Executive Summary: Macroeconomic Analysis

1. UTTAR PRADESH: TREND AND STATUS

As per the population Census 2001, Uttar Pradesh, with its 16.605 crore strong population, continued to be the most populous state in the country and accounts for 16.17 per cent of India's 102.702 crore population. An economically strong Uttar Pradesh with its huge market could be an important engine of growth for the rest of the country. It has a large agricultural base, fairly well-spread industrial activities, and some of the best learning centres in the country. However, the economic performance of the state over the years has fallen behind the rest of the country. During the post-reform period of 1993-94 to 2000-01, the real GSDP at factor cost (1993-94 prices) in divided Uttar Pradesh had an average annual growth of 4.22 per cent as against all-India average growth of 6.3 per cent. During the most recent period of 2001-02 to 2002-03 the average growth has been just about 2.24 per cent as against all-India average of 4.88 per cent.

1.1 Diverging Gap in Income from National Average

The result of poor overall economic activity and high population growth is reflected in extremely slow growth in per capita income as compared to all-India growth figures. During 2002-03, Uttar Pradesh had a per capita real income that was 47.7 per cent less than the all-India average. This is a considerable deterioration from 1980-81, when it was 17.2 per cent less than the all-India average. People are migrating from Uttar Pradesh because of the income gap between Uttar Pradesh and rest of India.

The share of real activity in undivided Uttar Pradesh, in terms of gross state domestic product, has shrunk from 13.8 per cent in 1980-81 to 10.5 per cent in 1999-2000. However, after division, the share has fallen even further from 9.22 per cent in 1999-00 to 8.48 per cent in 2002-03. The most dramatic decline is noticed in services (tertiary sector), while the best segment appears to be agriculture, which too, is holding ground with difficulty.

1.2 Where Has Growth been Affected during Recent Periods?

Uttar Pradesh has performed reasonably well in the organised manufacturing, communication, banking and primary sectors during 1993-94 to 1999-00. However, it has lagged in vital segments of infrastructure such as power, water supply, and railways. Similarly, growth in real estate and trade, hotels and restaurants, and unorganised manufacturing has also suffered. Services growth is also linked to the share of industrial activity in GSDP, which is low in the case of Uttar Pradesh. At the national level, the share of industry and services during 2002-03 has gone up to 27.34 per cent and 51.17 per cent respectively. In Uttar Pradesh, the corresponding numbers are 25.64 per cent and 41.99 per cent. This means that at the national level the dominance of agriculture has reduced significantly compared to Uttar Pradesh. Therefore, manufacturing activity in Uttar Pradesh must increase in size, scale and scope as fast as possible.

1.3 Poverty

Uttar Pradesh has seen a fall in the incidence of poverty from about 41 per cent in 1993-94 to 31 per cent in 1999-00. However, this achievement is far below the all-India figure of 26 per cent. The differences in poverty levels with respect to national figures are more pronounced in urban areas compared to the rural areas. Rural poverty has gone down by 11 percentage points as against a fall of 4 percentage points in urban Uttar Pradesh. This is not surprising given the consistent growth in agricultural sector as against a decline in the growth rate in the tertiary and industrial sectors.

At sub-regional level, approximately 44 per cent of total poor people in divided Uttar Pradesh during 1999-2000 lived in eastern part of the state. The corresponding figures for Western, Central and Bundelkhand were 28, 24, and 4 per cent respectively. In terms of reduction in poverty, Bundelkhand has been the leader where percentage of poor people below poverty line went down from about 69 per cent in 1993-94 to 24 per cent in 1999-00. During the same period, poverty in the Eastern region went down from about 48 per cent to 36 per cent, in Central region from 47 per cent to 40 per cent and in Western region from 30 per cent to 24 per cent.

1.4 Strengths, Weaknesses and Threats

The strengths of Uttar Pradesh lie in its strong agricultural base and diversified and naturally developed industrial activities across several regions and concentrated tourist centres. Several industrial activities are highly export-oriented. According to approximate estimates, about 8 per cent of India's export in 2000-01 originated from Uttar Pradesh. This is likely to grow further. Uttar Pradesh, being a leading state in artware, can reap huge dividend by modernising the processing and diversifying the products according to the taste of the buyers. Some of the progressive states such as Andhra Pradesh and West Bengal have commissioned extensive studies to survey and produce strategic reports to increase exports from the respective states.

However, there are several weaknesses in, and threats to, the progress of Uttar Pradesh. Although Uttar Pradesh can claim to be largest producer of foodgrains in the country, the yield and per capita production is much lower than other foodgrain producers in the country, particularly, Punjab, and Haryana. Foodgrain yield in Uttar pradesh is almost half that of Punjab. Low per capita production creates a vicious circle, which needs to be broken through government interventions. Rural people need alternative source of income, which can be provided only through industrialisation. Adopting policies, which could promote large-scale village and town industries can go a long way in meeting this goal.

In addition Uttar Pradesh is landlocked, which creates disadvantage in competing with other states, particularly in exportable goods. On top of that industrialisation in Uttar Pradesh is marked by low-level operations. Most of the investment and production is concentrated in a few industrial centres, primarily in western Uttar Pradesh. Worker emoluments also vary considerably across regions. The eastern part of the Uttar Pradesh needs special attention, as it remains the least industrialised region.

Almost 19 per cent of manufacturing output during 1999-00 came from a single district, while 21.8 per cent was produced in 3 other districts with individual contributions ranging between 5-10 per cent. There were 11 districts contributing between 2-5 per cent each, with a combined output of 31.6 per cent. There were another 10 districts producing 1-2 per cent of output each, which accounted for another 14.10 per cent. Thus, more than 87 per cent of the industrial output came from 25 districts, while the other 45 districts contributed only 13 per cent to output. The most productive districts lie in western part of the state, close to the national capital. The most prevalent sugar industry, grain mills and low-level textile industries seem to be spread across all regions.

During 1999-00 (ASI data), Uttar Pradesh accounted for 6.8 per cent of national factory output with 9.4 per cent of the national investment in fixed capital stock in 7.8 per cent of the total factories. On an average, a factory in Uttar Pradesh had a capital base of Rs. 366 lakh as against the all-India average of Rs. 305 lakh. There were 42 workers per factory in Uttar Pradesh compared to 48 nationally. This means average fixed capital per worker in Uttar Pradesh was Rs. 8.8 lakh as against an average of Rs. 6.4 lakh per worker nation-wide. Finally, gross value added per unit fixed capital stock (output to fixed capital ratio) was 0.34 in Uttar Pradesh compared to national average of 0.47. There is some improvement in productivity during 2001-02 and Uttar Pradesh has attained just about average level of GVA to FCS ratio. However, its share in total fixed capita in factory sector fell to 7.0 per cent. More disturbing is the closure of factories during 1999-00 to 2001-02. Almost 11 per cent factories have closed in Uttar Pradesh as compared to 3 per cent at all-India level resulting in reduction of workers in factory sector of Uttar Pradesh by almost 11 per cent.

Clearly, capital in Uttar Pradesh is not as productive as it is elsewhere, while the state displays average levels of industrialisation. Therefore, promotional strategies need to be worked out in order to transform factory composition and skill level to increase value addition and at the same time generating more employment.

Analysis of three-digit level ASI data also indicates that Uttar Pradesh is far behind from the leaders in production share in each of its 22 major manufacturing sectors, which contributed more than 80 per cent of manufactured output. The gross value added (GVA) from top five three-digit industries of India is of the order of 41.89 per cent, in which the share of Uttar Pradesh is just 1.8 per cent. GVA from these sectors in Uttar Pradesh as percentage of total GVA in the factory sector of Uttar Pradesh was 26.37 per cent during 1999-00. Nationally, the top 20 industries contribute a further 32.8 per cent of value added; for Uttar Pradesh, the corresponding figure is 48.63 per cent. This leads to the argument that Uttar Pradesh can do better if it uses a two-pronged strategy. One, it should enter into high value added products and second, increase scale of operation in areas where its presence is substantial.

The social and physical infrastructure of Uttar Pradesh is far below the national average in almost every major respect. Access to power, communication, roads and banking critically lag behind the other major states in the country. Uttar Pradesh has the lowest percentage of villages electrified and is second lowest in terms of per capita power consumption. In addition, the household access to power is just about 32 per cent much below national average of 84 per cent. This constraint has wide-ranging implications for industrialisation of Uttar Pradesh.

In the banking sector, while its share in deposits is respectable and next only to Maharashtra, credit dispersal is less than most of the fast growing states. Importantly, almost 62 per cent of the credit in Uttar Pradesh goes to priority sector, while in progressive states such a Maharashtra, Gujarat, the priority sector constitutes about 26 and 34 per cent share. This is not surprising given the low level characteristics of industrialisation in Uttar Pradesh. With changing definition of priority sector such as increases in housing loan limit, aggregate credit offtake in Uttar Pradesh may further get marginalised. The problem can be presented in a different way as follows: At present banks use Uttar Pradesh as a ground to fulfil their priority sector obligations. The moment such restrictions are lifted or relaxed, there is fair possibility of diverting their business to other states.

The state has lower level of literacy rate and inadequate institutional development as compared to national averages. Urbanisation and worker participation is also below national average.

Uttar Pradesh lacks in every institutional category—whether in the penetration of medical colleges, engineering colleges, universities, or research institutes. States such as Andhra Pradesh, Karnataka, Maharashtra, Tamil Nadu, Gujarat, Punjab, are all far ahead of Uttar Pradesh in one or more categories. Even in middle and secondary level institutes, which are providers of basic education, Uttar Pradesh has 20 middle and senior secondary schools and 59.54 primary schools per 100,000 persons as against national average of 32 and 65 respectively.

In addition to several weaknesses in the economic structure of the state, there are several threats that can jeopardise the prospects of growth in Uttar Pradesh. Agriculture continues to be critically dependent on rainfall, as scientific methods of irrigation and water resource management techniques have not been popularised. Religious fervour and communal tensions continue to threaten the peace in civil society.

The most important threat to the state's economy comes from the financial management of the state government. As on March 31, 2003 Uttar Pradesh had a liability including reserves and deposits, of the order of Rs. 103117.5 crore, which has increased to Rs. 119870.09 crore on March 31, 2004 (an increase of 16.3 per cent). In terms of percentages of GSDP these numbers mean about 50.82 and 54.65 per cent of GSDP. Net of reserves and deposits, the corresponding debt figures are Rs. 79508.16 crore (39.17 per cent of GSDP) and Rs. 94432.37 crore (43.1 per cent of GSDP). It is estimated that the debt (net of reserves and deposits) would have gone up to 44.5 per cent of GSDP by March 31, 2005. As against this, the average debt in 15 major states[1] was 36.44 per cent of GSDP as on March 31, 2003, with states such as Andhra Pradesh, Karnataka, Tamil Nadu, Maharashtra and Gujarat having debts of the order of 28.85, 25.12, 26.80, 21.58 and 33.93 per cent of GSDP respectively.

Uttar Pradesh pays almost 29 per cent (average of 2000-03) of its revenue receipt as interest on debt and at the same time maintaining a persistent primary deficit of more than 1.0 per cent of GSDP. This makes debt situation in Uttar Pradesh unsustainable. In addition debts in Uttar Pradesh cost more (in terms of interest rate) than the debts of most other state governments. The fiscal deficit until 1998-99 deteriorated at a greater rate, reaching a high of 6.81 per cent. However, in the years after 1998-99, there appears to have been a significant reduction in deficit

1. AP, BH, HP, HY, GU, KL, KT, MH, MP, OR, PU, RJ, TN, UP, WB.

to a level of 4.68 per cent in 2002-03, much of it on account of revenue deficit. With a high revenue deficit, little is left for development expenditure. This is a serious constraint on the capacity of the state to grow.

Last but not least, Uttar Pradesh is threatened by regional disparities. This has an impact on the politics of the state. The per capita income in Eastern Uttar Pradesh is half that in Western Uttar Pradesh. The Central and Bundelkhand regions are also better off than Eastern Uttar Pradesh. However, even the wealthiest part of the state, Western Uttar Pradesh, has a per capita income that is not higher than the national average. Eastern Uttar Pradesh lags in almost all aspects: urbanisation, investment, industrialisation and capital intensity of industrial activity. This calls for special measures to develop the region.

2. DIAGNOSTIC ANALYSIS OF THE MACROECONOMIC PROBLEMS

Cross-sectional regression and data mining-based analysis have been used to establish problem areas in development of Uttar Pradesh. Analysis yields several conclusions:

2.1 Industrialisation is Critical for Faster Growth

States with a larger share of industrial activity in their gross state domestic product were able to harness the benefits of liberalisation much faster than those dependent upon primary sector. Every percentage point increase in the share of the secondary sector contributes to a 0.27 percentage point increase in future per capita growth. The equivalent contributions from agriculture and the tertiary sector are far lower, at 0.15 and 0.11 percentage points. Even within Uttar Pradesh, it is observed that circles with higher shares in manufacturing output have larger per capita income. Clearly, Uttar Pradesh has to shift its emphasis from agriculture to industrialisation if per capita income has to grow at faster rate.[2]

2.2 Investment Climate Needs to be Improved

The projected growth of Uttar Pradesh during the Tenth Plan is 7.6 per cent. Uttar Pradesh will require an estimated investment of the order of Rs. 323161 crore during the plan period to attain this growth. Out of this amount, the Centre is likely to contribute Rs. 58170 crore and the state will have to contribute Rs. 27470 crore. The remaining investment of Rs. 227829 crore has to come from private and other sources. However, past experience shows that Uttar Pradesh has not got enough investment either from central plans or the private sector, while its own efforts have been seriously jeopardised due to poor fiscal management. Therefore, unless serious policy measures are implemented to attract large-scale private investment, growth prospects will remain bleak. It is learnt that several of the entrepreneurs backed out due to process delays and other problems but there is no mechanism to assess and scrutinise such cases and take remedial measures.

2.3 Inadequate Private Sector Response to Investment

Recent trends and movements in the investment shares of major states in the factory sector using Annual Survey of Industries (ASI) data; the implemented Industrial Entrepreneurs Memorandum (IEM) for Investment in the de-licenced Sector by the domestic private sector; and FDI approvals show either a declining or stagnant share of Uttar Pradesh as compared to fast moving states. There is, however, a little improvement in the state's inability to draw in foreign direct investment (FDI) proposals, which were stuck at 1.7 per cent of total approvals during August 1991 to May 2002, has moved to 1.95 per cent for August 1991 to August 2004. At the all-India level, FDI has been approved in some sectors where Uttar Pradesh holds stronger position such as oil refineries, information technology, telecommunications and transport. Therefore, strategies are needed to attract such investment in larger amounts.

2.4 Inadequate Central Government Efforts in Capital Building

Uttar Pradesh is way behind in terms of centrally funded capital formation per capita. This has been one of the reasons for poor performance of the state. During Ninth Plan Period, the level of per capita plan expenditure in Uttar Pradesh was just about 59 per cent of the national average per capita plan expenditure in all other states. Traditionally, plan expenditures in Uttar Pradesh have dominated economic activities such as irrigation, power and transport. However, during the recent plan periods, investments in these sectors have systematically reduced. The result has been a slowdown in the growth of agricultural GSDP as well as overall GSDP.

2. All quantitative effects given in this section are conditional upon other factors remaining same.

Further, Uttar Pradesh is also to be blamed for not utilising the allocated outlays. Data shows that, while other states could bargain for more than allocated outlays, as much as 133 per cent, Uttar Pradesh's expenditure actually reduced during the Ninth Plan period to just 63.5 per cent of outlay. This complacency on the part of officials and leaders of the state has cost it dearly.

The Twelfth Finance Commission (TFC) has proposed Rs. 918 per capita as grant for Uttar Pradesh during the TFC period of 2005-2010. This is much less than that allocated to some of the affluent states such as Punjab, West Bengal, and Kerala. However, the per capita allocation of grants-in-aid to Uttar Pradesh for TFC period is 3.2 times the amount that was allocated during Eleventh Finance Commission (EFC) period, while the average per capita grant for all the non-special category (NSC) states during TFC period is 3.04 times that of EFC period. Thus, apparently it may appear that Uttar Pradesh is a little better than the average states in getting grants but considering the poor social and physical infrastructure in the state, this may not be enough.

2.5 Jeopardised Capacity of State Government to Raise Revenues

The own capacity of Uttar Pradesh in raising revenue from taxes has been deteriorating over time *vis-à-vis* its revenue expenditure. In fact the government's ability to raise revenues has been below the average of all other states throughout the 1980s and 1990s. The services sector, which is now under the tax-base is the only hope through which Uttar Pradesh can improve its fiscal self-reliance, as agriculture is untaxed. Further, the tax collection levels and fiscal self-reliance of a state are critically dependent on the level of industrial

Drivers of Investment

Both quantitative and qualitative analysis indicates that Uttar Pradesh lacks in important factors, which make it an investment destination attractive for the private sector.

Governance: In an environment of fast globalisation, good governance has emerged as an important pre-requisite for attracting investment. Even in the context of overall development programmes, some analysts such as Reynolds (1983) go to the extent to argue political organisation and the administrative competence of government as the most important explanatory variable of development. Studies demonstrate that good governance affects economic growth and development positively by increasing investment flows and reducing poverty. Studies on corruption do indicate some countries growing despite high level of corruption, but at the same time there is a caution not to confuse corruption to be a source of growth. Therefore, it is argued that states/ countries would have done better in absence of corruption.

Incentives: Incentives are extensively used by other states to attract investment. However, incentives result in fiscal deficits. A state with a lower debt burden can afford such a policy. Uttar Pradesh, on the other hand, is in danger of falling into a debt trap. Analysis shows if a state can afford deficit without risking debt trap, then a 1 percentage point difference in fiscal deficit across state leads to 6.13 percentage point change in investment ratio. In the case of Uttar Pradesh, the deficit is high but not due to capital outlays for developmental activities and incentives but more so because of non-developmental expenditures.

Proximity to Commercial Market: Metropolitan cities are proxies for commercial markets and business centres. The metro dummy has highly significant coefficient of 0.09 and therefore, it is important to develop such agglomeration as quickly as possible. Even Kanpur and Lucknow together, included as proxy for metropolitan cities do not actually meet the standards of other metropolitan cities in the country. There is marked difference between Lucknow as a business centre, and the capital of any fast-growing states' capital. The roads, the cleanliness, the business centres, e-connectivity, institutional development, smartness of the administration, the police, the facilitation centres and work culture at service and attraction to tourists, are all key factors in ensuring that such a centre is a viable business destination.

Infrastructure: Progress in Infrastructure development is a testament to long-term vision and helps in formulating business decisions. Growth in the infrastructure growth index (based on figures from the period 1980-81 to 1993-94) has a significant positive effect on investment. Each percentage point change in the infrastructure index growth leads to a 5.8 percentage point change in the investment ratio. Uttar Pradesh critically lacks in all aspects of infrastructure development including power, telecom, roads, banking, and airports.

Presence of Quality Human Capital: Ensuring the presence of quality human capital too is vital for attracting investment. Analysis indicates that each percentage point difference in literacy attracts additional investments of the order of 0.24 percentage points. Thus, the literacy of a state is an important driver of growth. Several studies in growth literature have identified it as an important determinant of investment and growth. In the case of Uttar Pradesh, there are few institutions to produce a fundamental change in society.

activity. This is another reason for Uttar Pradesh to move down the path of rapid industrialisation.

2.6 Low Value Added Manufacturing

The efficiency of capital in manufacturing in terms of GVA to FCS ratio in Uttar Pradesh, is very poor, at 0.34 as against all-India average value of 0.47. This means, at current structure and efficiency of manufacturing, Uttar Pradesh will require much higher capital. The problem is augmented by low scale of operations.

2.7 Poor Drivers of Tertiary Sector[3]

Uttar Pradesh is lacking in banking operations, telecom usage and road development, which are critical components of tertiary sector. These sectors are closely related to developments in industrial sector and in general infrastructure as well. Slow growth in industrial activities and lower base of industrialisation affects tertiary sector directly. In addition, all the factors mentioned as important variables for investment decision are also important for the development of tertiary sector.

1. Smaller states are performing better in the service sector than larger states. Every per cent difference in size of the state inversely affects the rate of tertiary sector growth by 0.006 percentage points. Uttar Pradesh is a big state and not all parts are directly connected with business centres of the country. Creating responsible, market-focused and decentralised local authorities can stimulate development. Divide Uttar Pradesh equitably into focus zones with decentralised authority and responsibility in order to take advantage of more manageable administrative sizes in developing infrastructure.
2. Growth in literacy rates helps in growing the tertiary sector but institutional support, in the form of higher and technical learning centres is also critical. Every percentage point difference in change in literacy rate across states results in change in services sector growth by 1.06 percentage points. Overall literacy is poor in Uttar Pradesh and therefore, the state has a lot of catching up to do. In addition, compared to fast moving states, Uttar Pradesh seriously lags in technical training and professional education, which puts it in a disadvantageous position when it comes to developing knowledge-based industries.
3. Tertiary sector thrives in and around urbanised areas and, in particular the big cities. The presence of metropolitan cities causes a 0.01 percentage point change in the growth of the tertiary sector. Uttar Pradesh has suffered on this account also as discussed earlier.

2.8 A Low-yield Agricultural Sector

The economy of Uttar Pradesh is critically dependent upon agriculture. However, its productivity in terms of yield per hectare is far below the possibilities. There are several factors responsible for this:

Lack of Support from the Government in Irrigation

Farmers in Uttar Pradesh have done fairly well in creating their own irrigation facilities, given the fact that landholdings in Uttar Pradesh are small. This private groundwater development is strongly dependent on the public canals for improving groundwater availability. The state owned canal irrigation in states like Punjab and Haryana, Tamil Nadu, Andhra Pradesh and Karnataka cover between 32 and 52 per cent of total irrigated land as compared to 28.6 per cent in Uttar Pradesh.

Inadequacies in Input and Technology Use

Commercial farming is marked by mechanisation and scientific use of seeds, fertilisers, and land management. In addition, efficient farming as also good living condition in villages requires adequate supply and consumption of electricity in rural sector. Uttar Pradesh has extremely poor electricity consumption per capita in agriculture with respect to other states.

Lower Cropping Intensity and Crop Diversification

In Uttar Pradesh, less than half of the net cropped area is cultivated more than once. Cropping intensity was as low as 151 per cent in 1997-98, 147 per cent in 1990-91 and 142 per cent in 1980-81. Constraints to cropping intensity are region specific but largely related to water and land availability. Besides cropping intensity, there is also the issue of choice of the most appropriate crop for a particular region.

Lower Scale of Operations and Poor Tenancy Laws

Uttar Pradesh has relatively small average holdings compared to most major states. With appropriate tenancy laws that protect the interests of actual owners of the land, institutional arrangements like cooperative

3. All quantitative effects given in this section are conditional upon other factors remaining same.

and self-help groups, can be encouraged to take advantage of economies of scale in agricultural production.

3. MACROECONOMIC STRATEGIES AND RECOMMENDATIONS

Based on the foregoing discussions, the strategies and recommendations for the development of Uttar Pradesh are summarised. However, at the outset some clear findings need to be reiterated:

1. Relative decline of Uttar Pradesh in national economy.
2. Available resources provide a strong base in agriculture and wide range of production possibilities in industrial sector with export potential.
3. Growth is constrained due to overdependence on agriculture and low level of industrialisation, while agriculture itself is plagued with poor yield.
4. Investment climate needs to be improved through fiscal management, effective governance, progressive policy initiatives and effective use of central plans.

Thus, a focused approach is required to address the above problems, which include: the need for rapid industrialisation, and the need to improve yields of agriculture products. The solution lies in better investment climate, public-private partnerships, involvement of local bodies to a greater degree, a change in the attitude of the administration, increasing education and health facilities, rapid urbanisation, modernising the cities, and improving the connectivity, power supply and communication. A sense of competition with other states must be generated among bureaucrats and leaders of the state. The dynamism has to percolate from the top. The expenditure set out in the Ninth Plan was only partially utilised, in contrast to other states, which bargained for more. Such trends must be arrested. The financial condition of the state is in precarious situation and must be improved by cutting revenue expenditures, while at the same time generating other means of receipts.

3.1 Uttar Pradesh Needs to Improve its Financial Condition to Promote Development

The most important threat to the state's economy comes from the financial management of the state government. Uttar Pradesh is critically indebted and the debt is on the verge of becoming unsustainable. Average primary deficit as a percentage of GSDP is more than the difference between real growth and real interest rate. The primary deficit continues to be positive. This debt in Uttar Pradesh is relatively expensive, with higher interest rates than other states. Clearly, Uttar Pradesh needs to restructure its debt by adopting measures such as debt swapping. With a high fiscal deficit, little is left for development expenditure. This places serious constraints on the capacity of the state to stimulate economic activities. This also has negative effects on the investment decisions of potential investors. A comprehensive programme of reducing deficit should include both receipt as well as expenditure management and wide ranging reforms including adoption of a Fiscal Responsibility Bill, user charges, VAT, pension reforms, subsidy management, public sector enterprises reform and debt management.

3.2 Uttar Pradesh Needs a Green Revolution Programme for Agriculture

The strength of Uttar Pradesh lies in its strong agricultural base and high levels of output. However, in terms of per capita production and yield per hectare, Uttar Pradesh is an average state. Agriculture is not market-oriented in Uttar Pradesh as it has been in Punjab and Haryana. There is hardly any surplus to what is produced and consumed on an average in the country. Serious analysis and scientific development is needed to bring professionalism in agriculture. Modern science of agriculture including biotechnology, genetic engineering, new product processes and agro-climatic can be considered as the hallmark of new green revolution.

There are several areas of improvement, which can be accomplished only through scientific methods such as soil testing, better seeds, efficient irrigation, mechanisation and farmer education.

Irrigation in Uttar Pradesh is dominated by privately owned tube wells as against canal based irrigation in several other states. With predominant use of tube wells, replenishment of groundwater is critically dependent upon rain, which is not the case with canal based irrigation. Canals also help in replenishing groundwater utilised by the tube wells. Thus, a strategy of optimal combination of tube wells and canals may reduce dependence on regional rain. It is in this context that contribution from the governments (centre as well as state) is lacking compared to several other agriculture dominant states. Therefore, a comprehensive irrigation and water management system needs to be worked out. Currently most of the tube wells in the state are diesel powered, which need to be replaced by electric or solar power in order to increase profitability of the farmers. However, this requires fast and efficient rural electrification.

3.3 Uttar Pradesh Needs to Emphasise Rapid Industrialisation

The analysis clearly reveals that Uttar Pradesh must give top priority to rapid industrialisation and improving the yield of agriculture production. However, this requires basic changes in attitude and approach in administration and governance. Industrialisation through special economic zones (SEZ) and technology/industrial parks is considered to be effective ways to grow industry.

The eastern zone is by far the most backward region in terms of industrialisation and value addition. Three SEZs, one each at Gorakhpur, Allahabad and Varanasi, need to be created as soon as possible, besides those at Moradabad, Kanpur and Greater NOIDA are already planned. Action has been initiated with respect to Varanasi, this must be given top priority in implementation. Special incentives should be provided to attract participants. The network of special zones should be enlarged depending upon a programme of performance-based review.

Target Mega Investors under a Strategic Plan

Identify a competent and skilful advisor to the Chief Minister, and assign growth targets to key officials. Possibly, hire an international agency to market the strengths of Uttar Pradesh and mobilise mega projects. Mega projects should be given special packages if they agree to locate in industrially backward areas.

Investment in social, physical and financial infrastructure both in urban and rural areas are critical for industrial development. Development of airport, water supply, power, roads, education, communication and financial institutions should get priority in developmental expenditure and the strategy should be such as to reduce government's involvement in operating such programme.

Encourage Unorganised Manufacturing in Rural Sector to Increase Scale of Operation

Uttar Pradesh has relatively high share of unorganised manufacturing in rural sector as compared to the urban sector. However, this potential of rural entrepreneurship has not been fully exploited because of a very low level of operations. The state could formulate policies for village level enterprises according to prevailing specialisation to increase scale of operation based on the Chinese models of village and town level enterprises. However, the government should not indulge itself in managing such activities. Instead, the management should be in the hands of private or self-help groups.

3.4 Private Investment is Critical: Adopt Policies Conducive to Private Participation

Uttar Pradesh requires huge amount of investments in the industrial sector. In addition, investment is also required to build human capital and ensure social security. The right policies have to be selected to support these goals.

3.4.1 Implement Power Sector Reforms as Quickly as Possible

Uttar Pradesh is critically short of power and no development can take place in absence of adequate power. Existing industry suffers from power shortages and new industries consider it a major bottleneck.

The initiatives to privatise the power sector should be complete in all its functions including generation, transmission and distribution without any interference from the bureaucracy except that of the regulator. Competition at all levels must be the key test of disinvestment. Power sector reforms have strong signalling effects as well as tangible effects in attracting investment and promoting production process. However, making power sector reforms a success is a ticklish problem because it is already a highly inefficient system to be transferred to private sector. Therefore, government cannot expect itself to be completely free of past liabilities and plan a profitable proposition for both the operators and self. In this respect the recent N.K. Singh Committee report (not yet made public) on power sector reforms could possibly form a basis to strategise success.

3.4.2 Demonstrate Progressive Attitude in Policy Formulation

- Demonstrate change by the substantive implementation of radical policies, including VAT, labour reform, free entry and free exit, a genuine single window concept, a genuine escort facility, and full-fledged e-governance.

- Advocate and implement privatisation: Even Communist China and West Bengal are doing that. There is no clear data to support whether recent privatisation moves have increased employment. However, the dynamics of globalisation require governments to change their role from producer to regulators and facilitators. The same is happening in all fast moving states and countries.
- Promote economies of scale through legislation such as low tax regime and revoking reservations of products in small-scale sector and modifying labour laws. Small businesses should survive on merit and not support. Chinese garment and shoe industries are known to employ up to 80000 people. Limit of SSI (with benefits intact) may be increased to either 1000 workers or Rs. 10 crore of investment or based on matching turnover. Alternatively, concept of small scale should be abolished altogether leaving behind only tiny sectors.
- Develop initiatives in long-term, vision-driven policy formulation and implementation. Progressive legislations such as those related to ownership and tenancy of agricultural land, single window, time-bound clearance of projects and contractual labour should be enacted without delay.
- Set up an effective grievance cell to be monitored by the Chief Minister's office.
- Utilise the concept of private-public partnership to the maximum. Involvement of local people, private sector and commitment oriented incentives from the government can be very effective.
- Involve private participation in development and management of industrial clusters and corridors including rural industrial development.

3.4.3 Demonstrate Changes in Governance

Good governance has become a prerequisite for attracting investment. It was argued earlier, that political organisation and the administrative competence of government are the most important explanatory variables of development. A recent study by the World Bank has brought out a comparative analysis of India's regulatory environment with that present in China. Procedures in India are more complex, more numerous, and cause greater delays.

What could make a government set-up ideal is a complex question. However, in order to provide good governance, accomplishment of the following four features may be helpful: First, a transparent and result oriented system, which is simple to understand and implement. Second, equipping the system with the right kind of people, adequate resources and relevant infrastructure. Third, ensuring honesty and integrity of the people in objective delivery of services. And fourth, monitoring and measuring the efficiency of the system in a transparent way. There are multiple strategies to create these features in the system of governance. Some of these can be implemented.

Introduce Comprehensive Computerisation

Extensive use of IT can bring about transparency and accountability in all areas including online clearances of projects, taxation, information dissemination, land record, statistical data on all issues of development. Therefore, the pace of introducing e-governance in Uttar Pradesh should be accelerated.

Almost all fast moving states of the country are extensively utilising information technology to connect information with the people in the most convenient way. The first step towards matching these states is to man information technology departments with top quality IT professionals with clear vision of the systems needed, and the freedom to plan and execute these systems. The state machinery should be assigned the job of facilitator. Such programme should be directly under the Chief Minister for efficient and quick execution.

Simplify the System in all Spheres of Administration

Simplification of procedures and reduction of red tape barriers can go a long way in reducing corruption. Consider the progressiveness demonstrated by Karnataka, which has already passed a Karnataka Industry Facilitation Bill, focused on simplifying procedures and reducing bureaucratic controls. Choice of factories for inspection will be through random numbers and all inspections will be joint inspections so that factory inspectors, boiler inspectors, excise inspectors, or whoever is required to inspect, will go together and finish the inspection at the same time. Similarly, the multiplicity of application forms is to be replaced by a combined application form (CAF) in order to simplify the business operations. The focus of these programmes is not only to compete with other Indian states, but also to compete globally. Therefore, quality, delivery, services and product all are getting due consideration in policy design. Andhra Pradesh is also following a similar pattern and its implementation of single window programme has backing of law, along with online registration and automatic clearances after a deadline.

Adopt Positive Approaches

The state government should promote a culture of self-regulation of projects. This will also act to reduce paperwork by negative list by emphasising what is not permitted. Get commitments from the private sector on infringement of regulations, and set up a system of enforceable penalties.

There should be automatic clearance of projects if deadlines are not met by officials in processing a proposal, with a responsibility of concerned official to explain the delay.

Empower People with Information and Right to Information

Empowering people with information and the right to information is another possible way of improving governance. However, the moot question is about the mechanism to get justice against societal evils. The legal system is so slow and non-transparent that it is almost impossible to secure redressal.

One way is to involve local bodies in development activity effectively. The provisions of the 73rd and 74th Amendments must be implemented to reform management of revenue and expenditure. The First State Finance Commission had made a number of recommendations regarding financial power to local bodies. Government of Uttar Pradesh needs to pursue the recommendations of the SFC aggressively and give autonomy to urban and rural local bodies (ULBs). Transparency can be achieved through public disclosures of the revenue and expenditure statements at the local body level. Involve media and independent NGOs in dissemination of information about policies and programmes of the government so that the lapses at the middle level can be brought to public knowledge.

Legislate to Reduce Moral Hazards

Recently, the Indian Parliament has passed a bill that permits fund raising from private corporates for election under specified procedures. This is a good example of arriving at better policies by legalising the illegal. To consider another example, if driving licences are provided smoothly just on the recommendation of recognised motor training institutes with easily traced driving licences, then monitoring the quality of driving is far simpler. The police just have to record driving licence numbers into monitoring system while penalising the defaulters. This information can be used for delisting institutes from which more defaulters graduate. Thus, the risk of getting derecognised will ensure that institutes do not illegally sell licences. Technology needs to be used in order to make this possible. Another example could be transparent fee/ commission for bringing mega projects in the state.

Institute Focused Advisory Committee

It may be helpful to rely on focused advisory committees comprising top class professionals, industrialists, social scientists and journalists, instead of a bureaucracy-loaded system, to get advice on industrial/scientific/social developments. If governance through committees is to be successful then advice of the expert bodies should be made binding by a law.

3.4.4 Assign Targets to Investment Promotion Boards

In most states, bureaucrats with no implicit or explicit targets and incentives, head the investment promotion boards. One possible way to ensure the performance of these boards is to utilise the dual measures of actual investment and the ratio of offers to actual investment. Incentives should be linked to performance.

3.4.5 Systematise Urban Development and Bring Major Cities to Modern Standards

The state should create a comprehensive policy for urban development. Any area falling under urbanisation schemes must follow set norms, which should be enforceable. Basis of these norms should be a mandatory master plan including well laid-out roads, water, sewage systems, electrification and communication.

Special emphasis is needed to modernise Agra, Lucknow, Kanpur, Allahabad, Varanasi and Meerut. The development of these cities is priority.

3.4.6 Develop Tailor-made Infrastructure to be More Cost-effective

The results of investment in infrastructure are physically visible and demonstrate the seriousness of the government in enabling business. In creating connectivity, there are two types of facilities that are important. First, facilities that connect regions and big business centres. Second, connections between industrial centres of the state and the local system. Both are important variables in decision functions of the investors.

States are implementing tailor-made policies for different target industries. This flexibility is needed to realise efficiency gains from infrastructure development. It is important to identify the type of industrialisation suitable for an area. Attempts should then be made to create infrastructure such that investors are automatically motivated to go to that area.

This calls for a spatial strategy of industrial development through specialised agencies, which can take up industrial area development projects at large scale. For example, Karnataka Industrial Area Development Board (KIADB) has been assigned responsibility to develop sector specific and location specific industrial parks in Karnataka. Several such initiatives are needed in Uttar Pradesh.

3.4.7 Develop Financial Infrastructure

The financial infrastructure is closely related to all economic activities, particularly industrial and trade activities require extensive support in terms of financial markets. It includes not only the development of commercial and rural banks, but also, clearing houses, trade centres, world exposition centres, and exhibition parks. Uttar Pradesh should plan financial and commercial complexes at Lucknow with modern amenities, connectivity and research facilities through public-private participation. This will help attract major corporate houses to the city.

Andhra Pradesh has placed special emphasis on developing financial and other commercial services in order to make Hyderabad and Vishakhapatnam attractive locations for corporate headquarters and for transacting national and international business. Andhra Pradesh has also proposed well-designed and modern world trade centres at these locations through private participation. In addition, at Hyderabad, a World Export Exposition Centre is also being planned in collaboration with the Government of India. These policies have a vision and foresight.

In another instance, Haryana is concentrating on modernising the operations of the state financial institutions through reliance on information technology and greater professionalism. These institutions are redefining their role to focus on venture capital and small and medium size enterprises (SMEs).

Credit to the small and tiny sector has been a chronic problem. This needs to be solved through the mechanisms of self-help groups and incentives to local bodies for developing successful arrangements with rural banks.

3.4.8 Initiate Labour Reforms

The need for labour reforms are felt by most progressive states. Significant changes have already been made in selected sectors such as information technology, special economic zones and export processing zones. States such as Maharashtra and Karnataka have already initiated reforms on a limited scale. Besides, the central government is also in the process of changing legislation. Labour reforms are needed to meet new economic challenges, where efficiency and competition are the key considerations in policy formulation. The reforms include amendments in working time, exit policy, contractual labour, minimum wage, inspections related to labour disputes, trade unions and prevention of unfair labour practices and paper works related to labour laws.

3.4.9 Create a Strong Pool of Human Capital

Human capital is essential for attracting investment and achieving faster growth. Some states have built up a reputation for their skilled workers. Human capital is the composite effect of human development and intellectual disposition. It is important that the basic needs of every person are adequately met so that people can concentrate on their intellectual development. Therefore, the strategy of accumulating human capital should concentrate on health, hygiene, nutrition as well as intellectual development.

3.4.10 Promote Intellectual Development

The nature of the education policy, institutional development and the presence of quality faculties at the institutions are needed for intellectual development. The system should not permit very low quality students to secure professional degrees. This does not serve any purpose. Radical policy initiatives are needed to build an image comparable to states such as Tamil Nadu, Maharashtra and Karnataka.

Karnataka had been developing a network of Artisan Training Institutes (ATI), the District Training Institutes and Polytechnics to upgrade the quality and skill of manpower employed by SMEs. However, recently, ATIs are being closed and/or replaced by Centres for Entrepreneurship Development of Karnataka (CEDOK) and a chain of Rural Development and Self-

Employment Training Institutes (RUDSETI's), with the direct involvement from industry and communities.

CEDOK utilises the creative capabilities of the local community, particularly in less industrialised districts. The Government of Karnataka has ambitious plans to turn CEDOK into centres of excellence in entrepreneurship development, business management and training. RUDSETI's are now operational in most districts of the state. The management of these institutions is largely through private initiatives, focused on the needs of local industry.

3.4.11 Formulate Policies Leading to Economies of Scale and Increase in Domestic Consumption

Promote cost reducing policies such as low tax regimes so that domestic consumption increases. A large domestic market is essential for industry in the state to grow and attain economies of scale.

3.5 Create and Develop Institutions

There is ample literature to support the view that institutional development and long-term growth are positively correlated. However, institutions are known by their quality of work, delivery system and human resources manning them. Therefore, a proper environment is necessary to attract the right people to the right place. Private investment in education and institutional development, ranging from basic education to R&D, needs to be encouraged.

The need for institutional development has been recognised by most state governments, but Maharashtra and Karnataka are front-runners in this respect. Maharashtra is providing land in industrial areas for institutes for higher learning, including business schools, at nominal or subsidised rates.

There are many areas such as banking, legal system and constitutional matters where states have supportive roles in implementing central reforms. However, subjects such as business rules, law and order, state finances, state financial institutions, industrial development, rural development, statistics, education system, local-body programmes, academic research, economic analysis, which are at the heart of development, fall entirely under states' purview. These institutions need to evolve continuously because of a changing economic environment and new challenges.

3.5.1 Develop Centres of Excellence

Centres of excellence help build the image of the state as an attractive investment destination. The focus should be on promoting original research, and attracting the best staff. These should be merit-based and free from bureaucratic interference. Uttar Pradesh already has some of the important leaning centres such as Central Drug Research Institute (CDRI), IIT Kanpur, IIM Lucknow, Roorkee Engineering University, the BHU and Sanjay Gandhi Post Graduate Institute of Medical Science. However, it appears that state has not been able to project them as important contributors to the state economy. Many universities such as Allahabad University, once called as Oxford of the East, have lost their glory. Research and education centres need to market their potential through tangible results. Research activities from all key institutions should be documented and published to generate a sense of competition and awareness. An advisory body can be set up to publish and promote research in all areas of interest being contributed from the state.

3.5.2 Strengthen Statistical Analysis

Good decisions are helped by good analysis and high-quality data is the backbone of any meaningful analysis. If economic research is to be improved, special emphasis must be given to collection and analysis of data. States like Karnataka are developing data sources to estimate district level domestic product, when many states find it difficult to estimate state domestic product. Karnataka, through its institutions has also initiated a process of building extensive and credible databases on WTO matters, and its implications for various sectors, to be disseminated throughout industry for awareness.

3.6 Develop Sector Specific Policies

Different states have identified specific promotional activities or focus areas for industrial development and achieving high growth. These policies bring about clarity in the decision making process. Sector specific policies are also helpful in giving a direction to implementing authorities. In this endeavour, export promotion should be at the heart of overall policy frameworks. There is galaxy of policies, which can be simplified and compiled for public consumption. To enumerate some of these a list is presented below:

Facilitation and Knowledge Management Related Policies

1. Entrepreneurship development
2. Awards for meritorious entrepreneurs
3. Education policy

4. Environment and pollution control
5. Export promotion
6. Financial infrastructure
7. Simplification and streamlining of rules and procedures in administration
8. Development of industrial parks, complexes, estates and special economic zones and trade centres
9. Infrastructure development policy
10. Industrial policy
11. Investment policy
12. Land allotment policy
13. Labour laws and related procedures
14. Natural resources and conservation policies
15. Procedures and clearance to set up units
16. R&D policy
17. Human resource development
18. Tax related procedures
19. Sick industry policy
20. Women entrepreneurs
21. Single window system of project clearance

Promotional Policies

1. Agro and food processing policy
2. Electronic policy
3. Information technology policy
4. Transport policy
5. Telecommunication policy
6. Forest based industries policy
7. Handloom and handicraft policy
8. Biotechnology policy
9. Medical and medical college policy
10. Mineral and mineral based industries policy
11. Rice export policy
12. Road policy
13. Power policy
14. Rural non-farm sector policy
15. Sericulture policy
16. Tourism policy
17. PSU related policies
18. Small scale industry policy

3.6.1 Be Focused in Identifying Thrust Areas

It may be difficult to direct the incentives to every sector. In fact, an underperforming administration should focus on specific sectors, since it does not have the resources for more broad-based policies. Thrust areas should be periodically revised; as soon as the inflection point is reached in a sector, the government should change its focus to more underdeveloped sectors. Thrust areas should include comprehensive computerisation and quality education. Industries with a high ratio of capital stock to gross value added should be targeted for rapid development.

3.6.2 Analyse Incentives Provided to Industries by Other States

Andhra Pradesh, which attracted almost five per cent of FDI during 1991-2001, is known to offer some of the largest fiscal and infrastructure incentives for investment. On the other hand, states such as Karnataka do not mention any tax-based incentives in their policy document and prefers to focus on enabling factors. The GoK has withdrawn all exemptions on stamp duties and standardised the rates. The incentives on offer in Andhra Pradesh include:

1. Infrastructure facilities (roads, electricity, water, drainage, and allied infrastructure, etc.) at the doorstep of the proposed industry. Allied infrastructure includes facilities such as telecommunication, internet connectivity, transport linkages, housing complexes, container depots, exhibition halls.
2. Industrial Infrastructure Development Fund (IIDF) of Rs. 100 crore to take care of infrastructure needs of the proposed industry.
3. Whenever industries are located in places other than industrial areas (isolated areas), the government will bear up to 25 per cent or Rs. 100 lakh, whichever is less, infrastructure cost.
4. Captive power generation will be allowed.
5. To ensure no power cuts or tripping; dedicated feeders and dedicated lines will be laid to all existing and proposed industrial areas and industrial estates.

6. Up to 10 per cent of water from existing projects and new projects will be reserved for industrial purposes including existing industrial units.
7. Fifty per cent exemption on stamp duty, registration fee and transfer duty of lands meant for industrial use. Exemption of stamp-duty and registration fee for loan agreements, credit-deeds, mortgages and hypothecation deeds executed by the industries in favour of banks or financial institutions.
8. Additional investment subsidies at 5 per cent of fixed capital cost up to Rs. 5 lakh.
9. In case of large projects with capital investments exceeding Rs. 500 crore, the government should consider a special package of incentives, excluding tax-based incentives, on a case-to-case basis.
10. Twenty-five per cent rebate on power bills for three years, up to Rs. 50 lakh (large and medium scale) and Rs. 30 lakh for small-scale industry.
11. All procedures for inspections, maintenance of registers, pollution control procedures, etc. will be simplified.
12. Environment tax equal to the cost of plantation and maintenance for five years will be levied for growing green belts. Industries that cultivate green belts to the stipulated extent will be exempted from payment of this tax.
13. The need for conversion of land use from agriculture use to industrial use should be dispensed with except in the case of tank bed-lands.

Comments

Clearly, like Karnataka and several other states, Andhra Pradesh also is moving away from tax-based incentive to enablers in the large and medium scale segment. Andhra Pradesh is also trying to create facilities that are attractive to investors. Enablers are more sustainable than incentives. Once a facility is created it will continue to exist but incentives are likely to be withdrawn under fiscal pressure. In that case, it is not guaranteed that the investors would stay in the state. Therefore incentive schemes must be designed carefully. However, the case of mega projects where investment is long-term, the basis for considering incentives can be different.

3.6.3 Review Incentives to Small-scale Industries

Most of the states continue with the incentives for small-scale industries (SSI), probably because this segment is by far the largest employer. However, enablers and incentives differ across states. Some states, including Uttar Pradesh and Karnataka, have policies of preferential purchases from state SSI units. These governments also help in marketing SSI products through equity participation in agencies constituted for the purpose. However, at this time, existing subsidies are either being withdrawn slowly or being released in stages after careful monitoring as in the case of Tamil Nadu.

Comments

Deferral and exemption of interest rates, taxes and duties are inherently less sustainable policies. SSI should be freed from procedural hassles and permitted to develop competitively. A preferential purchase policy reduces the pressure on SSIs to maintain quality. In order to make SSI sector more competitive, the following policies could be implemented:

1. Most SSIs face high credit costs from commercial banks. States can help them by ensuring favourable credit policies so that credit is available at competitive cost and with fewer problems. Note that the prime lending rate (PLR) is no more the best rate for creditors.
2. Instead of supply side benefits, governments should consider influencing the demand side—by providing incentives to large customers of SSIs.
3. Further, taxes and duties can be brought down uniformly so that all segments benefit.