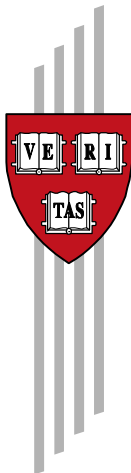


# **The Decade of Development: Goal Setting and Policy Challenges in India**

Jeffrey D. Sachs and Nirupam Bajpai

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### **Abstract**

The Government of India has proclaimed the new decade as a Decade of Development, during which India will meet bold targets for economic growth and social development. At his Independence Day speech, the Prime Minister announced that the government had set a target of doubling India's per capita income by the year 2010. This is an ambitious target, but one that we believe is certainly achievable. In order to achieve this target, India needs growth in GNP of the order of 9 percent per year over the next ten years. And in order to achieve this growth rate on a sustained basis, India needs a well-focused growth strategy. This paper outlines some of the key policy challenges in meeting these goals.

We believe that India has a chance for a tremendous breakthrough in economic development during the current decade. A decade of opening of the economy has produced new dynamism, most dramatically in the Information Technology sector, but in others as well. The world is waking up to India's crucial role as the largest democracy and as a dynamic economy, if still a low-income one on average. The new technologies (especially information technology and biotechnology) give new opportunities for economic and social development.

We suggest additional goals that India should set for herself, especially in the areas of health and education. These goals will help to galvanize domestic public opinion in support of the objectives of development, provide a gauge against which to judge the progress of policies, and help the world community to appreciate the efforts underway, and support them through increased flows of foreign investment. To make the first decade of the 21st Century a true Decade of Development will require a broad-based program of economic and social actions. We highlight some action areas in this regard.

**Keywords:** India's development, India's economic reforms

**JEL Classification Codes:** O11, O23, E65 and L86

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**Jeffrey D. Sachs** is the Director of the Center for International Development (CID) at Harvard University and the Galen L. Stone Professor of International Trade at the Department of Economics, Harvard University.

**Nirupam Bajpai** is a Research Fellow at the Center for International Development (CID) at Harvard University and the Director of the Harvard India Program at CID.

This paper was originally presented to the Prime Minister of India on February 2, 2001 in New Delhi. These observations are based on the ongoing analysis of India's economy at CID, as well as discussions that Prof. Sachs and Dr. Bajpai benefited from during several trips to India in the year 2000.

## The Decade of Development: Goal Setting and Policy Challenges in India

Jeffrey D. Sachs and Nirupam Bajpai

The Government of India has proclaimed the new decade as a Decade of Development, during which India will meet bold targets for economic growth and social development. During his address to the nation from the ramparts of the Red Fort, the Prime Minister announced on August 15, 2000 that the government had set a target of doubling India's per capita income by the year 2010<sup>1</sup>. This is an ambitious target, but one that we believe is certainly achievable. In order to achieve this target, India needs growth in GNP per capita of the order of 7 percent per year over the next ten years. In light of population growth of around 2 percent per year, total GNP should increase by around 9 percent per year. And in order to achieve this growth rate on a sustained basis, India needs a well-focussed growth strategy. This paper outlines some of the key policy challenges in meeting these goals.

The starting point for the Decade of Development is the setting of development targets for India. One key target is the rise in national income, but targets should also include improvements in health and education, as well as political participation. We therefore recommend the following additional targets for the Decade of Development:

- A decline of infant mortality rates from around 80 per 1000 live births to below 30 per 1000 live births by 2010. This should be combined with explicit targets for halting the AIDS epidemic, and treating key diseases such as malaria, tuberculosis, and other major killers.
- A reduction of adult illiteracy from around 45 percent to less than 20 percent by 2010.
- Universal primary education for ages 5-14 for girls and boys by 2010, with a school for all within 5 kilometers of home.
- All villages possessing electricity, a trunk road, telephone and internet connectivity, a school, clean water and sanitation, a village health worker, and local self-government by 2010.

### *The Two Pillars of Development*

There are two basic pillars of economic development. Broadly speaking, these are human development and economic growth. Human development signifies the ability of every individual to reach their full potential as healthy and educated citizens. This in turn requires major government commitments to health, education, and political participation of all citizens in

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<sup>1</sup> See Bajpai and Sachs (2000)

the country – with equal opportunity for all, and without discrimination by gender, caste, or region. No individual should be left behind. Economic growth signifies the broad-based and sustained increase in per capita GNP. Sustained economic growth depends on favorable business conditions, high levels of private-sector investment, technological upgrading, and successful integration into global markets.

There can be no sustained economic development without strong successes in both human development and economic growth. Development strategy therefore requires major public commitments to social sectors (especially health and education) and to improvements in the business environment in order to promote large-scale private investments needed for economic growth.

From a budgetary point of view, government resources need to be shifted towards investments in human development, leaving the private sector with the major responsibilities for increased economic growth. The government at both center and state levels should commit much greater resources to public health and education. At the same time, the government should turn over major infrastructure investments (in ports, airports, telecommunications, internet, electricity, large-scale water and sanitation facilities, and major roads) to private investors who can finance these projects using private capital.

The success or failure of the Decade of Development will therefore depend importantly on the quality and direction of public investments. Only government spending can promote the needed improvements in health and education. Only private spending can promote the needed improvements in infrastructure and productive enterprises. The major budgetary challenge is to shift government spending away from low-priority areas (such as untargeted subsidies, excessive bureaucracy, and investments that can better be left to the private sector) towards high-priority areas such as health and education that can only be met by public spending. India should also mobilize international financial support for the decade of development. This includes larger aid flows for human development as well as much greater flows of private investment to speed economic growth.

### *Meeting the Human Development Challenge in India*

India has not yet met the human development challenge. Adult illiteracy remains almost 50 percent, and up to 60 percent for women. Almost half of all children do not finish primary school. Only around 20 percent are in secondary school. Infant mortality rates are high by international standards, and life expectancy at around 63 years is much lower than in China, other countries in East Asia, and the advanced economies. Fertility rates are still very high, and the population continues to grow rapidly, pressing hard on India's fragile ecosystems and natural environment.

The shortfalls in health, education, and population control are of course mutually interactive. Illiterate mothers are much more likely than literate mothers to suffer the deaths of young children due to disease, since literate mothers are more effective at care giving and at seeking out medical help in emergencies. High infant mortality rates promote high fertility rates,

since households have many children to compensate for the risks of childhood deaths. High fertility rates, in turn, promote a social bias against educating young girls, since parents lack the resources to provide a quality education for all of their children, and therefore invest scarce resources in boys, for whom the market returns to investment are higher.

India dramatically under-invests in both public health and education and so do many other developing countries<sup>2</sup>. In the area of health, the Indian government (center and states) spends less than 1 percent of GNP for health, compared to an average of around 3 percent for all developing countries, and more than 5 percent for high-income countries. The public health services are broken down, especially at the primary level. Study after study shows that the primary health centers (PHCs) fail to provide an adequate set of services for the population. The poor in India are left with almost no health services, besides the very meager services that they can pay for out of pocket.

The situation in health will get worse, not better, if there is no increase in public investment in health. The AIDS epidemic threatens to rise dramatically in the coming years. Malaria is resurgent, as is tuberculosis linked especially to AIDS.

The governments of India should therefore take the following immediate steps:

- Announce specific and bold targets for health by 2010, which should be adopted nationally and in each state.
- Increase public spending on health, to at least 3 percent of GNP within three years. The increase should come mainly at the state level, and mainly to finance prevention and treatment of primary health conditions such as infectious diseases (AIDS, TB, malaria, respiratory infection, diarrhea), nutrition, and reproductive health.
- Increase public awareness and public measures to combat the AIDS pandemic, using both domestic budget resources as well as increased international funding.
- Convene a meeting of Chief Ministers of all Indian States in 2001 to discuss how the states will meet the health targets. This meeting will allow states to present their most successful initiatives, so that all states can adopt “best practices” in public health.
- Create fiscal incentives at the Center and state levels to promote the spread of health services into every village in the country. Madhya Pradesh has successfully trained a new cadre of community health workers for more than 50,000 villages in the state. This example may provide a strategy for all other states.
- Support community oversight of village-level health services, including panchayat responsibilities for oversight of doctors, primary health clinics, and other public health services.

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<sup>2</sup> Brazil's President Fernando Henrique Cardoso has recently launched an offensive on poverty, pledging \$6 billion for health and education programs to address what he said was 500 years of scant attention to the grinding plight of the poor.

- Aggressively utilize information technology (such as internet connectivity of primary health centers) to improve the performance of the public health facilities.

India needs a similarly bold strategy for universal education, at least through age 14. Special attention is needed to ensure the education of girls on the same basis as boys, and to ensure the continuation of children in school through the ninth year.

Public spending in education should rise from the current level of around 3 percent of GNP to at least 5 percent of GNP (and probably more) to meet these goals. This money should be spent mainly by state budgets, but with local responsibility for overseeing the effective operation of schools. In Madhya Pradesh, panchayats are given responsibility for ensuring school performance at the local level, including the right to withhold teachers' salaries in the event of poor teacher performance.

Studies have shown that more parents would like to send their children to school, but are dissuaded from doing so because of school fees, the poor quality of education in many schools, and great distances from home to school in rural areas. The large distances to schools especially hinder the attendance of girls. Part of the budgetary increase at the state level should therefore be to ensure the availability of schools within close proximity to every village.

One of the most effective ways to increase student enrolments is through the provision of free school meals (e.g. school breakfasts or mid-day meals, or both). Tamil Nadu has been very successful in implementing a school meals program, and this example should be generalized throughout the country. International donors, especially the United States, may be prepared to contribute to such a large-scale program, especially if the Government of India can demonstrate that such a program is an integral step in achieving universal primary education. School meals not only improve school enrolments and attendance, but also childhood nutrition. Regular school meals can be augmented with nutritional supplementation, such as Vitamin A tablets on a six-month basis.

In addition to formal education in schools, the government should promote programs of adult literacy. Students and literate family members can be encouraged to help teach their illiterate parents how to read. Small financial incentives can be organized to promote adult literacy. This would also enable the private sector to open private enterprises to promote adult literacy, with income generated by financial incentives provided by the government.

The governments of India should therefore take the following immediate steps:

- Announce specific and bold targets for education by 2010, that should be adopted nationally and in each state
- Increase public spending on education, to at least 5 percent of GNP within three years. The increase should come mainly at the state level, and mainly to finance universal education through age 14.

- Convene a meeting of Chief Ministers of all Indian States in 2001 to discuss how the states will meet the education targets. This meeting will allow states to present their most successful initiatives, so that all states can adopt “best practices” in public education.
- Create fiscal incentives at the Center and state levels to promote the spread of education into every village in the country.
- Support community oversight of village-level schools, including panchayat responsibilities for oversight of teachers.
- Introduce mechanisms such as a school mid-day meals program to increase school attendance, and to improve the overall health and nutrition of school children. The government should appeal to international donors to help support such a program throughout the country.
- Aggressively utilize information technology (such as internet connectivity of primary schools) to improve the performance of the public school facilities.

The social agenda should focus most urgently on health and education, but it should also include other social initiatives, such as increased political participation at the village level (through village councils or panchayats), and greater social and political equality for girls and women.

### *Meeting the Economic Growth Agenda*

Investments in health and education will have direct and beneficial effects on economic growth, by fostering a healthier, better educated, and therefore more productive labor force. But social investments are not enough. Social investments must be combined with a large improvement in the business environment in India in order to promote a more rapid rate of economic growth.

History has shown that export-led growth is a crucial component of overall economic growth. Without rapid export growth, there cannot be rapid growth of imports. But imports are necessary in order for India to obtain the modern technologies that have been developed abroad. Thus rapid export growth is a sine qua non for rapid economic growth.

Rapid export growth can only be achieved in areas of Indian comparative advantage. These include labor-intensive manufacturing sectors such as apparel and textiles, automotive components, footwear and leather goods, jewelry, processed foods, and electronics assembly. They also include high-technology areas in information technology and biotechnology (e.g. pharmaceuticals) that rely on India’s tremendous scientific and engineering capacity.

India has achieved some success in export led-growth, but much less than many other Asian countries, notably China. China’s exports grew from around \$20 billion per year in 1980

to around \$200 billion in 2000, or roughly increasing tenfold. India's exports, by contrast, grew from around \$17 billion in 1980 to around \$35 billion in 2000, or roughly doubling.

There are several barriers to more rapid export growth. Fortunately, most of these barriers can be overcome by regulatory changes and private investments rather than public money. Some of the crucial steps needed for a faster growth of exports include:

- Reform of labor laws to ensure the right of enterprises to hire and fire workers for economic cause, subject to the normal rule of law (e.g. prevention of arbitrary dismissals in retribution for union activity)
- Improvements of infrastructure, mainly ports, telecommunications, airports, power, and roads (discussed below).
- Elimination of remaining administrative barriers to foreign direct investment in export oriented sectors (e.g. elimination of need for government approvals)
- Much more active use of special economic zones and export processing zones as incentive schemes for export-oriented enterprises. States and private enterprises should be free to establish export processing zones according to general legislation
- Elimination of remaining reservations for small-scale enterprises, especially in export oriented sectors but also generally in the economy

### *Improvements in Infrastructure*

India's infrastructure is notoriously bad. The road networks are insufficient and in very poor quality. Ports are completely inadequate, so that most exports must be transhipped through Singapore or Sri Lanka, rather than shipped directly from Indian ports. Airports are insufficient and the airspace is reserved for just a few carriers. Telecommunications are notoriously poor in quality and coverage. Electricity supplies are irregular, scarce, and of low quality. Water supplies are scarce in many areas, and insufficient for key industries (such as chemical processes) as well as household use. And in general, neither the government at the center or the state levels can afford to upgrade these infrastructure systems out of budgetary funds. Indeed, many of these sectors already impose huge fiscal costs as government provides overt and hidden subsidies to these key sectors.

Fortunately, India could enjoy a major – indeed fundamental – improvement in infrastructure quality without major budgetary increases. The key is regulatory change, involving two main steps. First, regulatory and oversight responsibilities for almost all infrastructure should be devolved to state level. This includes areas now under central control, such as major ports and airports, and telecommunications. The states have a much better idea of their specific infrastructure needs than do the bureaucracies at the central level. Second, infrastructure should be provided mainly by privately financed projects without state guarantees. The entire cable TV industry in India has grown up without government subsidy, precisely



because it was not regulated. Other key areas – telecommunications, internet, water, power – would similarly expand dramatically if private investors were allowed to enter and compete.

Each sector requires its own reforms. Reforms in telecommunications have begun, especially with the end of the VSNL monopoly by 2002 and the intention to disinvest a majority part of the government's holding in the state company. Still, the regulations on local telephony and internet services are blocking a substantial growth of such services throughout the country. Similarly, barriers to building new airports and to licensing new aviation companies has stymied the development of an efficient and low-priced network of domestic and international flights. One can go on and on.

The government of India should therefore take the following steps in infrastructure:

- Devolve major regulatory responsibilities to the states in the following areas of infrastructure: ports, airports, power, telecommunications (international long-distance, domestic long-distance, local, data transmission, wireless), internet service, water and sanitation. The individual states should have the powers to liberalize these sectors, permit entry of private firms, and admit foreign investors.
- The center and the states should set goals for specific areas of infrastructure, including: universal village access by 2010 to telephony, electric power, internet connectivity, and roads to major towns and cities.
- Open each infrastructure sector to private-sector competition, including rights of entry in service provision, by both foreign and domestic providers

### *Information Technology and the Decade of Development*

The Information Technology sector will have three critical roles in India's development process. First, IT will be a major private-sector industry, providing India with the largest single source of foreign exchange earnings. Second, IT will be critical input into the efficiency of the private sector. India's exporting firms will require low-cost high-quality connectivity to ensure their competitiveness with the international competition. This is true in the whole range of export activities, from the labor-intensive sectors such as horticulture and apparel to the most sophisticated high-tech sectors such as machinery and pharmaceuticals. Third, IT will be a critical input into the social process, since IT will support effective provision of public services (e.g. e-governance), health (e.g. telemedicine), and education (e.g. distance learning).

India is blessed with world leadership in IT, with world-class and world-famous entrepreneurs stretching from Silicon Valley to Chennai, Bangalore and Hyderabad. But within India, the IT sector continues to be hampered by unnecessary government regulation (e.g. the VSNL monopoly until 2002), low bandwidth, and low take up of IT by government agencies, including the health and education sectors.

India needs a specific IT strategy to address the key areas of e-governance, e-commerce, e-health, and e-education. We therefore recommend the following steps:

- The center and state governments should hold an IT summit in late 2001 in order to spell out further regulatory changes needed to speed the introduction of IT into widespread use and application in India.
- State governments should be given much more freedom to adopt and adapt key technologies (e.g. the wireless local loop developed by IIT Madras).
- The center and states should adopt goals to ensure IT connectivity in all villages in India by 2010. A central fund should be established to provide matching grants to states for programs to support rural IT connectivity.

### *A Fiscal Strategy for the Decade of Development*

The center and state governments must undertake a fundamental review and reorientation of fiscal policies in order to support the decade of development. There are three goals. First, the overall budget deficit must be reduced sharply, from around 10 percent of GNP (center plus states) to around 4 percent of GNP by 2003. Second, the expenditures should be shifted from economic sectors (e.g. infrastructure) where the private sector can carry the investment burden, to social sectors (e.g. health and education) where increased public spending is vital. Third, social program should be redesigned to make a maximal impact per rupee spent. This can best be accomplished by replacing generalized subsidies (such as the Public Distribution System or free electricity for farmers) with targeted programs (such as school meal programs).

The current budget deficit is around 10 percent of GNP, and this should be reduced to around 4 percent of GNP to ensure macroeconomic stability, and to prevent an unmanageable buildup of public debt. Thus, the overall deficit should be reduced by around 6 percent of GNP. At the same time, social spending should rise by around 4 percent of GNP, including an increase of 2 percent of GNP for health and at least 2 percent of GNP for education. This means that the government (center and state) must find fiscal resources of around 10 percent of GNP in order to reduce the deficit by 6 percent of GNP and increase social spending by around 4 percent of GNP at the same time.

Most of this 10 percent of GNP should come from cuts in existing expenditures rather than from increases in taxation as a percent of GNP. Current government spending (center and state) is already around one-third of GNP, which is quite high by comparison with other developing countries in India's income range. If India were to increase expenditures further as a percent of GNP, it would have a very difficult time raising the internal tax revenues to cover the spending program.

Of the 10 percent of GNP needed, perhaps 1 percent of GNP can be found (negotiated) in the form of increased grant aid from abroad. Given a GNP of around \$US 400 billion, this

would mean an additional \$US 4 billion per year in international aid for India, a hefty sum, but not an impossible target for increased support for health and education. The remaining 9 percent of GNP (or so) will have to be found mainly by cuts or reorganization of current spending programs.

We can identify the following prime areas of potential expenditure reduction over a three-year period:

Central expenditures:

	<u>Percent of GDP</u>
1) Disinvestment of PSUs (with revenues used to pay down the public debt) <sup>3</sup>	1.0
2) Closure of loss-making PSUs <sup>4</sup>	0.3
3) Reduced bureaucracy <sup>5</sup>	0.3
4) Central power sector undertakings support to SEBs (NTPC, NHPC etc.) <sup>6</sup>	0.8
5) Reduction in subsidies, including PDS and transport	0.5
6) Reduced infrastructure investments, taken over by private-sector projects <sup>7</sup>	1.3
7) Reduced interest payments on account of contractionary fiscal measures <sup>8</sup>	1.0

State level expenditures

1) SEB commercial losses without subsidy due to differential pricing policy	1.3
2) Water sector reform, including rise in water tariffs	0.3
3) Transport reform, including rise in transport tariffs	0.4
4) Closure of state-level loss-making PSUs	0.6
5) Reduced bureaucracy	0.4
6) Reduced infrastructure investments, taken over by private-sector projects	0.2
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<b>Total public savings via furthering expenditure reforms:</b>	<b>8.4</b>
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<sup>3</sup> The net worth of central PSUs is estimated to be Rupees 1324 billion, a little over 6.5 percent of GDP. The capital employed is placed at around Rupees 2230 billion. (see Economic Survey 1999/00).

<sup>4</sup> Of a total number of 236 central PSUs, there are 104 loss-making PSUs that account for roughly Rupees 60 billion in annual losses to the central exchequer. (see 9<sup>th</sup> Plan Mid-Term Appraisal, 2000).

<sup>5</sup> A freeze on new employment matched by normal attrition through retirement and death. On an average, about 125,000 central government employees are taken off of government payroll each year due to these reasons. Implementation of such an approach over a period of four years could result in a reduction in the central government employment by approximately 12.3 percent, or a reduction of around half a million employees from the present total of about 4 million. On an average, the government could save about Rupees 20 billion every year on account of reduced wages and salaries, and the associated reduction in the operating expenses. ( see Bajpai and Sachs 1997).

<sup>6</sup> SEBs owe huge sums to the central power sector undertakings, such as the National Thermal Power Corporation (NTPC), National Hydro Power Corporation (NHPC), Damodar Valley Corporation (DVC), and the Power Finance

We estimate expenditure saving that could be achieved by each of these line items to a total of roughly 8.4 percent of GDP over three-years. Of course, we would stress that these are approximate. Perhaps these bold cuts could be augmented by 1 or 2 percent of GDP in increased tax collections, though credibility in collecting more taxes would depend firmly on making sharp cuts in major areas of waste.

It may seem politically impossible to proceed with such bold cuts, but it should be remembered that these cuts would be combined with substantial increases in public and private spending. Public spending would rise in health and education, including some highly visible and politically popular programs such as school meals and increased availability of primary health facilities. Private spending in infrastructure would also be politically popular, as it will mean the much faster diffusion of new technologies (cellular phones, internet connectivity) to rural areas.

The reorientation of spending should also be accompanied by a very different system for delivering public services. The key to effective social service delivery is responsibility of local providers to the local community. For primary schools or primary health clinics to deliver effective and quality services to the community, the teachers and doctors must be monitored effectively by the local communities. We have already mentioned the important experiences of Madhya Pradesh in devolving key responsibilities and authority to the panchayats in the areas of primary health and education. The state provides the funds to hire the doctors and teachers, but the panchayats can withhold payments to these service providers if they are not doing their jobs (such as failing to show up at the clinics and schools).

### *Some Additional Tasks in the Near Future*

There are, of course, a large number of additional policy areas that must be addressed to achieve a successful Decade of Development. Without going into great length, we want to mention briefly four additional themes:

- The Planning Commission and Finance Ministry should work closely with state governments to create new ways for monitoring the fiscal and reform performance of the individual states. There is not enough information available as to what is really happening in public policy and development outcomes at the state level.

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Corporation (PFC) etc. It is estimated that as of September 1998, the SEBs owed Rupees 16,800 crore (Rupees 168 billion) to these central power sector undertakings. (see Kannan and Pillai, 2001)

<sup>7</sup> Annual infrastructure investment for ALL India is placed at around Rupees 650 billion (US \$ 14 billion) which is roughly 3.2 percent of GDP. We figure that a little less than half of this amount can be reduced (1.3 % of GDP at the Center and 0.2 % at the States) in investments over a three-year period if the private sector were to take on large-scale investments in the infrastructure sector. (for details refer to India Infrastructure Report, 1996).

<sup>8</sup> This additional budgetary saving is a result of a reduction in real interest rates that will come from the overall package of contractionary fiscal measures suggested above. Interest payments were placed at Rupees 88,000 crores (Rupees 880 billion) in 1999/00 or 4.6 percent of GDP.

- The Planning Commission and Finance Ministry should create new incentive mechanisms (e.g. conditionality schemes or matching grants) to ensure that state governments take actions to meet announced targets.
- State governments should be required to come up with plans, within one year (and following working conferences of the center and state governments) to ensure that all villages within their states participate in the Decade of Development. They should commit, in particular, to a policy approach in order to extend basic infrastructure and social services to all villages within the state.
- The Government should harmonize its international economic policies to support the Decade of Development. India will need several billion dollars of international donor support to achieve the desired goals in the health and education sector. India will also need favorable market access in the rich-country markets in order to achieve the targets for export led growth. India will also need to attract very large-scale foreign investments, and this too will require support of source-country governments, (Government policies in the U.S., Europe, and Japan can have powerful effects on the direction of foreign investment flows of their multinational firms).

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