# India Development Update

## April 2013

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This update was prepared by Denis Medvedev and Smriti Seth (SASEP) under the guidance of Vinaya Swaroop (Sector Manager, SASEP) and Deepak Bhattachasi (Lead Economist, SASEP) and on the basis of discussions with experts in New Delhi’s think tanks and policy making circles. Section 3 was authored by Tehmina Khan and Sanket Mohapatra (DECPG) and Section 4 was authored by Somil Nagpal (SASHN) with inputs from Gerard La Forgia, Ajay Tandon (EASHH), and Smriti Seth (SASEP). The team benefitted from valuable comments and discussions with Martin Rama (SARCE), Rinku Murgai (SASEP), and Sudip Mozumder (SAREX). Onno Ruhl (Country Director, SACIN) and Ernesto May (Sector Director, SASPM) linked the team to the Bank’s overall strategy and steered them in that direction.

The updates are published twice yearly and give an overview of developments in the Indian economy in a global context, and also highlight topics related to medium- and long-term growth which are in the public debate at the time of writing. A special topic of the current update is India’s march towards universal health coverage and its fiscal implications.
Executive Summary

The Indian economy is expected to expand by 5.0 percent in FY2013. With this outturn, India is likely to remain one of the faster-growing nations in the world, although the expected pace takes a step back from the very high growth rates achieved in the late 2000s. As economic conditions around the globe remained challenging during the year, a large number of countries experienced a deceleration in growth and India was no exception. However, while the persistent weakness in the global environment contributed to the slowdown in India’s growth, only a small portion of the deceleration can be attributed directly to the adverse contagion effects from the euro area debt crisis.

Inflation and fiscal deficit have declined, but the current account deficit has widened. The Reserve Bank of India (RBI) has had to strike a tough balance between providing some monetary stimulus and restraining further price growth. As inflation, measured by the wholesale price index, has begun to decelerate in recent months, the authorities may gain additional policy room. Fiscal performance by the states has largely followed the adjustment path recommended by the 13th Finance Commission and, although the federal government deficit remains elevated, policy actions to reduce fuel subsidies and the recently presented FY2014 Union Budget have reaffirmed the central authorities’ commitment to fiscal consolidation. Weak exports, elevated imports, and a significant depreciation of the rupee in the first half of FY2013 have widened the current account deficit to a record high, although recent data point to some narrowing of the trade gap.

Going forward, growth is expected to accelerate to its high long-run potential. Recent data point to some improvement in economic activity. Private consumption and investment growth accelerated in the third quarter of FY2013. In the last few months, WPI inflation fell below 7 percent, exports growth turned positive, and imports growth decelerated. With a pick-up in domestic activity and a gradual improvement in the global environment, growth is expected to accelerate to 6.1 percent in FY2014 and 6.7 percent in FY2015. In the longer term, given favorable demographics, rising educational attainments, and high rates of capital accumulation, India could well achieve and surpass the average 8 percent GDP growth recorded over the past ten years.

Continued progress on the reform agenda is key to mitigating downside risks. The authorities’ ability to respond to negative external shocks is more limited today than during the 2008-09 global crisis. Although the RBI continues to maintain ample reserve coverage, further shocks to the current account could put further pressure on the rupee. Fiscal prudence will become increasingly important in the near future to achieve further reduction in debt-to-GDP ratios. Continued progress on the domestic reform agenda to encourage investment and unlock supply constraints while adhering to fiscal consolidation is critical to supporting growth and lowering macro vulnerabilities.

Additional efforts may be needed to create the fiscal space for India’s progress towards universal health coverage. Based on recent trends in the roll-out of a new wave of government-sponsored health insurance schemes (GSHIS) launched since 2007, the share of Indian population covered by some form of health insurance could rise from 25 percent in 2010 to 50 percent by 2015. In particular, the coverage of GSHIS could increase to more than 500 million persons by 2015. While the schemes are a crucial component of building human capital and fill an important niche for an otherwise under-served population, the additional expenditures required to finance the initiatives could amount to 0.4-1.0 percent of GDP in 2015. Based on recent history and under the benign assumptions of the baseline scenario developed in this update, the central government is likely to be able to finance its share of the incremental expenditure towards broadening access to GSHIS. However, divergence in growth performance at the state level and the lower income elasticities of public health expenditure at the state level imply that a
number of states may need to substantially reallocate fiscal resources to finance the expansion of GSHIS. Alternatively, the central government may have to take on a greater share of the cost, a prospect which could make the progress towards fiscal consolidation more challenging.
1. Recent Economic Developments

1.1 GDP and its components

Economic growth slowed in FY2013. The growth of real GDP at factor cost fell to 4.5 percent y-o-y in the third quarter (Q3) of FY2013, the slowest pace in the past 15 quarters.\(^1\) On a seasonally-adjusted annual basis, Q3 growth came in at 4.6 percent, below the growth rates achieved in the previous two quarters.\(^2\) The industrial sector, particularly manufacturing, was affected by weaker investment and export demand, reflected in a fall in production of capital goods and consumer durables. Contraction in the mining sector, on account of sealed mines, also contributed to the industrial slowdown. Agriculture growth was also affected by a delayed monsoon and lower-than-expected winter crop; it fell to 1.8 percent during FY2013 from 3.6 percent in the previous year.

Weakness in the industrial sector pulled down growth in services. Growth in the industrial sector began weakening in FY2012 as mining activity stalled and manufacturing output decelerated. These weaknesses continued in FY2013, bringing down the average industrial growth to 3.3 percent during FY2012-FY2013 from 9.2 percent during the preceding two years. Through forward and backward demand linkages, this outturn precipitated a deceleration of activity in the services sector, bringing down its projected growth rate to an eleven-year low of 6.6 percent in FY2013. Sectors like logistical services (e.g., transport, etc.) and financing and business services were particularly affected. However, in a sign that the deceleration may be bottoming out, there was some pickup in industrial growth in Q3 FY2013 to 3.3 percent y-o-y from 2.7 percent in the previous quarter, primarily due to an improvement in manufacturing activity.

Private consumption and investment gained some momentum in the last quarter. During the first half (H1) of FY2013, private expenditure and investment were affected by low levels of confidence. The business expectations index, as estimated by the RBI’s industrial outlook survey, fell by 6.4 percent during the first three quarters of FY2013 and consumer confidence in current and future economic conditions also worsened during the fiscal year. However, growth in final consumption expenditure and gross fixed capital formation picked up in Q3 FY2013, suggesting that the slowdown in demand may be bottoming out. Private final consumption—which decelerated to an average growth of 2 percent y-o-y during H1 FY2013 from 8 percent in the previous year—gained momentum and grew at 4.6 percent y-o-y during Q3. Similarly, growth in gross capital formation improved to 6 percent y-o-y in Q3 from an average growth of -2.8 percent in the previous two quarters and 4.4 percent during FY2012. On a seasonally adjusted basis, both private final consumption and investments registered the highest q-o-q growth rates in more than five quarters.

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\(^1\) Throughout the document, FY2013 refers to fiscal year ending March 31, 2013.

\(^2\) Seasonal adjustment carried out with TRAMO/SEATS.
pick-up in momentum was also reflected in the production of capital goods, which registered positive m-o-m seasonally adjusted growth rates for four consecutive months since October. In contrast to the private sector, growth in public consumption slowed in line with the central government’s fiscal consolidation efforts, declining to 1.9 percent y-o-y in Q3 from an average growth of 8.1 percent during H1 FY2013.

1.2 Balance of Payments

After widening to a record high last year, the current account deficit deteriorated further in FY2013. In FY2012, the deficit on the current account for the first time exceeded 4 percent of GDP, after averaging 2 percent of GDP during the previous five years. The deterioration in the current account balance continued in the current fiscal year when the deficit rose to a record 5.4 percent of GDP in the first three quarters of FY2013, compared to 4.1 percent during the corresponding period a year ago. Moreover, the worsening in the current account balance occurred despite a robust inflow of remittances, which increased to 1.7 percent of GDP during Q1-Q3 FY2013 from 1.6 percent last year.

Worsening of the merchandise trade balance explains the entire deterioration in the current account. Compared to the first three quarters of last year, the merchandise trade deficit widened to 11.3 percent from 10 percent of GDP. Some of the deterioration was offset by an improvement in services trade, which rose to a surplus of 3.5 percent of GDP during Q1-Q3 FY2013 from 3.4 percent last year. Nonetheless, the increase in the overall trade deficit—driven by a growing gap in merchandise trade—explains the entire deterioration in the current account balance.

Exports underperformed while imports remained elevated. In 2011, India’s export volumes grew by 25 percent, outpacing both the global and developing country averages (6.1 and 7.2 percent, respectively). However, as global trade growth decelerated to 3.6 percent in 2012, India’s export volume growth fell even more sharply to 2.5 percent. The combination of this deceleration in exports volume growth and a substantial depreciation of the rupee over the same period resulted in a 6.5 percent decline y-o-y in the US$ value of merchandise exports during Apr-Dec FY2013. Imports, on the other hand, remained virtually unchanged (in US$) due to largely to a 13 percent y-o-y increase in oil imports, which account for more than one-third of total imports. Although oil prices retreated from their highs of early 2012, the volume of oil imports grew by 15 percent in Q1-Q3 FY2013, negating any potential improvement in the trade balance. As a result, the merchandise trade deficit widened by nearly 11 percent in US$ and, due to the depreciation of the rupee, more than 27 percent in INR, driving the widening in the current account gap.

3 The cost of food imports rose substantially in FY2013 due to a rise in global food prices, but this had a small impact on the overall trade balance as the main categories of food imports amount to less than 3 percent of GDP.
The trade balance showed signs of improving in recent months. Merchandise export growth (in US$) turned positive during the first two months of 2013, bringing down the decline in exports from 6.5 percent y-o-y during Apr-Dec to 5 percent y-o-y during Apr-Feb. Growth in merchandise imports also slowed to 1 percent y-o-y during the Apr-Feb period from 33 percent last year. As a result, the trade deficit, which touched an all-time high of US$22 billion in October (24.7 percent y-o-y growth), fell to US$15 billion by February 2013 (same as February 2012). In an attempt to control the trade deficit by curbing gold imports—which accounted for more than 10 percent of total imports in Q1-Q3 FY2013—the authorities increased import duties on refined gold from 4 percent to 6 percent and on gold ore and bars from 2 percent to 5 percent.

Capital flows remained robust due to an influx of portfolio investments and NRI deposits. India, like several other emerging markets, attracted an influx of net portfolio investments during the first three quarters of FY2013, worth US$14.2 billion, up from US$2.7 billion during the corresponding period last year. In addition, a depreciated rupee and deregulated interest rates helped increase NRI deposits during Q1-Q3 FY2013 by 66 percent y-o-y. FDI flows, however, declined during the first three quarters of FY2013 by 26 percent y-o-y, due to poor business sentiment and uncertainty surrounding the FDI policies. In order to attract more FDI inflows, the government took several steps to encourage foreign investment by allowing FDI in multi-brand retail and aviation. On the whole, capital inflows increased by 21 percent y-o-y during the first three quarters of FY2013, but this growth was significantly below the 40 percent outturn registered during the corresponding period of FY2012. Consequently—even though capital inflows continued to provide more than ample cover for the current account deficit—the extent of the cover came down substantially.

The depreciation of the rupee appears to have lost steam, and the currency strengthened in the second half of the year. With a weaker BoP position, the rupee continued to lose value during FY2013 and hit an all-time low in June, remaining around that level until August. Between April and August 2012, the monthly average INR/USD exchange rate depreciated by 7 percent. However, during the last quarter of 2012, like currencies of most emerging economies, the rupee gained value and appreciated by 2 percent between September and January. While some of this appreciation can be attributed to a weaker dollar, it could also partly be due to an improvement in investor sentiments after the announcement of new FDI policies in September. The real effective exchange rate (REER) mostly mirrored the movement of the nominal exchange rate: it fell by 5 percent between April and August and gained 2 percent since. However, the REER has remained below its long term average.

Foreign exchange reserves declined somewhat but the import cover improved. As of end-March, foreign exchange reserves held by the RBI were US$1.8 billion less than a year ago, partly because of valuation effects and partly...
because of interventions in the forex market.\textsuperscript{4} However, the import cover (of reserves) improved to 6 months in FY2013, up from 5 months in FY2012, due a fall in import demand.

**External debt rose but remains low as a share of GDP.** Higher NRI deposits, commercial borrowings and trade credits pushed up India’s external debt to US$376 billion by December 2012, an increase of 9 percent from the beginning of the fiscal year. However, external debt remains relatively low at 20.6 percent of GDP. The composition of external debt also changed gradually, with an increased share of short term obligations, particularly trade credits. The share of short term external debt (by original maturity) increased to 24 percent by December 2012, from 21 percent two years ago. Foreign reserves cover of external debt has eroded over the years, from 98 percent in March 2010 to 78.8 percent in December 2012.

**1.3 Inflation and financial sector**

**Headline inflation fell to its lowest level in over three years.** Wholesale inflation averaged 7.4 percent during Apr-Feb, down from 9.1 percent during the same period last year. However, headline retail inflation increased to more than 10 percent y-o-y after December—even as wholesale inflation continued to decrease—primarily because food prices have a higher weight in the consumer price index.

Core inflation is now within RBI’s comfort level. Core inflation, or manufactured non-food inflation, is the biggest component of overall inflation and is used as a proxy for elastic consumption demand by the central bank. It fell to 3.8 percent y-o-y in February 2013, compared to an average of 7.3 percent during FY2012 and well within RBI’s comfort level of 4 percent.

**Food inflation remained high while fuel inflation accelerated after deregulation of diesel prices.** Food wholesale inflation averaged 9.3 percent y-o-y during Apr-Feb FY2013, significantly above 7.1 percent y-o-y during the same period last year due to a surge in vegetable prices. Consumer food inflation averaged a slightly higher 10.7 percent between April and February. In the meanwhile, wholesale fuel inflation rose to 10.5 percent y-o-y in February from 7.1 percent in the previous month after the government allowed phased deregulation of diesel prices in January.

After pausing for nine months, softening inflation prompted the RBI to reduce lending rates in two consecutive review meetings. The central bank reduced the policy repo rate by 25 bps twice (in January and March) to 7.50 percent, after holding it constant for the last seven meetings. The RBI governor cited softening inflation and decelerating economic growth as the primary considerations for monetary easing.

**RBI eases monetary policy**

**Slowing economic activity and rise in non-performing loans affected credit expansion.** Growth in gross bank credit slowed to 8.4 percent between Mar 2012 and Jan 2013, from

\textsuperscript{4} Foreign exchange assets including gold, SDR, and IMF reserve position. Foreign currency reserves (excluding the three items above) declined by US$343 million relative to last year.
10.5 percent during the same period last year. This slowdown was the most pronounced for small and medium industries, and the services sector. Part of this slowdown in credit was due to increased risk aversion in the banking sector as asset quality deteriorated, which prompted banks to switch from credit creation to investments in SLR securities or government bonds. Ratio of gross non-performing assets (NPAs) to advances increased significantly from 2.95 percent in March 2012, to 3.59 percent by September 2012 for all commercial banks—amongst which public banks were the worst affected.

**Credit growth has outpaced the growth of deposits.** Despite a slowdown in credit expansion, credit growth has been above the growth in deposits. The liquidity deficit remained above the RBI’s comfort level during most of FY2013 as the credit-deposit ratio of commercial banks increased to 77.4 by January 2013, from an average of 76.5 in FY2012. To raise liquidity, the RBI lowered the cash reserve ratio (CRR) and statutory liquidity ratio (SLR) by 0.75 percent and 1 percent, respectively, during FY2013. It also injected primary liquidity worth 1.5 trillion rupees into the economy through several open market operations.

**1.4 Fiscal Developments**

**The Union Budget delivered on the Finance Minister’s commitment to contain the fiscal deficit.** The FY2013 overall deficit—using the government of India definition—was limited to 5.2 percent of GDP, above the 5.1 percent goal in last year’s budget but below October’s revised target of 5.3 percent. Using the World Bank definition, which discounts one-time divestment proceeds from revenues, the overall deficit in FY2013 remained unchanged from last year’s budget target of 5.4 percent of GDP. This represents a 0.6 percent of GDP improvement over the FY2012 outturn and a 1.4 percent of GDP reduction from the peak deficit in of 6.8 percent of GDP in FY2010. However, the deficit remains well above the 3.7 percent of GDP average recorded in FY2005-FY2008, following the adoption of the Fiscal Responsibility legislation and prior to countercyclical stimulus in response to the global crisis.

**Revenues underperformed as the pace of economic activity slowed.** Although gross tax revenue improved to 10.4 percent of GDP from 9.9 percent a year ago, the increase was 0.2 percent of GDP less than the budgeted amount. Corporate taxes, excise taxes, and customs duties each brought in 0.1-0.2 percent of GDP less than expected, while income tax revenues were 0.1 percent of GDP higher. Non-tax revenue was 0.3 percent of GDP lower than budgeted, due mainly to lower-than-expected proceeds from telecom spectrum auctions. As a result, total revenue and grants reached 8.7 percent of GDP, 0.3 percent of GDP higher than last year but 0.5 percent of GDP below the budgeted amount.

**Expenditure compression in the social sectors and reduction in capital spending allowed for reaching the fiscal targets.** Despite the lower-than-expected revenues, total expenditure was contained to 14.1 percent of GDP, 0.5 percent of GDP below budget and 0.2 percent of GDP less than a year ago. Current expenditure registered a small decline vis-à-vis the budgeted amount—despite a 0.7 percent of GDP increase in the subsidy bill—on account of major reductions in plan spending on rural development (0.2 percent of GDP), health, schooling, and power. In addition, public investment declined to less than 1.7 percent of GDP, 0.3 percent of GDP below budget and 0.1 percent of GDP below last year’s outturn.
The central government’s pace of fiscal consolidation continues to lag behind the 13th Finance Commission (FC) targets. The report of the 13th FC, released in December 2009, provided a roadmap for fiscal consolidation for the FY2010-FY2015 period. However, the pace of fiscal adjustment has lagged the FC recommendations since FY2011. Following a 0.9 percent of GDP slippage in FY2012, this fiscal year’s deficit exceeded the FC target by 1.0 percent of GDP. While the Finance Minister indicated his commitment to bringing the deficit down to 3.0 percent of GDP by FY2017, this benchmark would be achieved a full three years behind the FC target.

Fiscal consolidation among the states, on the other hand, remains mostly on track. The combined fiscal deficit of all states declined to 2.3 percent of GDP during FY2012 from 2.9 percent of GDP during the preceding two years. This improvement in the states’ fiscal condition was due to an increase in tax revenue—particularly own tax revenues—in spite of an increase in current expenditures. States’ own tax revenue increased from an average of 5.8 percent of GDP between FY2010 and FY2011 to 6.1 percent of the GDP in FY2012. The states—barring a brief deviation after the global financial crisis—on aggregate have been able to achieve the targets set by the FCs since the implementation of individual state fiscal consolidation.

Box 1: Expansionary Fiscal Consolidation

Challenging Keynes’ original views on the role of fiscal policy, a number of authors have proposed that fiscal consolidation can increase output while simultaneously stabilizing public debt. The scope for such “expansionary consolidations” was first explored by Giavazzi and Pagano (1990) using empirical evidence from Denmark and Ireland in the 1980s. They found that fiscal consolidation could generate expectations of a permanent increase in private income and thereby stimulate today’s private demand and output. More recently, Alesina and Ardagna (2010) identified episodes of fiscal consolidation during 1970-2007 as a decline in the cyclically adjusted primary balance and found that spending cuts, in several episodes, have been associated with economic expansions. Alesina et al (2012) also show that these results are robust to alternative ways of identifying episodes of fiscal adjustments.

The success of any expansionary consolidation depends crucially on the type of consolidation. According to Alesina and Ardagna (2010), reduction in government spending is much less likely to be reversed and therefore has a positive wealth effect on individuals, via a reduction in future taxation, which in turn induces an expansionary effect on consumption. In fact, the authors found that in the case of successful fiscal adjustments about 70 percent of the adjustment came from spending cuts and in the case of expansionary adjustment almost 60 percent. Instead, in the case of unsuccessful and contractionary adjustments, more than 60 percent of the budget correction was on the tax side. Spending cuts are usually considered more credible—reducing risk premiums on long-term interest rates and boosting confidence. Therefore, spending cuts can have a positive effect on private investments, while tax increases can hurt investments through the labor market and firm profitability, as shown in Alesina et al (2002). The IMF (2010) also suggests that central banks may view spending-based deficit cuts more favorably, possibly because they interpret them as a signal of stronger commitment to fiscal discipline and are therefore more willing to provide monetary stimulus.

Complementary policies play a key role in increasing the likelihood of a positive effect of fiscal consolidation on output. Accompanying policies such as liberalization of goods and labor markets can limit the potential negative effects of consolidation on output and improve the likelihood of expansionary consolidation. For instance, income policies (such as wage agreements) can reinforce the effects of fiscal adjustments that slow down the growth of public sector wages. Alesina and Ardagna (2012) and Perotti (2012) find that such wage moderation, generated through supply side reforms, can more than compensate for the small recessionary effects of spending cuts on the demand side. The IMF (2010) also highlights the impact of a fiscal tightening on net exports, with a considerably larger improvement in exports under spending-based measures but a larger decline in imports during tax-based adjustments. However, since exports cannot increase everywhere, simultaneous consolidations are likely to be more challenging.
legislations in FY2005. According to the Thirteenth FC targets, the states’ aggregate fiscal deficit-to-GDP ratio should decline to 2.5 percent in FY2012 and FY2013. According to the states’ budget estimates, the fiscal deficit during FY2013 is budgeted at 2.1 percent of GDP, as own tax revenues are expected to increase by 0.3 percent of GDP during the year.

The strong downward trend in the central government’s debt-to-GDP ratio has mostly lost momentum. The ratio of central government’s debt-to-GDP fell by more than 10 percentage points in the second half of the 2000s, following the adoption of the Fiscal Responsibility and Budget Management Act in 2003. The decline in the debt ratio, however, was driven mostly by rapid GDP growth and, in the later period, very low real interest rates rather than fiscal consolidation per se, as the authorities were able to achieve a (modest) fiscal surplus in just two years during the past decade. In particular, the acceleration in growth in FY2006-FY2008 was responsible for most of the decline in the debt-to-GDP ratio between FY2003 and FY2013. Even though real interest rates remained low in the last two fiscal years, nominal growth slowed substantially, and the decline in the debt-to-GDP ratio came to a halt. In FY2012, the central government’s internal liabilities rose for the first time in seven years, reaching 48.1 percent of GDP. Moreover, debt is expected to remain at about the same level (as a share of GDP) in the current fiscal year and, had inflation not remained elevated, the debt ratio could have risen further, as the contribution of real growth to the decline in debt diminished substantially relative to earlier years. Similarly, the ratio of the central government’s internal liabilities to GDP, which declined from 60 percent of GDP in FY2005 to 48.5 percent in FY2010, remained at 48.3 percent in FY2013. Following these trends, the general government’s debt-to-GDP ratio is expected to remain about the same as last year, at nearly 68 percent of GDP.

Phased deregulation of petroleum prices is expected to help control the central government’s fuel subsidy costs. During FY2013, the government imposed a cap of 9 cylinders per year on the sale of subsidized LPG and later authorized oil marketing companies (OMCs) to raise diesel prices by Rs. 0.50 per litre per month till their losses are covered. By March 2013, state-owned OMCs were incurring under-recoveries of 8.64 per litre on diesel and Rs.439 per cylinder on LPG. Since nearly 60 percent of the OMCs’ under-recoveries are funded by the government, the phased deregulation is expected to help reduce the central government’s fuel subsidy bill, estimated at 1 percent of GDP in FY2013.

2. Outlook

The economy is likely to expand by 5.0 percent in FY2013. Although the slowing momentum of economic growth may have bottomed out in the third quarter of FY2013, even a substantial pickup in the last quarter of the fiscal year is unlikely to lift the growth rate of real GDP at factor cost much beyond 5.0 percent given the weakness observed over the previous three quarters. A minor increase in the growth rate of the trend-cycle component of GDP in the third quarter and a slight improvement in export performance in January and February give some reason for optimism that economic activity may be finally turning the corner. Together with a modest improvement in investment and some strengthening in the global economic activity, signs point to a gradual recovery in growth ahead.

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5 Internal liabilities include internal debt (market loans, treasury bills) and other liabilities (such as small savings and reserve funds, etc.).
Growth is expected to strengthen in the medium term as global conditions improve and domestic activity picks up. The improving global environment—reflected in strengthening industrial production and trade numbers—should help buttress India’s export performance. Continued strong inflows of FDI should also support investment growth. However, given the slow pace of global recovery, India’s growth drivers will increasingly have to come from domestic sources. The authorities’ commitment to fiscal discipline may give the RBI more room for accommodative monetary policy, while a series of investor-friendly measures announced in the FY2014 budget will provide additional incentives for increased investment. Thus, under a benign global scenario and with continued progress on the domestic reform agenda, growth is expected to improve to 6.1 percent in FY2014 and accelerate further to 6.7 percent in FY2015.

Inflationary pressures are expected to moderate. Despite the surprise uptick in wholesale price inflation in February and the pressure from food prices keeping consumer inflation persistently high, inflationary momentum is expected to wane over the coming months. The RBI has remained staunch on inflation and is unlikely to lower rates prematurely or be very aggressive with rate cuts. The stabilization of the rupee following a bout of depreciation in the first half of calendar 2012 is also likely to limit inflationary pressures. Good rainfall in the spring and another solid wheat harvest should help alleviate some push factors on food prices, although recent steps to curtail fuel subsidies are likely to contribute to higher impetus from fuel prices in the short term. However, to the extent that these reforms improve allocative efficiency and reduce the fiscal burden, the long-term effect on inflation is likely to be positive. The recent momentum of high price growth makes it unlikely that average WPI inflation would fall below 7.3 percent in FY2013; however, price growth is expected to fall below 7 percent in FY2014 and slow further to 6.3 percent in FY2015.

Fiscal deficits are likely to decline as the authorities have renewed their commitment to fiscal consolidation. Following notable fiscal slippages in previous years, the authorities delivered on their commitment to keep the FY2013 central government deficit within the revised target of 5.3 percent of GDP. Even if divestment revenues in FY2014 fall short of expectation, the authorities are likely to be able to meet the deficit target of 4.8 percent of GDP with expenditure compression and a recovery in tax revenues as economic activity picks up (Box 2). With states’ fiscal performance roughly on target with the adjustment path recommended by the 13th Finance Commission, the general government deficit is likely to decline to just above 7 percent of GDP in FY2014 and fall further to around 6.6 percent of GDP in FY2015.

Roll out of the National Food Security Bill could put pressure on expenditure targets. The National Food Security Bill (NFSB), cleared by the cabinet on March 19 2013, and expected to be tabled in the parliament during this budget session, is designed to provide five kilograms of subsidized food grains per month to 75 percent of the rural and 50 percent of the urban population. Using the average all-India price of wheat and rice during FY2013, the estimated total cost of providing subsidized grains to the NFSB target population could range from Rs.890 billion to Rs.1 trillion (0.9 percent to 1.1 percent of GDP). This amount is likely to differ from the incremental cost of the NFSB, as the provision of some of the grains under NFSB may overlap with existing initiatives under public food distribution system (PDS). In order to finance the initial stages of the NFSB implementation, the recently presented FY2014 Union Budget included an allocation of Rs.100 billion (0.1 percent of GDP)
to cover incremental costs under the bill, over and above the Rs.800 billion allocated to food subsidies.

Debt ratios are likely to resume their decline but at a slower rate than before. Since the mid-2000s, the downward trend in the central government’s debt-to-GDP ratio has been increasingly underpinned by high nominal growth and low real interest rates. In FY2012, as the deficit remained elevated following the global financial crisis while GDP growth slowed substantially, the debt-to-GDP ratio of the central government rose for the first time in

Box 2: Union Budget FY2014

The FY2014 Union Budget proposed a conservative deficit target for the central government’s fiscal deficit. Using the Government of India definition, the Union Budget expects the overall deficit to decline to 4.8 percent of GDP in FY2014. However, much of the gain is expected to come from higher divestment proceeds. Using the World Bank definition, which discounts divestment revenues, the fiscal deficit is expected to contract only marginally to 5.3 percent of GDP, despite a 0.6 percent of GDP increase in projected revenue and a 0.6 percent of GDP projected decline in subsidy costs. The main items responsible for higher projected spending in FY2014 include higher public investment (0.3 percent of GDP) and increased allocation to rural development (0.2 percent of GDP).

Revenue is projected to rise on account of tax surcharges and higher divestment proceeds. Gross tax-GDP ratio is expected to increase to 10.9 percent during FY2014, due mainly to improvements in direct and service tax collections. The budget announced a series of tax steps to improve revenue collection, some of them being one-time measures such as a tax amnesty (“voluntary compliance scheme”) going back to 2007 and new tax surcharges on individuals earning more than Rs.10 million (US$185,000) per year and domestic and foreign companies with income above Rs.100 million (US$1.8 million) per year. The surcharges are set to expire at the end of FY2014 and are expected to increase revenues by 0.1 percent of GDP during the year. Additional resources are expected to be realized from higher import duties and taxes on luxury goods and reduced tax allowances for high-end homes. Finally, privatization proceeds are expected to generate another 0.5 percent of GDP in revenue.

Expenditure increases are expected to largely offset the revenue gains. Total expenditure and net lending is budgeted at 14.6 percent of GDP during FY2014, the same as last year’s budget estimates but a 0.5 percent of GDP increase over the FY2013 actual outturn. Expenditure on subsidies is budgeted to decrease to 2 percent of GDP, primarily because petroleum subsidies are expected to fall from 1 percent of GDP in FY2013 to 0.6 percent in FY2014 after the partial deregulation of fuel prices during the past fall and winter. On the other hand, social spending is expected to rise due to an increased allocation to rural development (offsetting the budget cuts in FY2013). Although capital spending is projected to increase by 0.3 percent of GDP relative to this year’s outturn, it will continue to remain small at 2.0 percent of GDP.

The budget generated a muted reaction among observers and markets. In the several months preceding the budget, the authorities put forth a series of important reform efforts to boost investment and contain subsidy spending. Against this backdrop, the budget itself introduced just a few investor-friendly measures such as definition clarifications on portfolio vs. direct investment, greater flexibility for institutional investors to participate in derivatives and corporate bond markets, and tax incentives for capital equipment purchases. It was also characterized by increased reliance on revenue measures to limit the fiscal deficit, including new tax surcharges on high earners and increased taxes on luxury goods such as imported cars, motorcycles, and expensive cell phones. Although the budget announced an allocation of Rs.9,000 crore (0.1 percent of GDP) towards compensating states for revenue losses related to the roll-out of the Goods and Services Tax, it did not unveil a specific roadmap for implementation. Similarly, no specific commitments were made regarding the expansion of direct benefit transfers or further reductions in subsidies. Rating agencies reacted favorably to the fiscal consolidation efforts of the budget, but some cautioned that meeting the authorities’ targets may be challenging if economic growth comes in significantly below expectations.
seven years. In FY2013, the central government’s debt-to-GDP is expected to remain around 48 percent of GDP, just 0.1 percent of GDP lower than last year, and decline gradually over the next few years. Even if real interest rates rise, a recovery in growth and continued commitment to fiscal discipline are expected to offset any potential adverse effects on debt sustainability and contribute to a decline in central government’s debt to 47 percent of GDP by FY2015. However, the pace of decline is expected to be much slower than before as the central government remains off the adjustment path recommended by the 13th Finance Commission and growth recovers to its high long-term potential only gradually. Following a similar trajectory, general government debt is expected to decline to 65.9 percent of GDP in FY2015 from an estimated 67.9 percent outturn in FY2013. The baseline is subject to considerable uncertainty and a worst-case scenario of negative shocks to growth, inflation, and the exchange rate in each year of the forecast period could push the central government debt ratio as high as 67 percent of GDP.

The current account deficit is likely to widen further this year but is expected to narrow in the medium term. Despite the modest improvement in the trade balance in Jan-Feb 2013, the momentum of the first three quarters of the current fiscal year is likely to drive the current account deficit above 5 percent of GDP for the entire FY2013, exceeding last year’ outturn. However, the previous section argued that this record widening of the current account deficit has been driven primarily by strong imports flows and stagnant exports, both of which appear to be turning around. As trade is picking up around the world, India’s exports growth is improving and is expected to continue doing so. On the other hand, imports growth is expected to be less strong. In particular, imports of gold—which already declined to 10.4 percent of merchandise imports in Q1-Q3 FY2013 from 11.4 percent in the same period of last fiscal year—are likely to come down further as gold’s attractiveness as an inflation hedge declines with the expected deceleration in inflation and the increase of gold import duties in January further constrains demand. With an expected pick-up in economic activity in the major destinations for Indian migrants, remittance growth is likely to accelerate, providing further support to the current account. Under this scenario, the current account deficit is expected to improve to 4.5 percent of GDP in FY2014 and come down further to 4.1 percent in FY2015.

The near-term outlook is subject to important downside risks. Global industrial activity continues to strengthen after the slump in the second half of 2012. The incipient recovery—having been led thus far by developing countries—is supported by signs of gradual improvement and accelerating activity in the US. On the other hand, business sentiment remains weak in Europe and the latest readings from large developing countries suggest the pace of improvement may be decelerating. Adverse shocks to the global recovery could have substantial negative implications for India as multiple vulnerabilities—record current account deficit, high fiscal deficit, and persistent inflation—limit the room for policy response. Increased reliance on portfolio investment and NRI deposits to finance the current account gap could put pressure on the balance of payments as these flows tend to be more volatile than FDI. While S&P and Fitch have reacted favorably to the authorities’ fiscal consolidation measures

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6 The worst case scenario gives a (roughly) two standard deviation shock (corresponding to the 97.5th percentile of the normal distribution) to real GDP growth, inflation, and the nominal exchange rate in each year of the forecast period. The distribution of shocks is drawn from recent history.
and recent reform efforts, both agencies have thus far maintained a negative outlook to India’s investment-grade credit rating over concerns related to a slowdown in economic growth. On the other hand, Moody’s—the agency which has published the most recent credit opinion on India—has reaffirmed a stable outlook on India’s sovereign debt on the basis of robust savings rates and private sector dynamism. In this regard, continued progress on the domestic reform agenda to encourage investment and unlock supply constraints while adhering to fiscal consolidation is critical to supporting growth and lowering macro vulnerabilities.

Over the long term, India’s prospects remain very bright. Notwithstanding the current slowdown in economic growth, India’s long-term prospects remain highly favorable. India possesses the fundamentals to grow at sustained high rates over the next several decades on the strengths of its demographic transition, high savings and investment rates, rising educational attainments, and increasing agglomeration effects (urbanization and growth of secondary cities). India is entering demographic transition much later than many other developing countries, and will still be a relatively young nation twenty years from now even as its dependency ratio declines to 49 percent in 2030 from 56 percent today. Even as economic activity fell to a decade-low pace this year, investment rates did not decline much below 30 percent; combined with the demographic dynamics and a rising age-savings profile, India is likely to generate significant volumes of savings and investment over the coming years. The average schooling of the working age population will increase by at least a full year even with no further improvements in the educational attainment of today’s youth (i.e., simply due to the fact that younger cohorts are better educated) and could rise much faster if further progress is achieved on the education agenda. The proportion of population living in urban areas is expected to rise to 40 percent in 2030 from around 30 percent today, reinforcing productivity-boosting agglomeration effects.

Combined, these effects are likely to form the foundations of India’s strong growth for decades to come.

Education and demographic dynamics favor high growth over the long term

3. India in the Global Context

Global growth slowed significantly since 2010 compared to the heady pre-2007 economic crisis years. The debt crisis in the euro area, fiscal difficulties in the United States, and the

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7 United Nations, 2011. Working-age population is defined as being between the ages of 15 and 64 years.
The effects of the tsunami in Japan, among other factors, caused GDP growth in high income countries to slow from 2.9 percent in 2010 to 1.6 percent in 2011, and to 1.3 percent in 2012 (World Bank 2013). Largely as a result of the crisis emanating from high income countries and consequent deterioration in financial market conditions and slower growth of global trade (world trade growth halved from 13 percent in 2010 to 6.2 percent in 2011, before slipping to 3.5 percent in 2012), GDP growth in developing countries slowed from 7.4 percent in 2010 to 5.9 percent in 2011, and further to 5.1 percent in 2012. The Indian economy was adversely affected by these global economic events mainly through a sharp drop in demand for its exports, as private capital inflows have remained relatively resilient during this period, and negative impacts on consumer and business confidence. However, India’s economic performance was also adversely affected by domestic factors.

This section explores the importance of global factors in the observed slowdown in India’s growth and the expected recovery. The analysis draws upon the World Bank’s global macro model, developed by the Development Prospects Group, which covers some 150 economies and includes detailed trade linkages between each of these economies. It provides a rigorous and consistent structure for forecasting, and allows for the analysis of the implications of alternative global scenarios and policy developments. The global model allows for transmission of global trade, commodity price, and financial market shocks across countries. For instance, in the benign global scenarios modeled below, the positive effects from higher trade flows and of improved consumer and business confidence are partly mitigated by a rise in internationally commodity prices as global demand rebounds.

In a backward-looking scenario, growth in high income countries does not slow in 2011, and 2012, eliminating the contagion effects on developing countries. This scenario assumes that growth in the high income countries remains relatively robust and stable at about 3 percent between 2011 and 2012 instead of slipping to 1.3 percent as it did in 2012 with the intensification of the euro area debt crisis. One side effect of this is the negative shocks to business investment and confidence that had been the case at the time are largely eliminated. Rather, the simulations assume that household and business spending are on average about 2.0 percent and 1.0 percent higher (relative to baselines) in the G3 economies (which account for three-quarters of high income countries’ output) during 2011 and 2012, with small positive confidence spillovers to other developed and developing countries.

Simulations show that the worsening external environment explains only a small part of the observed slowdown in India’s GDP growth. In the backward-looking scenario of the previous paragraph, higher consumer spending in the United States, the euro area, and Japan, and positive demand spillovers to other high income and developing countries support an expansion of India’s real exports by 4.6 percent compared with the baseline in FY2013. Imports are also higher in the benign scenario reflecting India’s higher GDP and consumption growth, increasing by 3.2 percent relative to baseline. Domestic consumption and fixed investment are 0.5 percent and 0.6 percent higher in FY2013 due partly to the boost in external demand, but also from absence of negative global shocks for consumer and business confidence and spending. Overall, simulations show that India’s real GDP growth would have been about 0.3 percentage points higher in FY2012 and 0.5 percentage points higher in FY2013 had the contagion effects from the euro area crisis been sterilized. Compared to other developing countries where GDP would have been on average 1.6 percent higher by 2012 in this scenario, the impacts of the adverse external environment on India are smaller, reflecting a smaller share of exports in GDP.

Faster recovery in high-income countries could help India’s growth but would not be
by itself sufficient for a return to the record pace of the late-2000s. If the recovery in the global economy were to prove stronger than expected due, for example, to quicker resolution of political gridlocks in the US and the euro area, growth in high-income economies could rise by about one percentage point above the baseline of around 2 percent per year in 2014 and 2015. In such a scenario, the increase in consumption and investment demand in high-income countries and positive demand spillovers to developing countries would raise global import demand by 5.5 percent in 2014 and 2015. India’s exports would rise on average by 4.5 percent relative to the baseline in FY2015 and FY2016 and real GDP growth could accelerate by 0.4-0.5 percentage points in FY2014 and FY2015 and 0.2 percentage points in FY2016. If these favorable developments are accompanied by positive spillovers to investor and consumer sentiment and an easing in financing constraints for firms globally, India’s GDP could accelerate by another 0.1 percentage points relative to the baseline.

A reduction in global fuel prices could have similar positive impacts on output growth. The positive impacts of an improved outlook for the high-income countries on growth in India are tempered somewhat by a concurrent increase in world commodity prices in response to stronger global demand. In order to quantify the importance of fuel prices on growth, this paragraph considers the impact of a 20 percent fall in international crude oil prices (relative to baseline projections for 2013) on India’s growth. Taking into account the positive impacts of such a shock on global growth, simulations show that this would boost India’s GDP levels by about 0.5 percent compared to the baseline. Given the nature of the shock, impacts on growth will be limited to FY2014, when GDP growth accelerates to 6.7 percent from 6.1 percent in the baseline. In this scenario, GDP increases due to a boost in domestic incomes and spending power (domestic consumption, investment and imports rise by 1.9 percent, 1.5 percent and 3.8 percent in FY2014) as well as stronger export growth resulting from a positive impact on real consumption in the rest of the world.

4. Financing Progress to Universal Health Coverage‡

“Health for all and education for all remain our priorities” - Minister of Finance P. Chidambaram, FY2013-14 budget speech

Health spending in India is low by international standards. India has traditionally been a low spender on health care, allocating approximately 4.1 percent of GDP or US$40 per capita in 2008-09. Public spending on health has varied little over the last two decades, hovering at about 1 percent of GDP. Government (central, state and local) is the source of about one-fifth of spending while out-of-pocket payments represent about 70 percent – one of the highest percentages in the world. India is also significantly below its global

‡ This section is based on two recent World Bank publications. The first is a comprehensive and systematic review of all major GSHISs operating in India (La Forgia and Nagpal 2012) recently undertaken by the World Bank in response to a request from the Ministry of Health and Family Welfare (MOHFW) to assess GSHISs in terms of their organizational design features, spending, impacts, challenges and potential for contributing to the achievement of universal coverage. The second is a working paper on India (Nagpal 2013) forming part of a series of 25 country cases published by the World Bank under its Universal Coverage (UNICO) program.

10 MOHFW, 2009 (provisional estimations from 2005-06 to 2008-09).

11 Among Asian countries, this was exceeded only by Pakistan, Cambodia, Myanmar and Afghanistan in 2008 (World Health Statistics 2010).
comparators in terms of public expenditure on health as a share of GDP among countries with similar levels of income. Using data from 1990–2012, the estimated elasticity of general nominal government health spending to GDP in India was about 0.99. This is low when compared to other low- and lower-middle income countries in which the average elasticity is usually in the vicinity of 1.15. The below average elasticity is driven by a generally slower rate of state health spending growth relative to GDP growth. The elasticity of aggregate state health spending to growth is only about 0.94, whereas the elasticity of central health spending to GDP is commensurate with the average for low- and lower-middle income countries.

India also lags in health impacts achieved from its spending. When compared to the country’s level of income and total health spending per capita, India has not performed as well as its income comparators on lowering maternal mortality and performance is just about average for infant mortality (World Bank, 2010). Large disparities in health outcomes are still evident across states and social groups and improvements have not been shared equally. Public subsidies for health disproportionately favor the richer segments of society (Mahal et al, 2004). Peters et al. (2002) estimated that in the late 1990s, for every Rs. 1 spent on the poorest income quintile, the government spent an estimated Rs. 3 on the richest quintile. These financing challenges are compounded by entrenched accountability issues in the public delivery system.

Health finance and delivery in India developed along four main and mostly parallel lines. The first, and by far the largest, is out-of-pocket spending by households. Nearly all this spending is directed to fee-for-service private providers, but some are for user fees collected at public facilities. This method of finance places considerable financial burden on poor households, and is seen as one of the important reasons for impoverishment in India.

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12 This segmentation of finance and delivery has been observed in other low- and middle-income countries (Londoño and Frank, 1997; La Forgia, 2000; Baeza and Packard, 2006).
Health outcomes underperform

As much as 80 percent of outpatient and 60 percent of inpatient care is provided by private practitioners (NSSO, 60th round data). This translates into a flow of 77 percent of total health spending directed towards private providers (including charitable and other non-profit facilities). The second is tax-financed, direct public delivery (20 percent of total health spending) which in principle is available for all of India’s population. Operated mainly by the States, the public delivery system, which includes the centrally sponsored activities funded under the National Rural Health Mission (NRHM) of the Ministry of Health and Family Welfare, runs facilities at primary, secondary, and tertiary levels, and accounts for between 20 and 40 percent of outpatient and inpatient utilization in the country respectively. Considerable inter-state variation exists, especially in inpatient utilization (Mahal, et al., 2001) and there are significant sub-national disparities across various dimensions of vulnerability. The third segment consists of social insurance schemes for formal private sector workers and government employees (4.1 percent of spending). These schemes are generally mandatory and most are financed through employee and employer contributions via a payroll tax, but also benefit from partial government subsidies. The fourth segment is voluntary private insurance (PHI) which emerged in the late 1980s but has grown rapidly in the 2000s. In 2004-05, PHI accounted for 1.6 percent of total health expenditure, but reached an estimated 3 percent by 2008-09.14

The central and state governments have introduced several new initiatives to address existing challenges and improve the availability of and access to health services, particularly for the poor and vulnerable. These include two programs predominantly financed by the central government—the already-mentioned NRHM and the Rashtriya Swasthya Bima Yojana (RSBY) of the Ministry of Labor and Employment—and state programs such as the Rajiv Aarogyasri scheme in Andhra Pradesh15 as well as similar programs launched in several other states more recently. These programs were designed and implemented by various institutions almost in parallel, over a similar time period, and used different financing and delivery approaches. However, they all aim to extend health coverage and improved financial protection for the poor and other vulnerable groups in the country, are fully subsidized by the government and, to the extent of their benefits packages, they are ‘cashless’ requiring beneficiaries to make any

14 La Forgia and Nagpal 2012.  
15 Rajiv Aarogyasri is discussed in this note as a prototype of a state-financed health insurance program, focused on tertiary, often surgical, care. Other programs such as Vajpayee Arogyashree (Karnataka), Chief Minister’s Comprehensive Health Insurance Scheme (Tamil Nadu), Comprehensive Health Insurance Scheme (Kerala), Rajeev Jeevandayee (Maharashtra), Mukhyamantri Amritam (Gujarat), Megha Health Insurance scheme (Meghalaya), Mukhya Mantri Swasthya Bima Yojana (Chhattisgarh), and RSBY Plus (Himachal Pradesh) are example of recent programs that have several resemblances to Rajiv Aarogyasri.

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13 MOSPI 2004
contributions, upfront payments to providers or bear a share of the costs of treatment.

Main Actors and Fund Flows in Indian Health System, circa 2005

<table>
<thead>
<tr>
<th>Sources</th>
<th>Agents</th>
<th>Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Central Government (7%)</strong></td>
<td><strong>MHW/F (6%)</strong></td>
<td><strong>Public Providers (20%)</strong></td>
</tr>
<tr>
<td><strong>External Sources (2.3%)</strong></td>
<td></td>
<td><strong>As Relates, Outpatient 20%</strong></td>
</tr>
<tr>
<td><strong>State Government (11%)</strong></td>
<td><strong>Social Security</strong> (22%)</td>
<td><strong>Outpatient Plans/Providers (0.5%)</strong></td>
</tr>
<tr>
<td><strong>Firms (5.7%)</strong></td>
<td><strong>Government Employee Plans</strong> (4.3%)</td>
<td></td>
</tr>
<tr>
<td><strong>Households (71%)</strong></td>
<td><strong>Private Insurers (1.6%)</strong></td>
<td><strong>Private Providers (37%)</strong></td>
</tr>
<tr>
<td><strong>Out-of-pocket payments (69%)</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Includes spending by other central ministries and local governments (1% of total spending).

**Refers to utilization volume

**Includes other government employee schemes such as those in Railways and Defence ministries.

Does not include the new generation of GSHIS

The published NHA data contain certain inaccuracies which have resulted in both over and underestimate of spending. For example, social insurance was placed as a source rather than firms and households. Also, some very small sources not been depicted in this figure, and therefore the totals for sources do not add to 100 percent.

Source: National Health Accounts for 2004-05 (MOHFW, 2009) and authors’ estimates based on La Forgia and Nagpal (2012).

The design of new approaches differs substantially from earlier efforts. The NRHM supplements and strengthens the state-owned public health systems by providing additional resources with a focus on rural areas, primary care and public health programs. The NRHM also leverages this financial support to facilitate the creation of institutional mechanisms that enable some degree of financial autonomy and a faster flow of funds. The NRHM has led to several service delivery innovations and to significant, though still inadequate, increases in central government investments in health, especially for public health interventions and primary care. In addition to significantly increased financing, the flexibility around hiring contractual staff, supply chain reforms, introduction of a cadre of grassroots workers paid entirely based on performance, innovative financial flow mechanisms, and an overall increased emphasis on public health expenditure, distinguish the NRHM from the situation prior to its existence. Similarly, the new government-sponsored health insurance Schemes (GSHISs) introduced a new set of arrangements to govern, allocate, and manage the use of public resources for health, including an explicit (and delivered) package of services, greater accountability for delivering services with a focus on results-based payments and patient choice of public and private providers, and a bottom-up design to reach universal coverage by first achieving coverage of the poor. The bottom-up design for expansion of health coverage, starting with coverage of the rural and the poorest segments of the population first, and the rapid scale-up of population coverage in a short period of time, are unique facets of the contribution of these recent programs to India’s progress towards universal health coverage.

These new initiatives account for an increasing share of public health spending. In 2009–10, the major GSHISs spent an estimated Rs. 58 billion (about 8 percent of total government health expenditure). Counting private, community, and other insurance spending in the same year, total spending on health insurance accounted for Rs. 160 billion or 6.4 percent of the estimated Rs. 2.5 trillion total health expenditure in 2009–10. The NRHM, by itself, accounts for about 30% of the public health spending in the country, while the rest is contributed by state health spending and other central expenditure.

The reach of new interventions is rapidly increasing. The NRHM beneficiaries, in theory, can include anyone walking into a public health facility, regardless of income, geography, or other factors. The country’s rural population of 833 million (Census 2011), including 490 million residing in “high focus” states for the NRHM in particular, are the target beneficiaries of the program. One of the largest components in the NRHM is the Janani Suraksha Yojana, a conditional cash transfer to poor women who use the free institutional maternity services of the NRHM, which is currently utilized by over 10 million women each year. Over 22 million children stand fully immunized each year (NRHM 2012). With the advantages accruing from several favorable contextual factors that
existed in the country, including the use of a rapidly growing and highly competitive insurance industry to intermediate in the provisioning of services, GSHISs have been able to scale up rapidly. By 2010, about 240 million Indians were covered by GSHISs, about 19 percent of the population. Accounting for private insurance and other forms of coverage, more than 300 million people, or more than 25 percent of the population, had access to some form of health insurance in 2010.

Half of India’s population could have access to some form of health insurance by 2015. In light of current trends, and assuming continued political and financial support from government, insurance coverage is expected (perhaps conservatively) to reach more than 630 million people, 50 percent of the population by 2015. Most of the growth is likely to occur along three lines: RSBY, commercial insurance, and state-sponsored schemes. RSBY aims to reach 60 million families by 2015 (roughly 300 million members), and had already reached 34 million families by March 2012. State schemes such as Vajpayee Arogyashri (VA) in Karnataka have continued to expand and VA now covers BPL families throughout the state of Karnataka, while states such as Gujarat, Maharashtra, Meghalaya and Chhattisgarh have already launched new state-level programs since the above estimates were prepared. Other potential drivers of growth are commercial insurance as well as new state programs that continue to emerge. With additional states expected to launch schemes that expand coverage beyond the BPL population, the total membership could well exceed the projected 630 million.

The incremental costs of progressing towards universal health coverage could range from 0.4-1.0 percent of GDP by the end of the 12th five-year plan. In order to achieve a long-term objective of Universal Health Coverage (UHC) in the country, the 12th Five Year Plan envisions an increase in public health expenditure by about 1 percent of GDP per year by 2017, the end of the 12th plan (Planning Commission 2012). Significant central investments in NRHM (proposed to be expanded to urban areas too, and rechristened as the National Health Mission) and the 12th plan (Planning Commission 2012).17

### Population Coverage of GSHISs and Projected Growth (million people)

<table>
<thead>
<tr>
<th>Scheme</th>
<th>2003–04</th>
<th>2009–10</th>
<th>2015*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central government</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees State Insurance Scheme (ESIS)</td>
<td>31</td>
<td>56</td>
<td>72</td>
</tr>
<tr>
<td>Central Government Health Scheme (CGHS)</td>
<td>4.3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>RSBY</td>
<td>—</td>
<td>70</td>
<td>300</td>
</tr>
<tr>
<td>State government</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Andhra Pradesh, AP (Rajiv Arogyasri)</td>
<td>—</td>
<td>70</td>
<td>75</td>
</tr>
<tr>
<td>Tamil Nadu, TN (Kalaignar)</td>
<td>—</td>
<td>40</td>
<td>42</td>
</tr>
<tr>
<td>Karnataka, KA (Vajpayee Arogyashri)</td>
<td>—</td>
<td>1.4</td>
<td>33</td>
</tr>
<tr>
<td>KA (Yeshasvini)</td>
<td>1.6</td>
<td>3</td>
<td>3.4</td>
</tr>
<tr>
<td>Total government – sponsored</td>
<td>37.2</td>
<td>243</td>
<td>528.4</td>
</tr>
<tr>
<td>Commercial insurers</td>
<td>15b</td>
<td>55b</td>
<td>90</td>
</tr>
<tr>
<td>Grand total (includes others not listed above)b</td>
<td>55</td>
<td>&gt;300</td>
<td>&gt;630</td>
</tr>
</tbody>
</table>

Sources: Authors’ elaboration based on scheme data.

Note: — = not applicable, scheme not yet in existence.

a. The member base for 2015 is based on La Forgia and Nagpal, 2012 (see that publication’s Annex 3B for key assumptions and methodology).
b. Estimated based on average premium from Insurance Regulatory and Development Authority (IRDA) sample database Traffic Advisory Committee/ Insurance Information Bureau (TAC/IIB) applied to published revenue data of the industry.
c. Includes other health protection and health insurance schemes, including community health insurance schemes, publicly subsidized schemes for handloom workers and artisans, noncontributory coverage by employers of government (defense, railways, state governments) and nongovernment employees (where employers run their own facilities or provide reimbursements without using insurance mechanisms) as an employment benefit.

17 The 12th Five Year Plan aims to increase public health expenditure to 2.5 percent of GDP, but including therein the expenditure on water and sanitation, which translates into an increase of this magnitude from current levels.

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16 Since several states were already planning new schemes when these estimates were prepared, the estimates presented in the table should be considered conservative.
RSBY form part of the stated strategy of the plan, and a similar expectation is also made from the state level. A recent World Bank publication (La Forgia and Nagpal 2012) also proposes, as a starting point for wider discussion and debate, a possible pathway to progress toward universal health coverage based on realistic assumptions of fiscal capacity, the current configuration of health financing and delivery arrangements, lessons and innovations from NRHM and GSHISs, and international experience. Table 2, reproduced from the publication, estimates the costs of this package to be an additional 0.4 to 0.5 percent of GDP, in two possible scenarios, to cover the BPL and the vulnerable non-poor comprising of 77 percent of the country’s population.

The central government may have less difficulty securing its share of the required resources. Barring major policy reversals or unforeseen economic downturns, the central government’s financing share for resourcing universal coverage ought to be attainable in the short to medium term. This assessment is based on the benign economic outlook presented in the

<table>
<thead>
<tr>
<th>Proposed Source of financing</th>
<th>Proposed Intervention and target group</th>
<th>Unit cost per family per year (Rs.)</th>
<th>Scenario 1 500 capitation (Rs. crores)</th>
<th>Scenario 2 1,000 capitation (Rs. crores)</th>
<th>Number of beneficiary families (million)</th>
<th>Number of beneficiary families (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central</td>
<td>Standard package (secondary and maternity coverage)—BPL</td>
<td>1,000ª</td>
<td>n.a.</td>
<td>60</td>
<td>6,000</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>PHC performance-based primary care scheme: BPLª</td>
<td>500</td>
<td>(1)</td>
<td>60</td>
<td>3,000</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>1,000</td>
<td>(2)</td>
<td>60</td>
<td>3,000</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Central government total, all Components</td>
<td>9,000</td>
<td>12,000</td>
<td>9,000</td>
<td>12,000</td>
<td></td>
</tr>
<tr>
<td>State</td>
<td>Tertiary care top-off scheme- BPL</td>
<td>900ª</td>
<td>n.a.</td>
<td>60</td>
<td>5,400</td>
<td>5,400</td>
</tr>
<tr>
<td></td>
<td>Standard package (secondary and maternity coverage) for vulnerable nonpoor</td>
<td>600ª</td>
<td>n.a.</td>
<td>120</td>
<td>7,200</td>
<td>7,200</td>
</tr>
<tr>
<td></td>
<td>PHC performance-based primary care scheme—vulnerable nonpoor</td>
<td>500</td>
<td>(1)</td>
<td>120</td>
<td>6,000</td>
<td>12,000</td>
</tr>
<tr>
<td></td>
<td>1,000</td>
<td>(2)</td>
<td>120</td>
<td>6,000</td>
<td>12,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tertiary care scheme: vulnerable nonpoor</td>
<td>900</td>
<td>n.a.</td>
<td>120</td>
<td>10,800</td>
<td>10,800</td>
</tr>
<tr>
<td></td>
<td>State governments total costs, all Components</td>
<td>60 (BPL) + 120 (vulnerable non-poor)</td>
<td>29,400</td>
<td>35,400</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Estimated annual costs: all components for BPL and vulnerable nonpoor (77 percent of population)</td>
<td>180</td>
<td>38,400</td>
<td>47,400</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Authors’ elaboration in La Forgia and Nagpal 2012.
Notes: n.a. = not applicable.
All figures in nominal terms, estimates for calendar year 2015.
a. The price of the secondary and maternity package is estimated at Rs. 500 per family per year at 2010–11 prices with annual growth of 15 percent in nominal terms.
b. These denote additional costs for the performance-based primary care scheme. The primary care package assumes continuation of ongoing financing of services with the proposed performance-based credits being provided in addition. In Scenario 1, the performance-based primary care credit is provided at Rs. 500 per family; in Scenario 2 at Rs. 1,000 per family.
c. The price of the tertiary package is estimated at Rs. 450 per family per year at 2010–11 prices and annual growth of 15 percent in nominal terms.
d. Assumes a 40 percent copayment at point of service use by the non-poor, and no upfront premium contribution.
e. The cost of secondary and maternity scheme for the vulnerable, nonpoor is estimated at 60 percent of the costs of the BPL package, with a 40 percent copay at point of service. This reduces the costs proportionately (in practice, the cost reduction for the scheme may be higher than 40 percent due to changes in utilization).
Procuring the necessary public financing for universal coverage at the state level could be more challenging. Historically, growth performance has diverged substantially across states and the elasticity of health spending has been significantly lower than that of the central government. At current projections, securing the requisite financing for universal coverage would require aggregate state health outlays to increase by an estimated 20-25 percent per year in nominal terms. An increase in outlays of such a magnitude would require a major reprioritization of the health sector at the state level or substantial improvements in the efficiency of current health spending for many of the states. States such as Uttarakhand have significantly increased health spending in recent years and may have an easier time financing universal coverage, but Rajasthan and other states may be constrained in their ability to do so. Alternatively, the central government may have to contribute additional funds (beyond the proposed central-financial packages) to the proposed state-financed packages for states unable to generate sufficient funds.

If the benefits package is closely coordinated and adequately financed, the expansion of existing programs augurs well for India’s march toward universal health coverage.

Despite the apparent dichotomy in financing of these newer UHC programs, as well as the apparent fragmentation among the programs, the potential for an interesting complementarity does exist. The programs discussed earlier have their areas of focus clearly marked out—primary care in the case of the NRHM, secondary care in the case of RSBY, and tertiary care in the case of Rajiv Aarogyasri and other state health insurance schemes. Thus, if these programs could further evolve to a state of close coordination and similarly defined populations to be covered, and with smooth linkages, they could contribute to more seamless, comprehensive coverage for primary, secondary, and tertiary care, drawing upon their respective strengths and synergies. There is considerable scope, for example, of NRHM-strengthened primary care facilities serving as effective gatekeepers for the secondary and tertiary health insurance programs, and also contributing to effective follow-up care after these patients are discharged. Preventive interventions and effective case management for non-communicable diseases at the primary care level can contribute significantly to reducing the need for hospitalization, thereby simultaneously improving quality of life for the beneficiaries and containing the costs of hospitalization programs. Also, lessons from the demand-side financing schemes in aligning facility-level incentives for inpatient care can be used to introduce a performance-based remuneration system for public facilities providing primary care. If these programs can be coordinated in this manner for future expansion plans, their current configuration could be a promising foundation for a reformed health finance and delivery system.
5. References


International Monetary Fund (2010), World Economic Outlook, chapter 3.


### India: Selected Economic Indicators

|---------|---------|---------|---------|---------|---------|---------|---------|

#### Real Income and Prices (% change)

- **Real GDP (at factor cost)**
  - 9.3 6.7 8.6 9.3 6.2 5.0 6.1 6.7
- **Agriculture**
  - 5.8 0.1 0.8 7.9 3.6 1.0 2.0 2.0
- **Industry**
  - 9.7 4.4 9.2 9.2 3.5 3.0 5.2 7.0
- **Of which: Manufacturing**
  - 10.3 4.3 11.3 9.7 2.7 3.0 4.4 7.5
- **Services**
  - 10.3 10.0 10.5 9.8 8.2 6.9 7.4 7.5
- **Real GDP (at market prices)**
  - 9.6 3.9 8.5 10.5 6.3 4.7 6.1 6.7

#### Prices (average)

- **Wholesale Price Index**
  - 4.7 8.1 3.8 9.6 8.9 7.3 6.7 6.3
- **Consumer Price Index**
  - 6.2 9.1 12.4 10.4 8.4 ... ... ...
- **GDP Deflator**
  - 5.8 8.7 6.1 8.9 8.3 7.3 6.7 6.3

#### Consumption, Investment and Savings (% of GDP)

- **Consumption 1/**
  - 68.3 69.9 70.9 69.3 70.7 75.6 74.1 71.9
- **Public**
  - 10.3 10.9 11.9 11.4 11.6 13.8 13.0 12.8
- **Private**
  - 58.0 59.0 59.0 57.9 59.0 61.9 61.2 59.0
- **Investment 2/**
  - 32.9 32.3 31.7 31.7 30.6 30.5 31.3 32.9
- **Public**
  - 8.0 8.5 8.4 7.8 7.4 6.7 8.0 7.9
- **Private**
  - 24.9 23.8 23.3 24.0 23.2 23.8 23.3 25.0
- **Gross National Savings**
  - 30.8 35.1 36.9 36.1 33.3 29.2 30.3 32.1
- **Public**
  - 5.0 1.0 0.2 2.6 1.3 1.0 4.0 4.4
- **Private**
  - 34.8 34.1 36.7 33.5 32.0 28.2 26.3 27.7

#### External Sector

- **Total Exports (% change in current US)**
  - 26.6 15.0 -5.8 37.5 17.9 -1.9 24.0 24.5
- **Goods**
  - 28.9 13.7 -3.6 37.5 23.6 -4.0 23.4 26.3
- **Services**
  - 22.4 17.3 -9.7 37.5 7.1 2.8 25.2 21.0
- **Total Imports (% change in current US)**
  - 31.6 16.6 -0.1 28.8 24.2 1.3 18.6 19.9
- **Goods**
  - 35.1 19.8 -2.6 26.7 31.1 1.0 19.6 21.2
- **Services**
  - 16.2 1.1 14.4 39.4 -7.3 3.5 12.3 11.2
- **Current Account Balance (% of GDP)**
  - -1.3 -2.3 -2.8 -2.7 -4.2 -5.1 -4.5 -4.1
- **Foreign Investment (US billion)**
  - 43.3 8.3 47.0 37.6 38.6 35.0 44.5 75.0
- **Direct Investment, net**
  - 15.9 22.4 18.0 9.4 22.1 20.0 26.5 40.0
- **Portfolio Investment, net**
  - 27.4 -14.0 29.1 28.2 16.6 15.0 18.0 35.0
- **Foreign Exchange Reserves (US billion) 3/**
  - 299.2 241.4 254.7 274.3 260.1 214.2 230.9 276.7

#### General Government Finances (% of GDP)

- **Revenue 4/**
  - 21.0 19.4 18.2 18.6 18.4 18.1 18.5 18.5
- **Expenditure**
  - 26.0 27.8 28.0 27.7 26.6 25.7 25.7 25.1
- **Deficit**
  - 5.0 8.4 9.8 9.1 8.2 7.6 7.2 6.6
- **Total Debt**
  - 74.4 74.9 73.3 67.8 67.6 67.9 67.2 65.9
- **Domestic**
  - 69.7 69.8 68.6 63.3 63.0 63.5 63.2 62.2
- **External**
  - 4.7 5.1 4.7 4.5 4.7 4.4 4.0 3.6

#### Monetary Sector (% change)

- **Money Supply (M2)**
  - 19.3 8.9 18.2 10.0 5.8 13.9 15.2 13.4
- **Domestic Credit**
  - 17.7 23.4 20.2 20.5 17.8 19.5 13.7 11.5
- **Bank Credit to Government**
  - 8.7 42.0 30.7 18.9 19.4 16.1 17.9 15.7
- **Bank Credit to Commercial Sector**
  - 21.1 16.9 15.8 21.3 17.1 21.1 11.7 9.5
- **Velocity**
  - 4.3 4.5 4.3 4.7 5.2 5.1 5.0 5.0

**Notes:**

1/ Consumption is equal to final consumption expenditure plus valuables
2/ Gross fixed capital formation
3/ Excluding gold, SDR and IMF reserve position
4/ Excludes receipts from 3G spectrum auctions

**Sources:** Central Statistics Office, Reserve Bank of India, and World Bank Staff Estimates.