From poverty to empowerment
India’s imperative for jobs, growth and effective basic services

MGI INDIA | March, 2014
McKinsey Global Institute: our research on India

- 2007: "The Growth Imperative" - Understanding the Barriers to Rapid Growth and Employment Creation
- 2010: "India's urban awakening: Building inclusive cities, sustaining economic growth"
- 2014: "From poverty to empowerment: India's imperative for jobs, growth, and effective basic services"
Encouraging progress on extreme poverty reduction

Headcount ratio of population below India’s official poverty line

<table>
<thead>
<tr>
<th>Year</th>
<th>Headcount below official poverty line</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-94</td>
<td>404 (Million)</td>
</tr>
<tr>
<td>2004-05</td>
<td>407 (Million)</td>
</tr>
<tr>
<td>2009-10</td>
<td>354 (Million)</td>
</tr>
<tr>
<td>2011-12</td>
<td>270 (Million)</td>
</tr>
</tbody>
</table>

SOURCE: Planning Commission of India; McKinsey Global Institute analysis
What it would take to economically empower every Indian – fulfilling eight basic needs

1. **Food**
   - Sufficient calories, proteins, and fats

2. **Energy**
   - Clean fuel for domestic needs

3. **Housing**
   - A minimum decent dwelling unit

4. **Sanitation**
   - Sanitary latrine / sewerage systems

5. **Drinking Water**
   - Adequate piped water for the household

6. **Education**
   - Primary + secondary schooling (or vocational training)

7. **Healthcare**
   - Essential primary, secondary, and tertiary care

8. **Social Security**
   - Insurance to cover income loss

**Basic needs**

**SOURCE:** McKinsey Global Institute analysis
680 million live below the Empowerment Line –2.5 times the extremely poor and 7 times their consumption gap

Average monthly consumption expenditure
INR per capita per month, 2011-12, in 2011-12 prices

SOURCE: National Sample Survey Office survey, 68th round; McKinsey Global Institute analysis
Health, drinking water and sanitation form the largest share of the Empowerment Gap

Empowerment Gap by service and sector, 2011–12 %; INR thousand crore ($ billion¹)

<table>
<thead>
<tr>
<th>Service</th>
<th>Urban</th>
<th>Rural</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel</td>
<td>107</td>
<td>226</td>
<td>332</td>
</tr>
<tr>
<td>Housing</td>
<td>32</td>
<td>18</td>
<td>17</td>
</tr>
<tr>
<td>Education</td>
<td>21</td>
<td>25</td>
<td>19</td>
</tr>
<tr>
<td>Food</td>
<td>9</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>Health, water, sanitation</td>
<td>37</td>
<td>40</td>
<td>39</td>
</tr>
<tr>
<td>Others</td>
<td>-1</td>
<td>-1</td>
<td>-1</td>
</tr>
</tbody>
</table>

¹ Using average exchange rate of US $1 = INR 48.0769 for 1 April 2011 to 31 March 2012.

SOURCE: NSSO 68th round, McKinsey Global Institute
An average Indian lacks access to 46% of services

Average deprivation scores by basic service (percent)

<table>
<thead>
<tr>
<th>Two types of basic services</th>
<th>CDS</th>
<th>HDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community level services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Healthcare¹</td>
<td>53</td>
<td>59</td>
</tr>
<tr>
<td>Education¹</td>
<td>23</td>
<td>18</td>
</tr>
<tr>
<td>Household level services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>57</td>
<td></td>
</tr>
<tr>
<td>Sanitation</td>
<td></td>
<td>53</td>
</tr>
<tr>
<td>Drinking Water</td>
<td></td>
<td>46</td>
</tr>
<tr>
<td>Housing</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Overall ADS²

1 Healthcare metrics include ORS, immunisation and health infrastructure; education metrics include net enrolment and classroom and teacher availability; energy includes electricity and LPG usage
2 ADS is a population-weighted average of district-level access deprivation score
SOURCE: McKinsey Global Institute analysis
Access deprivation varies by type of service

**HDS**: Housing, energy, sanitation, drinking water

**CDS**: Healthcare & Education

### Most Deprived
- 62% HDS
- 56% CDS

### Moderate Deprivation

1. 57% HDS
   - 39% CDS

2. 41% HDS
   - 41% CDS

3. 38% HDS
   - 31% CDS

4. 20% HDS
   - 46% CDS

### Least Deprived

5. 46% HDS

**SOURCE**: Census 2011, District-Level Health Survey 2007-08, DISE 2009-10, MGI analysis
Historical reduction of Empowerment Gap largely from higher incomes

Empowerment Gap, 2005–12
% ; INR thousand crore

Government social spending is 6% of GDP but half of it does not benefit the people

2011-12 government spending

100% = INR 570,000 crore

Estimated efficiency/effectiveness of all-India government spending
% of spending that typically reaches the people

- Food: 64%
- NREGA: 52%
- Education: 51%
- Fuel: 47%
- Health, drinking water and sanitation: 36%

Inefficiencies and leakages

If subsidy delivery nationwide was as effective as in India’s best performing states, 85 million more people would be above the official poverty line

Best performing states at 80-90%

SOURCE: NSSO, government fiscal statistics, MGI analysis
Looking ahead, two possible scenarios for India

Percent of population

**Below Empowerment Line**

- 2012: 56
- 2022 – Stalled reforms: 36
- 2022 – Inclusive reforms: 7

580mn

**Below Poverty Line**

- 2012: 22
- 2022 – Stalled reforms: 12
- 2022 – Inclusive reforms: 1

250 mn

GDP growth rate 5.5% vs. 7.8%

SOURCE: McKinsey Global Institute analysis
Four inclusive reform themes

More and better non-farm jobs

- Million
  - 2012: 237
  - 2022 - stalled reforms: 312 (up by 75)
  - 2022 - inclusive reforms: 352 (up by 115)

Accelerate farm productivity improvements

- Yield (tonnes per hectare)
  - 2012: 2.3 (2.0% p.a.)
  - 2022 - stalled reforms: 2.8
  - 2022 - inclusive reforms: 3.9 (5.5% p.a.)

Improve effectiveness of public spending

- Percent
  - 2012: 50
  - 2022 - stalled reforms: 50
  - 2022 - inclusive reforms: 75 (up by 25 p.p.)

Increase public spending on basic services

- INR '000s crore, 2012
  - 2012: 570
  - 2022 - stalled reforms: 771 (3.1% p.a.)
  - 2022 - inclusive reforms: 1,088 (6.7% p.a.)

SOURCE: McKinsey Global Institute analysis
90% of potential impact comes from productivity and efficiency levers, just 10% comes from more social spending

Percentage of population:
- 56% below Empowerment Line 2012
- 25% create new non-farm jobs
- 10% increase farm productivity
- 9% improve effectiveness of public spending
- 4% increase public spending on basic services
- 7% population below Empowerment Line 2022E

Contribution to poverty reduction:
- 50% poverty reduction
- 20% population below Empowerment Line 2012
- 20% increase farm productivity
- 10% population below Empowerment Line 2022E

SOURCE: McKinsey Global Institute analysis
BACK UP
India’s glut of low-productivity small enterprises keep average worker incomes low

Share of manufacturing employment by business size

<table>
<thead>
<tr>
<th>Business Size</th>
<th>India</th>
<th>Philippines</th>
<th>Indonesia</th>
<th>Thailand</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>200+ employees</td>
<td>6</td>
<td>23</td>
<td>29</td>
<td>42</td>
<td>52</td>
</tr>
<tr>
<td>50-199 employees</td>
<td>11</td>
<td>8</td>
<td>6</td>
<td>13</td>
<td>23</td>
</tr>
<tr>
<td>1-49 employees</td>
<td>84</td>
<td>70</td>
<td>65</td>
<td>46</td>
<td>25</td>
</tr>
</tbody>
</table>

Value add per worker for 200+ employee businesses¹
2005, USD ‘000 per year

- India: 13.1
- Philippines: 14.0
- Indonesia: 12.4
- Thailand: 13.1
- China: 31.1

Value add per worker for 5-49² employee businesses¹
2005, USD ‘000 per year

- India: 1.5
- Philippines: 3.2
- Indonesia: 2.3
- Thailand: 5.7
- China: 15.1

¹ Both manufacturing & non-manufacturing businesses
² Productivity data is only for small enterprises (i.e., 5-49 employees) and does not include micro enterprises (i.e., 1-4 employees)

SOURCE: Asian Development Bank; “Enterprises in Asia: Fostering Dynamism in SMEs,” Key Indicators for Asia and the Pacific (2009), McKinsey Global Institute analysis
Agricultural policy has emphasised input subsidies over investment or high quality extension

Expenditure in agriculture, INR thousand crore

<table>
<thead>
<tr>
<th>Year</th>
<th>Input subsidy(^1)</th>
<th>Output support (food subsidy(^2))</th>
<th>Gross capital formation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006-07</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008-09</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010-11</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Growth rate
Percent per year

Input subsidy\(^1\)
- Fertilizer
- Irrigation

Output support (food subsidy\(^2\))

Gross capital formation
- Research & extension
- Post-harvest infrastructure
- Irrigation infrastructure

1 Does not include electricity subsidy accruing to agriculture and subsidy to indigenous urea production
2 A part of the food subsidy is actually a consumer subsidy rather than a producer subsidy, but a break-up is unavailable

SOURCE: Planning Commission (2012); McKinsey Global Institute analysis
Basic services spending needs to grow in line with GDP, shifting towards healthcare, drinking water and sanitation.

Public spend on basic services
Percent; INR ’000 crore, 2011-12

Per capita¹
INR per month, 2011-12

<table>
<thead>
<tr>
<th>Service</th>
<th>2012</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare</td>
<td>42%</td>
<td>40%</td>
</tr>
<tr>
<td>Education</td>
<td>13%</td>
<td>9%</td>
</tr>
<tr>
<td>Food</td>
<td>14%</td>
<td>9%</td>
</tr>
<tr>
<td>Fuel</td>
<td>7%</td>
<td>11%</td>
</tr>
<tr>
<td>Social Security</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>Housing</td>
<td>15%</td>
<td>4%</td>
</tr>
<tr>
<td>Water &amp; sanitation</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>Health</td>
<td>1%</td>
<td>3%</td>
</tr>
<tr>
<td>Total</td>
<td>571</td>
<td>1,088</td>
</tr>
</tbody>
</table>

+6.7% per annum

Per capita values:
390 INR per month, 2011-12
662 INR per month, 2022

¹ Not accounting for inefficiencies and leakages.
NOTE: Numbers may not sum due to rounding.
SOURCE: IPFS; McKinsey Global Institute analysis
Effective service delivery can be achieved through policies that emphasise three elements

**Leverage External service providers**
- School vouchers funded by the Govt.
- PPP schools (e.g., charter schools)

**Involve the community, especially women**
- School management committees
- Low-cost, semi-skilled teachers trained intensively
- Community health workers
- Village health committees
- Dispensaries by micro-entrepreneurs

**Create IT-based performance monitoring mechanisms**
- Assessment systems
- Alternate teacher certification
- Digital attendance recording
- Online medicine supply database
- SMS-tracking of patients based on biometric identification

**Education**
- Health vouchers funded by the Govt.
- PPP and tech-enabled primary health care centres

**Health**
- Cash transfers – service providers will be private
- NGOs, for-profit companies running Fair Price Shops
- Gram panchayats identify beneficiaries and monitor FPS performance
- Women SHGs running FPS

**Food**
- Digital tracking of supply chain
- Surprise audits
- Web-based portal for grievances

SOURCE: McKinsey Global Institute analysis
<table>
<thead>
<tr>
<th>10 action areas for productive job creation (50% of impact)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Set national priority</strong></td>
</tr>
<tr>
<td>1.1 Set explicit goal – to create 115 million non-farm jobs (40 million more productive jobs) in the next 10 years</td>
</tr>
<tr>
<td>1.2 Shift allocations to public capital investment by at least 1.0% of GDP (Rs. 100,000 crore per year) to fund job creation engines</td>
</tr>
<tr>
<td>1.3 Implement a system for measurement and tracking of jobs data</td>
</tr>
<tr>
<td><strong>Create four job engines</strong></td>
</tr>
<tr>
<td>2 20 tourism circuits – investment of Rs. 5,000 crore per year to create 10-15 million jobs over 10 years through state Empowered Agencies &amp; a Delivery Unit</td>
</tr>
<tr>
<td>3 30-50 world class industrial clusters, greenfield and brownfield – invest Rs. 30,000 crore per year to create &gt;5 million jobs and 25-30% IRR for government through state Empowered Agencies and a national Delivery Unit</td>
</tr>
<tr>
<td>4 30-40 mid-sized cities – investment of Rs. 50,000 crore per year for urban infrastructure and affordable housing in Tier 3 and 4 cities</td>
</tr>
<tr>
<td>5 8-10 education and innovation corridors – investment of Rs. 10,000 crore per year for world class higher education campuses and R&amp;D hubs</td>
</tr>
<tr>
<td><strong>Put in place enablers</strong></td>
</tr>
<tr>
<td>6 Deliver infrastructure (especially power and logistics) e.g., debottlenecking &gt;150 projects through empowered PM-driven Delivery Unit</td>
</tr>
<tr>
<td>7 50% measurable improvement in “business’ satisfaction with government” – “Business charter” or Right to Services for administrative and labour issues – National and state CIOs to drive e-governance/government re-engineering</td>
</tr>
<tr>
<td>8 Labour market reforms – ease interpretation of laws/inspections and undertake more fundamental reform in restrictive laws e.g., unfair dismissal laws</td>
</tr>
<tr>
<td>9 “Skills vouchers” to 5 million workers per year through certified skill providers</td>
</tr>
<tr>
<td>10 Reduce in distortions – implement GST, remove sector level distortions</td>
</tr>
</tbody>
</table>
10 action areas to double agricultural yield (20% of impact)

1. **Set explicit and binding goal** to double agricultural yield over 10 years
2. **Shift agri-spending towards investment and capital formation** - commit and additional Rs. 30,000 cr. pa to rural roads, cold chains, research, extension, water harvesting and efficient irrigation systems
3. **Revamp agricultural universities and raise investment in agricultural research by 50%** (say Rs. 10,000 cr pa)
4. **Overhaul farm extension services** through PPP, monitoring of public extension workers and technology-based expert systems to bridge gaps in human resources
5. **Create a National Agriculture Incentive Fund** (say Rs. 10,000 crores), for states that adopt reforms – e.g., model APMC act, pricing of water, power and improvement in extension services
6. **Raise farmers’ demand for APMC reform and organised retail buyers** through proactive price information using SMS and other technologies
7. **Reduce distortions in price supports** to promote diversified food production e.g., by making it a function of an independent agency
8. **Incorporate agricultural credit into banking inclusion** and drive credit absorption by an additional 10-15 million farmers per year
9. **Institutionalise mandatory Krishi raths** to visit villages in a coordinated way
10. **Collapse myriad departments** and ministries associated with agriculture
Shift focus to job creation with investment in infrastructure and skills

Redirect social spending budgets to boost access to health, water, sanitation

Adopt relentless outcome measurement, leveraging IT

Create accountable Empowered Agencies & Delivery Units to get things done