Executive summary

A rich endowment of economic infrastructure and a legacy of relatively strong development policies pursued over many decades, account in large part, for Punjab's current position as the State with the highest per capita income among major Indian States (excluding the State of Delhi). However, an economic growth rate below the national average since 1986 threatens to dislodge Punjab from this position. Redirecting the State's economy on to a higher growth path will require a major redirection of sector and fiscal policies.

Major factors that cause concern about the future growth and development prospects in Punjab include:

- a slowdown in infrastructure investment;
- reliance on capital outlay to carry the overwhelming burden of fiscal adjustment;
- increasing inefficiencies of water use and an unviable power sector that is imposing high and rising costs on the State exchequer -- this problem has been aggravated by the recent political decision to provide water and power free to all farmers;
- abolition of important local taxes, which have undermined the capacity of the local government to function effectively and to perform a developmental role; and
- high drop-out rates at all levels of primary education (a result in part of teacher absenteeism) and migration of rural girls to urban schools at upper primary level (reflecting the unfavourable environment in rural schools for the older girl-child in particular).

GROWTH PERFORMANCE AND SECTOR POLICIES

Slower than average growth is a major cause of concern. Punjab remains predominantly an agricultural State with 44 percent of the Gross State Domestic Product (GSDP) generated in agriculture. Among all the Indian States, Punjab was the leading beneficiary from the Green Revolution that dramatically raised food grain yields in the 1970s. Growth in the State was affected negatively during the 1980s due to terrorism and the high fiscal, economic and social cost of combating it. By the early 1990s, the threat to economic stability posed by terrorism and separatist agitation had receded. The structural reforms initiated by the Government of India in 1991 reduced the bias against agriculture, a change which ought to have favoured Punjab. The stage was set for a renewed spurt in agriculture and other sectors of the economy. However, the expected growth revival has failed to materialise. Without a renewal of rapid growth, there is a danger of increasing unemployment among the youth with potential risk of social unrest returning to the State.

Among the leading constraints to growth revival in Punjab are the sector policies affecting power and water. Free water and free electricity for farmers -- a policy that was popularised as a farmer-friendly policy, is neither yielding the promised benefit to the majority of farmers nor laying the basis of higher and sustained growth. On the contrary, inefficient and wasteful use of water leads to an erosion in soil quality. The free power policy means in reality that there is no reliable supply for the farmer. The Punjab State Electricity Board (PSEB) continues to lose over Rs.10 billion (1000 crore) annually, a burden that will ultimately rebound on the Government of Punjab (GoP). This is a high cost to pay for a policy that promotes neither efficiency nor equity objectives.

The GoP needs to find a way to quickly reverse the policy of highly subsidised but unreliable supply of power and canal water for irrigation. The farmers as well as the State economy as a whole would stand to gain substantially from institutional and policy changes that would lead to a reliable and financially viable supply system in both power and water. Considering the importance of predictable water supply for the success of modern technology in agriculture, it should not be difficult for the GoP to seek and obtain the cooperation of the farming community in implementing such sector reforms, provided that the potential benefits and saved costs are clearly communicated through public awareness campaigns.

Part of the potential fiscal savings from power and water sector reforms deserve to be earmarked for gender-specific upgradation of school facilities. Essential public services such as primary education continue to suffer from poor rural facilities, underfunding and other systematic constraints. High drop-out rates persist at primary level, as does migration of girls to urban schools. Investments targeted at improving the rural environment for retaining girls in school have potentially high private and social returns. There is considerable scope for improving performance through institutional reforms such as devolving the function of monitoring primary schools to the village local body.

Declining levels of budget outlays for public investment is a trend that needs to be reversed. Since 1987-88, the revenue account (or current account) balance has turned negative in Punjab, an indication that the State had started borrowing even to finance recurring expenditures. Accumulation of debt to finance Central paramilitary forces in the battle against terrorism led to further fiscal deterioration in the State. Rising debt service payments (a portion of the debt thus contracted has since been waived by the Centre) and the pursuit of populist policies in the power and irrigation sectors have imposed a high cost in terms of foregone development opportunities. Among other impacts, they have squeezed budget allocations for investment projects in the State and for maintenance of existing assets. Capital outlay in the budget of the GoP has declined from 3 percent of GSDP in 1985-86 to

1.5 percent in 1996-97. Higher levels of public investment in critical infrastructure (irrigation and roads) and improved maintenance are essential to crowd in private investment.

ALTERNATIVE SCENARIOS

In the absence of any reforms, the Punjab economy is likely to lag behind the rest of India as public investment is likely to decline further, from its estimated current level of about 1.5 percent GSDP to less than 0.5 percent over the medium term. This base case scenario shows that the prevailing fiscal trends are unsustainable. It shows that in the absence of reforms, the GoP would be unable to pursue the higher growth target of 6-7 percent that the State needs in order to avoid losing its position as one of the developed States of India.

Reform options that need to be considered in order to create the fiscal space for additional public investment and to strengthen maintenance include: (a) ***restructuring the power sector*** to eliminate the loss of over Rs. 10 billion annually; (b) ***ensuring adequate allocations for maintenance and enhancing cost recovery*** in the case of departmental enterprises (such as in irrigation and road transport sectors); (c) ***zero net growth in staff numbers***, achieved by controlling recruitment (confining it mainly to the key subsectors) and allowing attrition to compensate for the new recruits; (d) ***rebuilding the revenue raising structure*** so as to provide *panchayat raj* institutions with the resources needed to achieve a degree of fiscal autonomy; and (e) ***a freeze on budget support to those Public Sector Undertakings (PSUs) which should be capable of breaking even.*** It is estimated that these reforms will enable the GoP to raise capital outlay in its budget by about 1.8 percent of GSDP, while at the same time stabilizing the ratio of debt to GSDP at a little below 30 percent.