

Lecture
Day 4 Session II
FINANCING FOR HUMAN DEVELOPMENT

Time – Two Hours

Lecture- 1.5 hours

Exercises- 30 minutes

Learning Outcomes

Knowledge acquired through this module will allow the participants to

- Discuss the fiscal constraints for financing for development in an Indian context
- Define the ratios to analyse the public spending
- Discuss the various sources for mobilizing resources

Financing for Development in an Indian Context*

The decade of the 1990s has been a watershed in Indian development in many ways. The initiation of economic reforms and the onset of the process of globalization have led to far reaching changes in the economy. This has had repercussions on the relationship between the Centre and the States as well. Though economic reforms were initially implemented at the level of the Union government, measures to restructure the fiscal system such as reduction in tax rates in which the State governments had a substantial share, the pruning down of the grant component in central assistance to states and the consequent increase in reliance on market borrowings, the hike in the rate of interest at which the state governments borrow funds from the Centre and the general upward trend, till recently, in interest rates in the financial markets have had their cascading effect on State government finances. The recommendations of the Fifth Pay Commission, and the substantial hike in salaries of government employees that it entailed, added to the woes of the State governments.

* This section has been taken from a publication titled '*Financing Human Development During Fiscal Stringency: Strategies And Options For Indian States*' by Dr.K.Seeta Prabhu
<http://goa.undp.org.in/resources/seeta%20Prabhu.pdf>

The cumulative effect of the above measures has been that State government resources have been under considerable stress during the 1990s. This in turn necessitated the State governments to initiate reforms, particularly since they have been facing rising expectations from the people with respect to better governance and ensuring a minimum quality of life. The developmental agenda has become increasingly important both as an end in itself and on political grounds for demonstrating that the government is progressive and responsive to people's aspirations.

An additional dimension is the importance that decentralised governance has acquired as a means of deepening democracy. In India, the impetus that decentralization received through the 73rd and 74th Constitutional amendments, particularly the one-third representation given to women has been widely commended (UNDP, 2002). The rising strength of Panchayati Raj Institutions (PRIs), and the attempt to reverse the traditional 'top-down' planning to 'bottom up' planning (at least in some States like Kerala and Madhya Pradesh) has meant that development priorities are decided by the people and fulfilling this agenda becomes the responsibility of the PRIs. Since as many as 29 functions have been devolved to the local bodies, the finances for their implementation assume significance. Thus, the need for devolution of resources from the Centre to the States is extended further to meet the requirements of the local bodies which now have an impressive array of functions which they are expected to implement. However, while the institutions to ensure transfer of resources from the Centre to the States are well established, a similar institutional set-up to ensure transfer of resources from the State government to the local bodies which was visualised through the setting up of State Finance Commissions has yet to gather strength.

The issue of financing assumes importance also from the global context where there is realization among the developed countries that increasing polarization between the haves and the have nots is a 'preeminent moral and humanitarian challenge' of our age (Zedillo Report, 2001) and led to the adoption of the Millennium Declaration in 2000 which committed governments to work towards commonly agreed goals, known as the Millennium Development Goals (MDGs).

As a follow-up to the Millennium Summit, the Conference on Financing for Development, held in Monterrey in March, 2002, highlighted resource mobilization strategies and options available to

developing countries as well as the responsibilities of the developed countries in this regard⁵. Chief among the options discussed were domestic resource mobilization, private capital flows and international development cooperation. With the international debate also focusing on such issues, the impetus that national planning received has been significant. The Planning Commission, Government of India, for instance, commented extensively on the performance of social sectors in the Mid-Term Review of the Ninth Plan and documented in detail the performance of various States in this respect in the first National Human Development Report (Planning Commission, 2001). The Approach to the Tenth Plan follows up on some of the recommendations made in these documents and accords high priority to Human and Social Development with several initiatives being suggested for improving social attainments⁶. In a federal polity like India, the realization of national and international commitments rests to a large extent on the initiatives and strategies adopted in States. Additionally, many of the subjects that constitute social sectors are included in the State list according to the division of responsibilities between the Union government and the States in the Indian Constitution. It is with this in view that the Tenth Plan document for the first time sets out monitorable targets for the States.

The challenge of meeting the development goals is indeed daunting as the State governments are faced with an acute fiscal crunch in recent years. Restructuring state finances is a long pending imperative that has been harped upon by several official committees. However, the goals of such restructuring have not been as widely or clearly articulated. Achieving fiscal balance is a laudable objective, but it cannot be a goal in itself, particularly in a country with a huge backlog in terms of social sector attainments. We suggest that one of the main goals of such restructuring should be to enable State governments to regain fiscal health that in turn equips them to allocate the resources required for enhancing human development attainments.

Our focus is on human development for two reasons. The first is that the status of human development needs substantial improvement if the goals of Education for All (adopted in the National Policy on Education in 1986 and reiterated in the revised policy in 1992), and the goal of Health for All (adopted in the National Health Policy of 1983) which were to be achieved by 1990, continue to be elusive. In fact, in the case of education, the Sarva Siksha Abhiyan (Programme for Universal Elementary Education) articulated in November 2000 has set as its goal the provision of elementary education to all children in the ages of 6-14 by the year 2010. In the case of health, the National Policy on Health announced in 2000, has reiterated the importance of achieving several ambitious targets pertaining to infant and maternal mortality

within a time bound manner by the year 2010. In the same spirit, the Tenth Five Year Plan accorded prime importance to Human and Social development and set out monitorable targets in social sectors for the States to achieve by the year 2007 and 2012. The increasing emphasis on human development and human development reporting across states⁷ also implies that State governments are required to take up more seriously the responsibility of ensuring equitable access and provision of social services to the disadvantaged sections of the population.

The second reason for focusing on social sectors is that the process of economic reforms adopted by several State Governments in the recent past could release resources as the government withdraws from sectors in which it is no longer required to be present and begin to focus on social sectors which are now accepted to be a high priority for State intervention. This provides an opportunity to adopt innovative strategies for financing of social sectors now than in the past.

As the State Human Development Reports (SHDRs) have shown, the achievement of ambitious targets pertaining to social indicators requires a two-pronged strategy of improving the functioning of delivery systems so that the intended benefits of government spending do reach the people for whom they are meant, *as well as considerably enhancing the levels of spending for social sectors*. For example, the Maharashtra HDR (Government of Maharashtra, 2002) highlighted the fact that there was a decline in the utilisation of public health services in rural areas characterised by high levels of poverty- a symptom of the deterioration in the public health system (p.68) The Report reiterated the need for improving rural health infrastructure and enhancing capacity to deal with curative health care in addition to preventive health care services currently being provided. This task cannot be accomplished without sufficient resources. Recognising this need, the State HDR suggested enhancing the allocation to the health sector to 5 per cent public expenditure.

The low level of spending on health in Maharashtra is not an isolated instance. The National Human Development Report notes the low and declining levels of public spending on health in several Indian states. The ratio of revenue and capital spending on health as a proportion of gross domestic state product in 1998-99 was 'about 2.5 per cent in Himachal Pradesh and Jammu and Kashmir, 1.6 per cent for Andhra Pradesh and between 1 and 1.5 per cent for Tamil Nadu, Orissa and Karnataka and less than 1 per cent for the rest. It turns out that the proportion of public resources for health at the State level declined in the last two decades for almost all

States (Planning Commission, 2001, p.87). As the Report points out, there has been a misplaced emphasis on maintenance and strengthening of private health care services at the expense of 'broadening and deepening of public health care system targeted at controlling the incidence of disease, particularly of communicable diseases in rural areas' (ibid). Obviously, such strengthening cannot be achieved without adequate resources and improved structures that govern the utilisation of such resources.

In the case of education, free and compulsory education for children in the age group of 6-14 years has been declared a fundamental right and an ambitious target to have all children in school by 2003 has been formulated under the Sarva Siksha Abhiyan or the Programme for Universal Elementary Education. As per the National Human Development Report (Planning Commission, 2001, p. 60), broad estimates made by the Department of Elementary Education and Literacy, Government of India, indicate that nearly Rs. 60,000 crores of additional budgetary resources are required over the next ten years from the Central and State Governments for implementing this initiative.

There has been a consensus that public spending on education needs to be 6 per cent of GDP as echoed by various official committees on Education. As against this target, the levels of spending across Indian states between 1990-91 and 1998-99 ranged between 2.5 to a little over 3 per cent with only some smaller North-Eastern States touching levels of 8 to 10 percent (Planning Commission, 2001, p.60).

It may be useful to remind ourselves of the statement in the National Human Development Report 2001, which points out that the provision of financial resources is only a necessary condition that in itself cannot guarantee the attainment of social goals. It is equally important to ensure that the institutional mechanisms for delivery of services are efficient. It is of course true that the need to improve delivery systems is paramount not only in social sectors but also in other sectors. It has been pointed out repeatedly that governance has a profound bearing on development outcomes and its importance should not be undermined. However, this does not preclude the need to ensure adequate resources for being able to provide quality services at various levels. Indeed, emphasising either delivery systems or finances alone would be self defeating as both are equally important in the quest for improving social indicators. Our focus is on understanding the extent of resources required so that measures are undertaken to fulfil the

necessary conditions, which will enable, given better governance, the attainment of the much cherished goals of human development.

The successful achievement of various development goals is dependent on the availability of human and financial resources as well as improved efficiency of existing resource use. The other factors that affect implementation and outcome of programmes are population changes, community awareness and community involvement in development programmes, the pattern of economic development, the efficiency of the administrative infrastructure, the status of women and other social and cultural factors, which differ from State to State

Tenth Five-Year Plan (2002-2007)

The Government's development strategy is spelt out in the Tenth Plan (2002-2007), emphasizing that development must be defined not just in terms of increased GDP, but more broadly in terms of human well-being, i.e., reduction in income poverty and also human poverty. As proportion of GDP, expenditure on social services constituted less than 6% of GDP whereas the recommended level for both education and health alone is 6% of GDP. In the light of these recommendations the allocation to social services (includes eleven heads such as medical and public health, water supply and sanitation, housing, urban development, welfare of SCs, STs, and OBCs, social security and welfare, nutrition, and relief on account of natural calamities) is inadequate.

While acknowledging the resource constraints at the Union and State levels, the Tenth Plan document recognizes the complementary role that the private sector and civil society can play with the public sector in the provision of infrastructure and social services, as well as in developing financial innovations to widen access to financing for all segments of society. The NHDR 2001, does stress on the fact that mere allocation of sufficient public resources for furthering human development is not enough. It is equally important to use them efficiently and effectively.

State governments are basically responsible for developing the social sectors. Health care, urban development, housing and water supply are under the exclusive jurisdiction of the State governments, while education, family welfare, social security and labour welfare are under the concurrent jurisdiction of the Centre and States. The Central government through its central

sector schemes provides grants to the States to cover programmes like those for poverty alleviation, women and child development, income generating schemes, and programmes for developing tribal population. This also helps the government to provide leadership in terms of focusing on critical issues in the development process. Overall, *expenditure on education forms the largest component of the social sector, followed by public health and water supply*. Labour, social security and welfare is another important crucial expenditure head. Financing of the social sector has primarily occurred on the basis of domestic resources.

Social sector expenditure as a percentage of GDP has not increased if the Centre and the States are taken together. The Union budget for 2003-04 reveals that the year 2002-03 will end with Central Government expenditure on Plan programmes in the social sector about 5 per cent less than the budgeted Rs. 26,823 crores¹. The deficit cuts across all social sectors. Spending, according to the revised estimates, has been less than budgeted in the areas of elementary and secondary education, health, drinking water and sanitation and tribal welfare. Unfortunately, elementary education is where the gap between budgeted and actual spending is the largest in the current financial year.² The decline in the share of developmental expenditure is also significant. Plan expenditure as a ratio of aggregate disbursements declined from over 30% in 1991 to 26-27% in mid 1990s and even lower levels of 22-24 % in the last three years of the 1990s. The implications of this fiscal stress for social services expenditure have been adverse.

Pronab Sen³ point out “Although, India has large investible resources and reasonably good performance on poverty reduction and social development there are still considerable challenges especially in the context of regional and interstate disparities and disparities between social groups and classes.”

Public policy and public spending must facilitate, encourage and complement private spending to ensure that human development needs are met. If a government is to allow for sufficient spending in priority areas, a public expenditure of 20-25% is desirable. A study done in 1988 found that private spending often exceeds public spending. Today, the ratio between private and public spending on human development is in most countries approximately 1:1. It is most important for developing countries to increase the overall level of human development spending. Needless to say, the creation of an enabling policy framework for private sector development

¹ The Hindu, 2003, ‘Short Shrift to Social Sector’, March 4; URL: <http://www.hinduonnet.com/thehindu/2003/03/04/stories/2003030400971000.htm>

² *ibid.*

³ HDRC Discussion Series Paper “ Financing For Development”

would not only help unleash the capacity of people at large, as well as that of domestic entrepreneurs. It would also be critical to attracting foreign investors and the employment and income they could help generate, and thus open up new avenues for human development.

Analysing the Public Spending

Several commentators have pointed out that it is the lack of political commitment, not lack of financial resources, that is the real cause of human neglect. This is the main conclusion of Human Development Report 1991 - the second in a series of annual reports on the subject. The Report points to an enormous potential for restructuring of both national budgets and international aid allocations in favour of human development. But the plea for greater allocative efficiency and more effective spending does not mean indifference to the need for economic growth, or for increased resource mobilisation. The Report's position is that a more efficient and effective public sector will help strengthen the private role in human development. And the best argument for additional resources is that the existing funds are well spent.

To analyse how public spending on human development can be designed and monitored, four ratios have been suggested in the Human Development Report 1991.

- a. **The Public Expenditure Ratio** - the percentage of national income that goes into public expenditure. A high public expenditure ratio is neither a virtue nor a necessity. Public policy and public spending must facilitate, encourage and complement private spending to ensure that human development needs are met. If a government is to allow for sufficient spending on priority areas, a public expenditure ratio of 20-25 per cent is desirable.
- b. **The Social Allocation Ratio** - the percentage of public expenditure earmarked for social services. Governments also differ greatly in how much of their spending goes to social areas like nutrition, health and education. 'Social spending' includes expenditure on education, health, welfare, social security, water, sanitation, housing and amenities. High social spenders devote over 40 per cent of public expenditure to the social sector and the low spenders, 20 per cent or less.
- c. **The Social Priority Ratio** - the percentage of social expenditure devoted to priority areas. What is considered to be a priority will naturally change from one country to another, and change over time as human development proceeds. Countries that have already achieved high standards of literacy may well regard higher education as their

next priority area. Where basic standards of health have been achieved, health ministries will want to increase attention to more sophisticated kinds of curative care.

- d. **The Human Expenditure Ratio** - the percentage of national income devoted to human priority concerns.

The **human expenditure ratio** is the product of the first three ratios. It is a powerful operational tool that allows policy-makers who want to restructure their budgets to see existing imbalances and the available options.

If public expenditure is already high (as in many developing countries), but **the social allocation ratio** is low the budget will need to be reassessed to see which areas of expenditure could be reduced. Military spending, debt servicing and loss-making public enterprises are often likely candidates.

If the first two ratios are high, but the ultimate human development impact, as reflected in human development indicators, is low the social priority ratio must be increased. For the poorest countries, this is likely to involve seeking a better balance between expensive curative hospitals and preventive primary health care, between universities and primary schools and between focusing greater attention on the cities and on the rural areas, where most poor people live.

The human expenditure ratio should increasingly become one of the principal guides to public spending policy. When resources are tight, greater attention must be paid to allocation priorities and efficiency in spending. It is wrong, however, to confuse a plea for greater efficiency with indifference to the mobilisation of additional resources. The best argument for mobilising more resources is spending existing resources well.

Group Exercise No.1 – Time: 20 minutes

Divide the participants into State-wise groups and ask each group to develop a strategy for one of the following for their own State:

- Raising the level of investment in primary education to 6% of State GDP.
- Mobilising resources for repair and maintenance of handpumps in rural areas.
- Doubling the allocation for rural health centres in the State budget.



After presentations in plenary, invite participants to critique and strengthen the suggested strategies.

