development strategy—two areas crucial for reducing rural poverty. Similarly, sectoral lending volumes should be linked to agreements on sector-specific policies and institutional frameworks. New lending should be concentrated in reforming states in which the state government has agreed to an assistance strategy, but the Bank should continue a strong policy dialogue with the central government and should support analyses of state finances, policies, and institutions in non-reforming states.

Bank assistance has become more pro-poor in recent years, but the Bank should make greater efforts to monitor systematically the impacts of Bank-assisted projects and programs on poverty and gender and to mainstream gender issues beyond the social sectors. It should also help government agencies do the same for their spending programs. To make external assistance more effective and Bank programs more selective, the Bank should strengthen aid coordination in country assistance strategies and in critical sector strategies where consultations among donor and development agencies have been lacking (for example, agriculture and rural development).

Box 3: Management Response

Bank management questioned the feasibility both of the Bank of carrying out a comprehensive public expenditure review (as recommended by the CAE) and of OED managing a balanced evaluation of assistance for a country as large and complex as India. It stressed that its program included some of the poorest and most populous states (Uttar Pradesh) and that other “focus states” also had large pockets of poverty. It nonetheless acknowledged the need to increase the focus of its assistance on rural development and poverty. Management added that the CAS and CAE teams had worked in consultation, and the new CAS incorporated the lessons of the CAE.

Box 4: CODE Response

The CODE Subcommittee welcomed this comprehensive study, noting that it was particularly pleased with the broad consultations carried out during its preparation. The members stated that they would like to see the chapter outlining feedback from the government and civil society become a regular CAE feature. The Subcommittee shared the concern with the lack of progress in addressing rural poverty and implementing a rural and agricultural strategy, weak donor coordination, and poor dissemination of economic and sector work (ESW). Members also agreed with the approach of assisting poor performers with ESW and Technical Assistance programs, but supported the recent shifts in the Bank's program in favor of good performers and selectivity in Bank interventions based on receptivity to reform. The Chair, representing India, noted that the government supported the state-focused approach, but disagreed with concentrating Bank social sector lending on focus states alone and with linkage of lending to reform in agricultural and rural development.



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