GOVERNANCE AND ECONOMIC PERFORMANCE OF INDIAN STATES

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CERTIFICATE

This is to certify that the dissertation entitled **"Governance and Economic Performance of Indian States"**, submitted by me is in partial fulfilment of the requirements for the award of the degree of **MASTER OF PHILOSOPHY** of Jawaharlal Nehru University. This dissertation has not been previously submitted for any other degree of this or other university and is my own bonafide work.

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INTRODUCTION

1.1 CONCEPTUALISING GOVERNANCE: ISSUES AND CONCEPTS

In this world change stands at the heart of all things and every nation faces the challenge of making the best of circumstances. Today the primary focus of the dominant economic process is on harnessing the wealth creating nexus of skills, technology and science and access the global market with the outcome.

There are strategic as well as tactical choices to be made to improve economic performance. While the old diction of state sponsored economic development lie collapsed by the way side, yet the role of the state has shifted to a new frontier. Indeed the process of development poses powerful dilemmas for governance.

It is clear that a modern market economy cannot run efficiently unless there is appropriate government regulation and a proper system of governance.

While experience has shown that unleashed market forces have the power to generate and sustain growth, much depends on the state of institutions that support markets, and are publicly provided. The ability of the state to provide these institutions is therefore an important determinant of how well individuals behave in markets and how well markets function. Successful provision of such institutions is often referred to as "good governance".

The World Bank defines governance as the manner is which power is exercised in the management of a country's economic and social resources. The World Bank has identifies three distinct aspect of governance (1) the form of political regime; (2) the process by which authority is exercised in the management of a country's economic and social resources for development and (3) the capacity of governments to design, formulate and implement policies. But exactly what constitutes appropriate regulation and what is good are very hard questions to answer.

Good governance includes the creation, protection and enforcement of property rights without which the scope of market transactions is limited. It includes the provisions of a regulatory regime that works with the market to promote competition. And it includes the provision of sound macroeconomic policies that create a stable environment for economic performance. Good governance also means the absence of corruption, which can subvert the goals of policy and undermine the legitimacy of the public institutions that support markets.

The United Nations Development Programme views Governance as the exercise of political, economic and administrative authority in the management of a country's affairs at all levels. It comprises mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations, and mediate their differences.

The concept of governance as used by **Organization for economic cooperation and development** encompasses the role of public authorities in establishing the environment in which economic operators function and in determining the distribution of benefits, as well as the nature of the relationship between the ruler and the ruled.

The Commission on Global Governance defines Governance as the sum of the many ways in which individuals and institutions, public and private, manage their common affairs. It is a continuing process through which conflicting or diverse interests may be accommodated and cooperative action may be taken.

It includes formal institutions and regimes empowered to enforce compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interest.

The Mahbub Ul Haq Human Development Centre defines Human Governance as governance dedicated to securing human development. It must enable the State, civil society and the private sector to help build capacities, which will meet the basic needs of all people, particularly woman, children and poor. It requires effective participation of people in state, civil society and private sector activities that are conducive to human development.

A useful approach to analyze the issue of governance whether it is restricted to political, economic or civil governance or looks at the system in its entirety, is to view the process of intermediation as involving a continuous interplay of three elements, each representing a specific set of deliberate arrangements. These are institutions, the delivery mechanism and subordinate framework of rules, procedures and legislation. Based on these ideas the Planning Commission (2001)* has come up with an alternative model of governance in India.

Efficient governance requires efficient institutions which in turn depends on its adopted delivery mechanism and the supportive framework of rules and procedures. Moreover, in changing domestic and global scenario in a developing economy, a

* Adopted from Report of Planning Commission, 2001 on Successful Governance in India.

continuous adoption in each of these elements is required. In the absence of such a capacity in the institutions, the governance invariably suffers.

These changes may be classified as:-

(i) Natural changes like population and planned development changes. The failure to take a holistic perspective while building institutions results in inadequacies which get compounded over time.

(ii) Some changes could be rooted in the global context and developments elsewhere and also require anticipation. In such cases, a capacity for anticipating, continuous scanning, analysis of relevant information, as well as the deployment of requisite expertise has to be in built in the institutions. Rigid ideological positions and political divide in society, may, somehow, hinder such capacities to be developed.

(iii) There are also some changes, though confined largely to the state machinery, that are deliberated but adhoc in nature. Such changes affect institutions in a counter productive fashion. The adhoc interpretation and changes in civil service rules, promotional policies and job responsibilities are example of such changes. They have had detrimental effect of morale, incentive structures and the overall work ethos, in the process, encouraging mediocrity and corruption in the state machinery.

1.2 INTERACTION BETWEEN STATE, MARKET AND ECONOMIC AGENTS

The relative roles of the market and governments in promoting social welfare has been a topic of debate for several decades.

The two justifiably celebrated results of neoclassical economics are its theorems on welfare economics: that a competitive equilibrium is pareto optimal and that production efficiency and distributional equity are compatible.

A curious facet of this neoclassical result is that it is "institution free" in that it does not explicitly refer to any state. However, a complete set of smoothly functioning commodity, factor, insurance and capital markets is presumed. It is presumed that producer and consumer decisions are taken with full confidence that the parties to a trade will fulfill their obligations.

The end of the second world war witnessed the world wide rejection of the laissez faire doctrine which had failed so spectacularly during the inter-war period. After the second world war, during the next quarter century or so, a variety of interventionist theories set the agenda for the debate on the role of the state. These interventionist theories identified a horde of market failures-pervasive externalities, increasing returns, non existent markets, moral hazards and adverse selection and argued that active state involvement was necessary to correct these failures. All theories agreed on a mixed economy frame of one sort or another.

From the 1970's onwards, a new debate was set on the role of the state. The central argument was that we cannot assume the state to be an impartial and omnipotent social guardian. Neo liberal economists argued that imperfect nature of the state results in government failures and the cost of government failures is typically greater than the cost of market failures. Government intervention proved ineffective or worse than the disease of market failure.

Critics of neoliberalism emerged and it was soon realized that limitations of the framework could not be overcome by marginal tinkering but by a different approach that takes the role of institutions and policies seriously.

From a somewhat different perspective, some students of the economic developed countries began focusing attention on the interaction between public policies and private lobbies and interest groups. An important element of this analytical effort is an attempt to understand why some economies grow faster than others, as well as why the same economy grows faster in some periods than in others. This is of particular interest to the development of developing countries. Equally important is the contribution of some economic historians on the theory of three important institutions: property rights, state that enforces these rights and the ideology.

Colander christened this area of research neoclassical political economy. He distinguished it from neoclassical economics by its assumption that the state far from being an exogenous force trying do good is at least partially endogenous and the policies it institutes will reflect vested interests in society. Such a view of the state is not particularly new and goes back to Marx. The neoclassical political economy applies the standard tools of individual optimization to lobbies and interest groups. It turns out that the benign Smithian metaphor of the 'invisible hand' guiding self-interested individuals to achieve social good has to be replaced by Magee's colorful metaphor of the 'invisible foot' symbolizing the welfare reducing effects of competitive self interested behaviour in the political arena over redistribution.

The two major strands of this literature are-

i. The collective choice analysis of Olson and his associates;

ii. The public choice school of Brennam, Tallock and their followers;

i) Collective Choice Analysis

Olson observes that even though a group of individuals or firms had some interest in common and can be expected to organize and lobby for that interest, in the absence of special arrangements or circumstances, rational individuals will not act in their group interest. The reason is that the services of such a lobby, like those of a state, are 'public goods' such that their provision to anyone means provision to everyone. This results in the 'free rider problem'.

At the private level distributional coalitions such as cartels can operate through the markets and not only by influencing government policy. Such coalitions at all levels will slow down economic growth and redistribute national product, not necessarily to the poor. In such a situation, laissez-faire perse would not be sufficient to counter them.

Neoclassical economic theory presumes that the only social loss associated with a distortion introduced by a policy is the dead weight loss associated with it. The theory of collective action attempts to explain the likelihood of success by given set of individuals in undertake activities including the establishment of rules, which may benefit them collectively. The flip side of the theory is of course why and how collective action failures come about. Such failures derive primarily from the public goods aspects of group action.

To bring about collective action, individuals form interest groups which develop into organizations that are relatively permanent. These organizations facilitate collective action on the part of interest groups by reducing start-up and long run average costs, interest groups and the state. While groups and organizations may undertake private actions to provide directly for their own public goods, they so indirectly by means of the state. By gaining access to the state and its ability to impose regulations, monitor and enforce them, interest groups can successfully undertake collective action.

Among the means by which the state can do so are:-

i. Changing the level breadth of distribution and composition of the benefits it provides free of charge to the public.

ii Passing the judgement on the legality of imposing negative incentives upon those not participating in collective acts.

iii. Insisting on certain voting procedures, such as the secret ballot which may affect the feasibility of imposing selective incentives on those supporting or opposing collective action.

Rent Seeking. It is a matter of common observation that pressure groups, faced with different information and different costs of delivery instrument with which to deal with free riding, interact in the political market, to obtain regulations in their favour in pursuit of wealth.

They are successful in doing so because regulators and policy makers are themselves not neutral. Pressure relationships shape their utility function just as tastes play a role in consumer choice theory.[*]

These regulations take the form of government restrictions such as granting of monopoly positions, imposition of tariffs, quotas and other non tariff barriers, and

[*] See Peltzman 1971.

result in contrived rents to the beneficiaries. Between the two main contending interests in regulatory processes, producer interest tends to prevail over consumer interest resulting in "small group dominance". The winning group, however, does not obtain even a gross gain through political process as great as is within their power to grant it.[**]

Mc Cormick & Tollison (1981) formulate a model of both the demand for and supply of wealth transfers in which the transfers are mediated by politicians who extract them from the suppliers and then deliver to the demanders.

Rent seeking is generally portrayed as a zero or negative sum game when an interest group is aimed at increasing the group's share of a fixed or diminishing stock of wealth.

Rent seeking also involves cost of collecting information, coordinating and monitoring efforts. The ratio of collective efforts to collective beneficiaries may vary because government restrictions are in the nature of a public good-people will try to free ride on this account.

On the positive side, one can view revenue seeking as a positive sum game. When the action promoted by a Group A is efficiency increasing in the long run, with benefits accruing both to A itself and to another group B, even though in the short run, A's net gains might be more than B's net losses.

Bhagwati and Srinivasan point out that in the theory of second best, rent seeking may be welfare improving and may result in reduction in importable output. If relevant information about the lobbying and other activities is assumed to be open

[**] See Stiger, 1971.

and available to all, the outcome of competition among groups will be efficient in the sense that the given amount of income and wealth transfers is obtained in a way that minimizes the social cost of achieving them.

(ii) The Public Choice School*

Focuses attention on interactions and institutions outside of and beyond the confined competitive market process i.e. to non market decision making. Activities, legal and illegal such as tax avoidance, tax evasion, and smuggling, are also covered by the analysis. An essential feature of these activities is that while they are rational and not wasteful from a private viewpoint they are often socially wasteful, therefore, government intervention becomes necessary.

However, the public choice school argues that the social loss associated with a policy is not confined only to the dead weight loss. In fact a person or a group which is differentially affected, favorably or unfavorably, by a government may-

i. Engage in lobbying efforts to institute or repeal it.

ii. Engage directly in politics to secure access to decision making power

iii. Shift resources into or out of the affected activity.

Resources may be employed at all three levels simultaneously while traditional dead weight loss calculation is confined only to the last level.

An important policy implication is that as long as governmental action is restricted largely to protecting individual rights, persons and property, and enforcing voluntarily negotiated private contracts, the market process dominates economic behaviour and ensures that any economic rents that appear will be dissipated by the

* Main advocate of this school are Brerman, Tallock and their followers.

force of competitive entry. Furthermore the prospects for economic rents enhance the dynamic process of development, growth and orderly change.

If, however, government action moves significantly beyond the limits defined by the minimal or protective state, if Government commences to interfere in the market adjustment process, the tendency toward the erosion or dissipation of rents is countered and may be shortly blocked.

If political allocation is to be undertaken without giving rise to rent seeking, then such allocation has to be done without creating differential advantage to some groups and a credible pre-commitment not to depart in future from such an allocation procedure needs to be given. This suggests that such a scheme will be more difficult to implement the larger is the size of government and the extent and scope of its intervention. The public choice school arrives at the desirability of the minimal protective state from an instrumentalist approach.

The political philosopher Nozick arrives at the same conclusion from the view point of moral philosophy and respect for individual rights. He concludes that 'a minimal state', limited to the narrow functions of protection against force, theft, enforcement of contracts, and so on, is justified; that any more extensive state will violate persons rights not to be forced to do things.

The approach of North (1981) to the evolution of the state is based on the importance of the structure of property rights which in their view 'causes growth or stagnation or economic decline depending on its efficiency.

In a neutral state, property rights that would emerge from completion would be efficient relative to the existing constraints of technology, information costs and uncertainty, efficient presumably being identified with the minimization of transaction costs. In postulating a neutral state and thereby allowing it a role and level of activity, this school differs from the extreme that is attributed to the public choice and rent seeking schools, namely, the belief that the state is nothing more than a redistributive machine.

But in real world, the state is not neutral and the emerging property rights would reflects the tension between the desires of rulers of state and efforts of the parties to exchange to reduce transaction costs.

The state emerges as a monopolistic provider of protection and justice because there activities are subject to indivisibility and increasing returns to scale. It attempts to maximize revenue acting as a discriminating monopolist in setting property rights, subject only to the constraint that it does not force its constituents to other available means of assuring themselves the same services. Since the revenue potential will in general increase with the production potential of the economy the state will also attempt to devise a structure of property rights that will reduce transaction costs and hence raise output.

Yet the structure that maximizes state revenue need not coincide with the one that maximizes output and growth. Lal, for instance, argues that successive empires in North India were essentially predatory revenue-maximizing states and each fell when it attempted to extract more than the maximum natural 'rent' that the system could provide*.

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* Many formal models exist in literature that highlight both productive and potential predatory nature of the government. See Findley and Wilson (1984) and North (1981).

1.3 LITERATURE REVIEW

Good governance matters for growth and poverty reduction. Many studies have documented strong associations between per capita income and measures of the strength of property rights, absence of corruption etc.

There is also evidence that poor macroeconomic policy adversely affects a country's growth performance. The quality of policies adopted by governments around the world varies tremendously. Average inflation in the best performing sample was 4 percent per annum in eighties and 2 percent per annum in the nineties. Among the worst performing countries, inflation averaged 200 per cent per year. The same is true of budget deficits, which were insignificantly small or surplus in nineties among the best performing countries but averaged over 10 percent of gross domestic product among the worst performing countries. The difference between tariffs between the top and bottom half of the samples is around 15 percent.

Through its powerful effects on overall economic growth, good governance is therefore central to the goal of poverty reduction. Moreover, several dimensions of poor governance notably corruption and high inflation – impose costs that fall disproportionately on poor people. Improvements in these dimensions of governance may be especially important for poor people.

Many studies however have shown that excessive regulation undermines growth. There is also evidence that public officials have to be constrained from using this power arbitrarily in the interest of the privileged few. As James Madison (1978) put it, "In forming a government, the great difficult lies in this – you first enable the government to control the governed, and it the next plan oblige it to control itself".

The Human Development for South Asia (1999) has identified the causes behind crises of governance in South Asia and held them responsible for limited prospects of growth in many regions. The report states that governance has failed in many important aspects – political, economic and civil. Economic governance has failed because the public sector in these economies have become giants in size but dwarfs in effectiveness. Inspite of huge increase in public expenditures, the social sector and physical infrastructure remain underdeveloped. The fiscal situation in many countries like India, Pakistan and Srilanka is in a mess. Not only are the public expenditures misplaced, the tax structures are inelastic and regressive in character. There is lack of transparency, corruption, administrative hurdles and lack of accountability at all levels of governance in this part of the globe. South Asia can progress fast only if these hurdles in governance practices are first removed.

The overall policy environment and the quality of governance are important factors determining the growth potential of a state. Ahluwalia, Montek (2000) highlights that since liberalization, the degree of control exercised by the centre over the states has reduced leaving much greater scope for state level initiatives.

There are several ways in which good governance affects growth. It has a direct impact on the effectiveness with which development programmes are implemented. Poor administration and corruption are now widely recognized as major problems reducing the effectiveness of many government policies. The study reveals that poor performing states have problems in this area.

The quality of governance can help stimulate growth by making the policy environment more business friendly through deregulation, decontrol and procedural simplification. Entrepreneurs setting up an industrial unit in most states typically need as many as thirty permissions from various departments each of which subjects the entrepreneur to harassment, delay and corruption. Sweeping reform of these regulatory systems at the state level is needed to reduce the transaction costs of during business. Ahluwalia (2000) points out that some Indian states have begun to take initiatives in this area and have introduced simplified procedures and one-window arrangements to improve the business climate. The poorer states have lagged far behind the more advanced states in this dimension.

The general conditions of law and order are a reflection of the overall level of governance and are particularly important for stimulating private investment. The conditions on this ground, which vary across states, are sometimes taken for granted in formulating economic policies. Disturbed conditions in rural areas, urban mafias, protection rackets and even kidnapping affect economic performance.

State governments could take initiatives with regard to labour laws. It is commonly said that labour laws are too inflexible in the matter of retrenchment of labour and closure of units both of which require permission of the state government which is almost never given. The need to amend the central legislation to allow flexibility has been pointed out in many occasions. A more transparent structure may actually help to attract more investment and increase the total volume of employment.

Institutional factors and public policies determine property rights and the structure of incentives which in turn determine productivity in the economy. The system of tenurial relations in agriculture and common environment for private enterprise in manufacturing and services are important institutional determinants of private investment. A favourable environment results in strong linkages and states with strong linkages grow faster [Kalirajan and Shand (1996)].

A very important aspect of economic governance is the fiscal and budgetary position of governments.

Fiscal Correction for economic growth

Rapid economic growth is not possible without significant fiscal correction. The deteriorating fiscal position has affected the government's ability to invest. Gross capital formation from the public sector has been declining continuously since the late eighties [Mohan, 2000].

The public sector is becoming prominent if we look at the total public expenditure. Total public expenditures at a percentage of gross domestic product rose from 16 percent in 1980-85 to 17.3 percent in 1985 – 1990. This has been falling in the nineties to about 16.5 percent. The main adjustment has been made in capital expenditure falling continuously from 5 percent of gross domestic product in early eighties to about 3 percent now, showing a serious deterioration in the quality of expenditure. The net result is rising non development expenditures and compression of state government's ability to invest in productive activities. The main problem lies in increasing debt service payments, from 0.9 percent of gross domestic product in early eighties to around 2.5 percent now.

State governments are responsible for the process of social services, for most infrastructural facilities as well as law and order. Thus a deterioration in the states ability to invest is very serious for human development and economic growth.

It is interesting to observe that, relative to the central government, states have performed better in keeping up the tax effort. Their own tax revenues have increased marginally from 5.7 percent of gross domestic product in late eighties to about 6 percent now. In contrast the non tax revenue has been falling. The net result is some deterioration in revenue receipts. This has led to serious consequences for their ability to sustain plan expenditure and investment is social and physical infrastructure. Unlike central governments, states are unable to indulge in deficit financing.

The overall state averages exhibited above follow from considerable differences between states. In the past, economically more advanced and better off states also exhibited more responsible fiscal behaviour. This is no longer the case. The fiscal malaise has now spread across all the states. In the annual plan for 1998-99, the BCR was negative for all major states except Karnataka. Borrowings of some states such as West Bengal exceed total plan outlay. As many as seven major states are now borrowing more than two thirds of their plan outlay requirements.

It is therefore desirable to subject state governments systematically to credit ratings so that their ability to borrow depends on their fiscal health. Such a system will provide appropriate signals to policy makers and will be more successful in ensuring fiscal health of states in future Mohan [2000].

Public Expenditure: Misplaced Priorities

The fiscal situation has deteriorated in the past due to government expenditure and revenue policies. Kurian (2000) has made a comparative analysis of the emerging trends in fifteen major states in respect of a few intrinsic parameters like development and non development expenditures, shares in plan outlay, investments and infrastructure development which have important bearing on social and economic development.

Kurian's study uses data on state wise per capita expenditure on development and non development for two periods 1980-81 and 1995-96. In 1980-81, the average per capita development expenditure for all states was Rs. 207.40. All the states in the forward group had an above average per capita expenditure except Tamil Nadu. In contrast only Orissa in the second group had above average per capita development expenditure. The level of development expenditure of this state was almost twice that of Bihar and higher than that of three states in the developed group.

In 1995-96, the average per capita development expenditure, rose by more than 50 percent to Rs. 367. The highest per capita development expenditure was Rs. 491 in Maharashtra and the lowest was Rs. 161 by Bihar.

It is also important to note that the real per capita non development expenditure has grown faster than development expenditure. The ratio of development to non development expenditure has come down steeply from 3.2 in 1980-1 to 2.1 in 1995-96. The major reason for the increase in non development expenditure has been the steep increase in interest payment of the states.

Table 1.1: Developmental and non developmental expenditure: of the State Governments (Rs. At 1980-81 Prices)

State	1980-81			1995-96		
	Per capita Dev. Exp	Per capita Non-dev. Exp	D.E. as a Multiple of N.D.E.	Per capita Dev. Exp	Per capita Non-dev. Exp	D.E. as a Multiple of N.D.E.
Andhra Pradesh	27.7	54.8	3.8	392.0	141.0	2.8
Gujarat	253.0	80.1	3.2	483.4	164.5	2.9
Haryana	314.3	79.0	4.0	522.5	396.1	1.3
Karnataka	208.8	74.3	2.8	423.5	155.7	2.7
Kerala	246.1	66.0	3.7	386.5	212.1	1.8
Maharashtra	259.8	104.8	2.5	491.2	178.9	2.7
Punjab	283.7	94.1	3.0	445.5	391.3	1.1
Tamil Nadu	188.7	67.7	2.8	407.0	165.9	2.5
Assam	166.9	54.3	3.1	313.5	139.2	2.3
Bihar	128.0	43.5	2.9	160.5	100.1	1.6
Madhya Pradesh	195.7	47.3	4.1	275.8	109.5	2.5
Orissa	223.5	54.8	4.1	295.3	134.6	2.2
Rajasthan	194.1	63.8	3.0	403.3	204.2	2.0
Uttar Pradesh	152.2	46.5	3.3	206.2	152.6	1.4
West Bengal	163.7	56.6	2.9	253.1	123.8	2.0
All States	207.4	64.9	3.2	367.3	177.2	2.1

Source: Ninth Five Year Plan (1997-2002), Planning Commission, GOI.

Kurian (2000) has also analysed the sectoral composition of eighth plan outlay in different states. The combined share of agriculture and irrigation at the All India level is 24 percent of the total. Six states in the first group and four states in the second have a share higher than the national average. The low share of Punjab and Tamil Nadu are explained by near saturation reached by these states.

The state wise share of plan outlay on energy, transport and services turns out to be 23.6 percent, 8.6 percent and 26.2 percent respectively in the total. High priority was given on energy by Punjab, West Bengal, Madhya Pradesh, Uttar Pradesh , Orissa and Tamil Nadu, the lowest share was in Madhya Pradesh. The highest share in social services went to Assam, Tamil Nadu, Haryana and Himachal Pradesh. The sectoral composition is seen in the following table.

Table 1.2: Eighth Plan Outlay And its Sectoral Distribution

State	**Per capita Anticipated Exp. (in Rs.)**	**Percentage Share of Expenditure**			
		Agriculture & Irrigation	Energy	Transport	Social Service
Andhra Pradesh	1858	28.4	23.5	12.2	19.9
Gujarat	2700	36.1	20.4	6.7	24.0
Haryana	2833	25.9	24.0	6.0	35.2
Karnataka	3138	28.6	21.3	6.0	29.6
Kerala	2370	26.4	24.8	8.1	19.5
Maharashtra	3101	27.2	20.5	8.2	21.0
Punjab	2951	16.7	41.1	4.1	26.8
Tamil Nadu	2457	15.9	22.0	9.8	36.0
Assam	2066	20.3	13.6	8.1	41.1
Bihar	592	26.8	10.4	8.6	20.3
Madhya Pradesh	1742	25.7	30.1	2.7	26.2
Orissa	2123	28.4	18.4	10.1	25.5
Rajasthan	2548	24.7	26.2	7.6	25.9
Utter Pradesh	1372	20.1	26.9	10.9	24.8
West Bengal	1144	14.0	38.9	7.3	19.3
All India	1965	24.0	23.6	8.6	262

Source: Ninth Five Year plan (1997-2002), Planning commission

Public Expenditure and Private Investment

The inequitable nature of public expenditure results in inequitable spread of infrastructure spread across states. This in turn causes divergence in allocation of private investments resulting in divergence in interstate growth rates and income levels [Das, Shand and Kalarajan (1999)].

Per capita public expenditure can be taken as a proxy for infrastructure. This factor has been found to exert a significant influence on the distribution of investment across states which is proxied by loans given by All India Financial Institutions. The analysis reveals that the relation is positive and significant i.e. per capita private investment is significantly influenced by per capita government expenditure. Every one percent higher value of the latter results in higher loan assistance by financial institutions of more than two percent.

Yet another aspect of public investment is the distribution of stock of central investment in public enterprises. In India this stock does not follow any regular pattern. This shows that the location of central public enterprises has not contributed much towards strengthening forward and backward linkages.

Nor have the poorer states been able to reap full benefits from investments in industries like steel and coal which are located within their boundaries due to policies like freight equalization. The transport subsidy given to equalize the prices of these basic inputs throughout the country has not only robbed the forward linkage benefits of locating these industries, in poorer regions but has also led to allocation distortions.

Relative tax performance across states

In the federal structure of governance in India, the constitution has defined the tax jurisdiction of the constituent state governments. The states can decide how much of their taxable capacity they will exploit. Given the taxable capacity, a state's actual tax revenue collection will depend, among other things, on the tax effort made, efficiency of tax collection machinery and the performance of the economy. Such an assessment becomes a major issue when one tries to evolve an objective policy of devolution of central funds to the states with a federal structure.

Coondoo, Mazumdar and Mukherjee (2001) have examined relative tax performance of selected states based on annual data on state tax revenue for the period 1986-87 to 1996-97 using quantile regression. The technique of quantile regression can help examine whether and how, given the level of per capita state domestic product, the ordinal position of individual states changes over time. It can also indicate whether the rate of change of tax state domestic ratio with respect to real per capita state domestic ratio is different across ordinal group of states.

Table 1. 3: Observed Tax SDP Ratio for Indian States, 1990-91 to 1996-97

States	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Andhra Pradesh	8.49	8.18	8.66	7.98	7.57	6.40	6.76
Assam	4.42	4.82	4.49	4.68	4.34	4.52	4.56
Bihar	4.97	5.23	5.35	5.33	5.63	6.70	6.03
Gujarat	9.92	11.10	9.87	10.18	9.23	9.92	9.55
Haryana	8.74	8.88	9.55	8.66	8.63	8.83	7.14
Karnataka	11.35	10.85	10.62	11.28	10.85	11.65	11.48
Kerala	11.01	11.08	10.99	11.91	12.05	13.11	13.69
Madhya Pradesh	6.62	7.60	7.51	6.97	6.83	7.45	7.47
Maharashtra	8.81	9.05	7.99	7.85	8.46	8.20	7.70
Orissa	6.92	5.39	5.68	5.55	5.08	5.29	5.97
Punjab	7.72	7.62	7.55	7.80	8.24	7.47	6.66
Rajasthan	6.65	7.72	7.33	7.89	7.58	8.10	7.46
Tamil Nadu	11.30	11.47	10.99	10.42	10.98	12.40	12.07
Uttar Pradesh	6.39	6.11	6.26	5.93	6.17	6.18	6.11
West Bengal	6.77	6.72	6.73	6.55	9.93	6.68	6.04

Source: Condoo, Majumder et al. (2001)

The results reveal that the performances can be classified broadly into four categories (a) The best performing states are the South-Western states i,.e. Gujarat, Karnataka, Kerala, Rajasthan and Tamil Nadu and have remained so over the sample period (b) The worst performing states which have remained so over the sample period were the eastern states of Assam, Orissa and West Bengal; (c) The medium level performance throughout the period was shown by the states of Bihar, Haryana, Madhya Pradesh and Uttar Pradesh; (d) The fourth level of performance which start out at the medium or top level and then show a declining trend in performance over the sample period are the states of Andhra Pradesh, Maharashtra and Punjab.

The results show that the statês in South and West India display a superior tax performance compared to the rest of India. This may be due to a number of reasons a relatively larger taxable capacity, relatively greater tax effort made by these states and some deep seated political economic characteristics that these states may share. The table below gives the observed tax state domestic ratio for different states during the nineties.

Higher per capita expenditure in richer states are caused mainly by their high revenue capacity. Even when tax rates are identical, the states with higher per incomes capita income collect higher per capita taxes and are thus able to provide higher standards of public services. In other words, states with lower per capita incomes will have to levy at higher rates in order to provide the same standard of services. Such an argument for redistributive transfers has been made on grounds of horizontal equity [Broadway and Flatters (1992)].

The study shows that the degree of redistribution was not very high in the early eighties . It increased steadily upto 1992-92, but declined thereafter, coinciding with the fiscal adjustment programme undertaken by the central government. Nevertheless, this redistribution was not adequate to offset the fiscal disabilities of poorer states arising from their low revenue capacities.

Inequitable transfer of resources may be due to implicit transfer such as (a) Interstate tax exportation (b) Subsidized lending to the states by center & banking system (c) subsidized lending to the private sector by long term refinancing institutions for priority by long term refinancing institutions for priority sector activities.

Interstate tax exportation arises from the levy of origin based cascading-type sales taxation along with taxation of inter-state sale of goods. The sales tax levied by states are predominantly on the basis of origin, at the stage of manufacture or import. As the tax is fully shifted due to oligopolistic nature of the market, the levy of tax causes significant interstate tax exportation on taxes imposed on interstates sale of goods, inputs and capital goods. This results in the tax burden from more affluent producing states to the consumers in poorer consuming states.

The second source of implicit transfers arises from subsidized lending to the states. Loans from the central Government alone comprise 68 percent of states liabilities, market borrowing constitute another 22 percent which in subscribed mainly by banking system to subscribe to statutory liquidity requirement. The extent of these transfers depends on pattern of interstate allocation of these loans and the difference between interest rates charges and market rates of interest. Incase of Indian states with high per capita incomes, per capita transfers are higher than low and medium income states.

Mukhopadhyay & Das (2003) have estimated horizontal imbalance (measured by the coefficient of variation in own revenue as a percentage of total expenditure) persisting in India today. Variations in tax base, tax effort and infrastructural facilities –are found to be important determinants of horizontal imbalances.

The following relationship was proposed to be estimated

OR = f(DI, TB, THE, FP, DC)

Where OR : own revenue as a percentage of total expenditure.

DI : Development index; TB : Tax Base; TE : Tax Effort

FP : Proxy of political instability

DC : Dummy variable used for discriminator central policies.

The authors ran a panel data regression for seventeen major Indian states for 1995-96 and 1996-97. The results show that persistence of horizontal imbalances can be explained by persistence of variations in independent variables across states in India. When states are being ranked by per capita income (tax base), own revenue as a percentage of state domestic product (tax effort) or the development index during 1990-91 and 1996, the ranks are more or less unchanged.

Table 1.4: Rank of States according to Tax base, Tax effort and Development index

State	Development Index		Tax Base		Tax Effort	
	1990-91	1996-97	1990-91	1996-97	1990-91	1996-97
Andhra Pradesh	8	11	7	8	7	11
Assam	13	10	10	14	16	16
Bihar	14	14	16	16	15	15
Gujarat	5	9	4	4	4	4
Haryana	4	4	2	3	6	6
Karnataka	9	8	9	7	1	3
Kerala	2	2	11	6	3	2
Madhya Pradesh	16	16	13	12	12	10
Maharashtra	6	7	3	1	5	5
Orissa	12	13	15	15	9	12
Punjab	1	1	1	2	8	7
Rajasthan	15	15	12	11	11	9
Tamil Nadu	3	3	5	5	2	1
Uttar Pradesh	7	6	14	13	13	14
West Bengal	11	12	8	10	10	13

Source: Mukhopadhyaya and Das (EPW, 2003)

Decentralization for Economic Growth

Decentralization resolves the size of the nation trade-off between economies of Scale and heterogeneity of preferences (Alasina and Spolaore, 1997). It enables better efficiency in resource allocation because the provision of public goods becomes more responsive to local conditions. India's Panchayats may open prospects of poverty reducing growth (Rajaraman, 2002).

A number of empirical works on Panchayats have highlighted their role in influencing key economic variables. Mahal et al. (2000) have pointed out that increased decentralization/democratization increases school enrollment for given values of other variables (NCAER data base). Chattopadhyay and Duflo (2001) studied the impact of gender of sarpanch on choice of public goods (Birbhum district, West Bengal). It was found that women opt more for employment generation projects directly relevant to their needs like water, fuel, roads, etc. whereas men opt more for education Rajaraman and Vasistha (2000) have found that untied grants impact negatively on panchayat revenue effort with a collollary funding on impact of ethnic fragmentation on local fiscal discipline (Kerala).

Poverty reducing growth requires that the massive annual central budgetary provisions for rural infrastructure be effectively utilized. The low rates of these provisions suggest procedural obstacles to fund flows and centrally dictated avenues of utilization as obstructive factors. Rajaraman (2002) finds no observable impact of panchayat involvement (since 1999) on rates of utilization of these funds, although quality of utilization may have improved.

Effectiveness of Welfare Improving Programmes

The central and state governments in India have launched various poverty alleviation programmes which are aimed at directly helping the poor to improve their social, physical and economic conditions. These programmes may provide (a) productive assets or credit to households for self employment, (b) employment opportunities to rural poor and to generate public goods such as physical infrastructure (c) essential commodities through the public distribution system to millions of poor suffering from malnutrition (d) social security to poor households in the case of old age, death of head of family and maternity.

The dent in poverty in different states depends among other things, on the state government capabilities to implement such programmes and providing institutions at the grass roots that support the provision of such services.

The public distribution system for example has many problems (a) it is benefiting the poor only marginally (Parikh, 1994); (b) in some areas poor have to pay higher market prices in the presence of public distribution system (Radhakrishna, Indrakant (1987); (c) considerable increase in food subsidy due to high costs of procurement and carrying costs; (d) Leakages to open market (Ahluwalia, 1993) etc.

The effectiveness of poverty alleviation programmes come under critical scrutiny. The problems are associated with corruption, weak administration, lack of infrastructure planning, bureaucratic delays, poor repayment etc. For example several studies on the success of Integrated rural development programmes has shown the IRDP has been successful in only the developed and prosperous areas and the poorest of the poor were unable to take advantage of the scheme. There are significant interstate variations as well. Parthasarthy (1995) points out that Andhra Pradesh showed good results as very poor population was also able to retain their assets and make productive use. In Karnataka (Vyarulu) and Rajasthan (Sagar) only the better off farmers benefited, not the landless labourers. CHH Rao and Rangaswamy point out like in Uttar Pradesh, the poorest were not only able to manage to hold on to their assets but also derived income from the assets on a sustained basis.

Rajaraman (2002) brings to light the problem of utilization of funds inspite of massive annual developmental expenditure flows from the center to the states. The table below gives the fund flows into major central rural schemes.

Table 1.5: Major Central Rural Schemes :Fund Flows (2001-02)

Rs. Cores

Ministry of Rural Development	12275
Ministry of HRD. Primary Education (DPEP)	1100
Ministry of Health	
Rural Family welfare services	1360
Backward area projects	250
Ministry of Social Justice and Empowerment	482
Social Plan for Schedule Castes in Agriculture	408
Rehabilitation of scavengers	74
Ministry of Agriculture	1172
Water Management	61
Crop Insurance	261
Supplement to State Work Plans	850
Total	Rs. 16386

Source: Rajaraman (2002)

For poverty reduction and economic growth the massive annual central budgetary provisions for rural infrastructure have to be effectively utilized. The major rural development schemes of Fund Utilization April- September /December 2000 are given below

Table 1.6: Fund Utilization of Major Rural Development Schemes (2000)

	% Released Allocated	% Utilization Available
Rural Employment		
JGSY (VP Select/Imple)	49	42
EAS (DP selec/Imple)	56	42
Rural Water Supply	63	47
Rural Sanitation	32	11
National Social Assistance		
Old age Pension (NOAPS)	68	45
Death Compensation (NFBS)	68	54
Maternity (NMBS)	59	49
Rural Self Employment SGSY	31	40

Source: Rajaraman (2002)

The ability to the states to effectively utilize these funds has important bearing on the poverty reduction and welfare enhancement and thus indicates good and effective governance.

Community Participation in Governance

In the modern concept of the role of state, community participation plays a very important role whether it is through people or through non government organizations. Many successful government initiatives in India are a result of people's participation.

Joint forest management is one successful area in this regard. For example, Behroonguda is one of 77,000 hamlet and villages in Andhra Pradesh with no firewood and teak, there was a threat to the more survival of the 97 families who inhabit this region. They formed themselves into a forest protection group in 1990. The state government officially recognized their efforts in 1993 and allotted 500 acres of land to the forest committee. In five years time, the residents began to derive benefits from the forest. Today their natural asset base is valued at Rs. 67 million. Their operations have had a positive impact on income, employment and local seasonal out migration.

Planning Commission (2003) has highlighted a number of successful governance initiatives of Indian states in the field of Land, Water and Livelihood; Human development and social services and public interface with government. Many of these projects like TANWA, Tamil Nadu involved women in agriculture; Participatory poverty reduction in Kerala; Shiksha Karmi and Lok Jambish in

Rajasthan; Community Owned Rural Intranet project in Madhya Pradesh would not have been possible without community participation.

It has been firmly established by now that good governance is an important determinant of economic growth of any economy.

1.4 OBJECTIVES OF THE PRESENT STUDY

(i) To study the development of India, in general and major states in particular during the nineties.

(ii) To study the improvement or deterioration in indicators of governance during the nineties.

(iii) To construct and compare composite index of governance for two points of time 1991 and 2000.

(iv) To establish the relationships between indicators of economic performance and economic governance for major states of India.

1.5 METHODOLOGY, DATA BASE AND ANALYTICAL FRAME WORK

The purpose of the present study is to establish (a) whether the economically better off Indian States are also better governed and (b) does improvement in governance over time result in improvement in economic performance.

The process of development can be viewed from both economic and social indicators. Economic attainments in this study are measured through-

(i) Net state Domestic product is the reflection of benefits and opportunities that the state generates for its people.

(ii) Head Count Ratio indicates the state of deprivation of the state

(iii) Level, composition and growth in employment opportunities.

(iv) Spread of Education, as an important means for individuals to improve personal endowments and choices for a sustained improvement in well being.

(v) Indicators on health and longevity are important constituents in the framework under human development approach.

Governance for better performance is a widely inclusive term and incorporates political, civil and economic governance. The present study incorporates only economic governance and its effect on the growth processes.

Successful governance in economic spheres is analysed through the following indicators.

(i) Size of the public sector- measured by (a) Share of public sector in total employment; (b) Public Expenditure as a percentage of GSDP.

(ii) Budgetary and Fiscal Deficit measured by (a) Trends in revenue and fiscal deficit of states; (b) Tax Effort of State Governments; (b) Development and non development expenditures.

(iii) Financial Performance of Selected Public Sector Enterprises.

(iv) Movement of Inflation Rate as an assessment indicator of monetary policy.

(v) Decentralization in economic growth has been measured through (a) Expenditure per capita on core services by local bodies; (b) Own tax effort of local bodies.

To establish a link between governance and economic performance, we test the significance of accepting the hypothesis of a relation between: (a) NSDP and Public

Expenditure of State Government; (b) NSDP and revenue deficit of state governments; (c) NSDP and fiscal deficit of governments in India; (d) NSDP and development expenditures.

Data Base

The study is based on secondary data analysis. Data from various sources have been used.

* Data on Net State Domestic Product has been collected from various volumes of economic survey.
* The data on poverty ratio has been obtained from Planning Commission, Government of India.
* Data on incidence of unemployment has been obtained from NSS rounds on employment and unemployment situation in India.
* Data on literacy has been obtained from Selected Educational Statistics, Ministry of Human Resources and Development.
* Data on budgetary aspect of governance has been obtained from Finances of state governments, RBI Bulletin, various issues.
* Data on public sector employment is obtained from Employment Review, DGE & T, Ministry of Labour, Government of India.
* Data on finance of Panchayati Raj Institutions have been obtained from Report of the Eleventh Finance Commission.

The Analytical Framework

1. The Compound Annual Growth rate of net state domestic product, employment and governance under have been calculated for the two time points 1991-92 and 1998-99 using the following formula $P_t = P_0 (1 + r/100)^t$

where P_t = Current year

P_0 = Value for base year

T = Time period

R = Exponential rate of growth of expenditure which is again calculated by

Log $(P_t - P_0)/t$

2. Coefficient of variation has been used to analyse the variations in values of various indicators across states in India.

   CV = (Standard deviation/Mean) x 100

3. Correlation between various indicators of economic performance end governance have been calculated according to Karl Pearson's Coefficient of Correlation

4. The composite index of governance is based on: (i) Index of fiscal stability; (ii) Index of social and economic infrastructure; (iii) Index of effective decentralization; (iv) Inflation rate; (v) Performance of Public Sector enterprises; (vi) Effectiveness of welfare programmes; (vii) Community Participation in elections.

However, before calculating the index, the enter data was transformed to the same range from 0 to 1. To achieve this the following transformation was used for each indicator-

(Value X – Minimum Value in the Series)/ (Maximum value in the series – Minimum Value in the Series)

Second it was ensured that all values closer to 1 be preferred. From the above, the index of minimum inflation state should be 1 and maximum, inflation state be 0.

After transforming the data, to the desired range and order, composite index was constructed by allotting equal weightage to all indicators.

This index may not be the perfect index. Governance is a dynamic concept, difficult to bring under empirical discipline. No single number can hope to capture all the essential elements of governance. The index is essentially a policy index serving as a informed tool for informed policy.

Organization Of The Study

We have presented the introductory note and analytical framework in the present chapter. Chapter 2 analyses the economic performance of Indian States during the nineties. Chapter 3 studies the trends in governance indicators over time for major states. Chapter 4 we construct the composite index of governance and bring out the relation between economic and governance indicators. Chapter 5 presents summary and conclusions and policy implications for governance.

CHAPTER 2

ECONOMIC PERFORMANCE OF INDIAN STATES

2.1 INDICATORS OF ECONOMIC DEVELOPMENT

The process of development, in any society, should ideally be viewed and assessed in terms of the benefits and opportunities that it generates for people and how these are eventually distributed between people and across regions.

Economic attainment of individuals have conventionally been captured through indicators like per capita income or per capita domestic product of the economy. This indicator is also useful in capturing the stock of available resources or means, that in a sense, facilitate other attainments for individuals and the society at large.

If an economy is not able to succeed in achieving a high rate of growth of per capita income for a vast majority of its population, then it results in a state of deprivation. In absolute terms it reflects the inability of an individual to satisfy certain basic minimum needs for a sustained, healthy and a reasonably productive being. The head count ratio is a useful indicator to segregate the poor population.

Yet another indicator of the process development in any economy is the level of employment, its composition and the growth in employment opportunities. It is also an indicator that, in most cases, directly captures the economic attainments and the level of well being of individuals. In India, because of the nature of labour market, the data on employment is not entirely adequate. Of the total employment in the country nearly 90 percent is in the unorganized or informal sector where the data is available only through surveys that are periodically mounted. This is unlike the data for the organized sector where most employment details are reported and are available.

The process of education and attainment thereof has an impact on all aspects of life. The level and spread of education has been an important precondition for sustained economic growth both in developed and developing countries. Education is perhaps the single most important means for individuals to improve personal endowments, build capacity levels, overcome constraints and in the process, enlarge their available set of opportunities and choices for a sustained improvement in well being.

For most individuals the choice to live a healthy life and a reasonable life span are crucial attributes in the notion of personal well being. Indicators on health and longetivity are important constituents in the framework for evaluating the development process under the human development approach.

On the basis of the above discussion, we list below the chosen indicators of economic performance of Indian states

(i) Net State Domestic Product.

(ii) Head count ratio.

(iii) Incidence of unemployment in states.

(iv) Literacy differences across states.

(v) Infant Mortality Indicators.

We begin with a brief discussion of macroeconomic assessment of India before analyzing the regional differences.

2.2 INDIA: MACRO ECONOMIC ASSESSMENT

Gross Domestic Product growth in 2001 is estimated at 5.4 percent stronger than 4 percent in 2000 but below the 6.5 percent average of the previous five years. Several factors prevented the economy from achieving growth rates comparable to those of the mid nineties. The global economic slowdown impacted on exports which contracted after growing at double digit rates in India. Domestic demand growth remained weak despite some strengthening in 2001, partly reflecting poor performance in agriculture sector in 1999 and 2000. These two elements, plus a perception among the business community of slow progress in reforms eroded business confidence and slowed the pace of growth in physical investment.

Due to relatively favourable weather conditions agriculture is projected to have improved significantly in performance. This raised the expectations of a possible demand led pick up in economic performance fueled by higher rural incomes. However, prospects for a continued sustainable agricultural improvement over the medium term depend on investment both to ease infrastructure bottlenecks (irrigation and rural electrification) and to modernize the sector.

Industrial growth for the whole of 2001 is estimated at around 3.3 percent, the lowest in five years, Manufacturing accounted for the bulk of industrial output, expanded by a mere 2.3 percent in 2001 after showing at growth of 7-8 percent in 2001. However moderate signs of improvement are evident since then.

The performance of the services sector improved moderately in 2001 but fell short of the outstanding growth rates of nineties. The services sector is expected to grow at 6.5 percent, a substantial improvement over 2000 (4.8%) growth rates and reflects more robust performance in the financial business services segment, particularly the IT and software services sector, which after growing by a disappointing 2.9 percent in 2000, expanded by 25 percent during the third quarter of 2001 compared with the same quarter in 2000.

The central government's lack of progress in reducing its deficit meant more domestic borrowing which led to upward bias in interest rate structure and increased the complexity of monetary management.

During 1992-2000, employment growth in the organized private sector averaged 1.3 percent a year compared with 0.2 percent in the public sector. The largest contribution to the employment generation is likely to have come from the informal sector, for which data are not available. Stronger agricultural performance is likely to have improved rural labour market conditions and helped reduce poverty, while slower growth in industry and a retrenchment in the public sector have likely resulted in a deterioration of labour.

Table 2.1: Major Economic Indicators, India (1999-2003) percent

Item	1999	2000	2001	2002	2003
GDP Growth	6.1	4.0	5.4	6.0	6.8
Gross Domestic Investment/ GDP	24.3	24.0	24.0	24.5	24.9
Gross Domestic savings /GDP	23.2	23.4	23.0	23.6	23.8
Inflation rate (WPI)	3.3	7.2	4.7	4.0	5.0
Money supply (M3) growth	14.6	16.7	11.2	14.0	15.0
Fiscal balance /GDP	-5.4	-5.7	-5.7	-5.3	-4.8
Merchandise export growth	9.5	19.6	-1.0	11.0	14.0
Merchandise import growth	16.5	7.0	-0.9	13.0	14.5
Current account balance/GDP	-1.1	-0.6	-0.5	-1.0	-1.5
Debt/GDP	22.2	22.3	22.0	21.0	20.0

Source: Asian Development Outlook, 2002

A low inflation environment accompanied a modest improvement in domestic demand. The annual average inflation rate measured in terms of wholesale price index dropped from 7.2 percent to 4.7 percent in 2001. This drop stemmed from lower fuel and power prices.

However inflation, was measured by year to year variations in the consumer price index for industrial workers was higher in December 2001 than a year earlier. This resulted from increases in prices of some primary articles, such as fruits and vegetables. However, as long as prospects of agricultural growth are positive, inflation, should stay within moderate levels.

In terms of fiscal performance, falling imports and slowing industry hurt central government tax collections, which were down by about 8 percent through the 2001 relative to the previous year. Overall, revenues remained the same.

In terms of fiscal performance, falling imports and slowing industry hurt central government tax collections, which were down by about 8 percent through the 2001 relative to the previous year. Overall, revenues remained the same because of better than expected non tax revenues.. In order to contain the fiscal deficit, the government took steps to curtain non defence expenditure growth, including reducing the size of civil service through reductions in capital expenditures. Despite these measures the central government is likely to miss its fiscal deficit target of 4.7 percent of gross domestic product with actual deficit of 5.7 percent. However, with some improvement in fiscal performance at the state level the combined government fiscal deficit may worsen significantly.

Monetary and financial developments were characterized by relative stability. Non food bank credit decelerated considerably. In 2001, M3 growth slowed to 10.5 percent from 13.2 percent in the previous years. Bank deposits surged in response to adverse developments in other segments of the financial market presenting the banking sector with the challenge of deploying these resources in a context of low credit and investment demand.

Mindful of maintaining interest rate and price stability, the Reserve Bank of India reduced bank rate from 7.0 percent to 6.5 percent its lowest level since May 1973. It also reduced the cash reserve ratio in a staggered manner down to 5.5 percent in December 2001.

The current account deficit is likely to have narrowed slightly to remain less than 10 percent of GDP in 2001. The capital account also strengthened during 2001 reflecting mainly an increase in foreign investment flows due to delisting of many foreign companies on the Indian browses. In the light of these developments, the balance of payments registered a moderate surplus for the sixth consecutive year in 2001.

India's external debt position is also manageable. The debt service ratio decreased from a peak level of 35.3 percent in 1990 to 17.1 in 2000.

2.3 ECONOMIC ATTAINMENTS: TRENDS IN NET STATE DOMESTIC PRODUCT

Economic Attainments of individuals are conventionality measured through trends in per capital Net State domestic Product over time. The following table gives the compound annual growth rate of state domestic product and population of different Indian States.

Table 2.2: Compound Annual Growth of NSDP, 1990-1 to 1999-2000

States	1990-91 (Rs. Cr.)	1998-99 (Rs. Cr.)	CARG of NSDP (A)	CARG of Population (B)	A-B
Andhra Pradesh	46391	65760	5.11	1.31	3.8
Assam	12704	14879	2.28	1.74	0.54
Bihar	25506	42469	2.59	2.43	0.16
Gujarat	38551	62717	8.45	2.65	6.4
Haryana	18019	24943	4.75	2.50	2.25
Karnataka	32619	51930	6.87	1.60	5.27
Kerala	20129	29672	6.68	0.9	5.78
Madhya Pradesh	41254	54689	4.81	2.20	2.61
Maharashtra	83716	135496	7.12	2.06	5.06
Orissa	14503	18810	3.78	1.49	2.29
Punjab	24806	33093	4.20	1.82	2.38
Rajasthan	29650	40866	4.7	2.53	2.17
Tamil Nadu	45560	71671	6.69	1.67	5.02
Uttar Pradesh	75264	100926	4.28	1.79	5.62
West Bengal	43188	68177	6.96	1.65	5.31

Source: Calculated from the data on NSDP taken from Economic Survey, various issues.

The fastest growing states in India were Gujarat, Maharashtra in the high income category whereas Punjab and Haryana showed a tendency towards slow growth. It is encouraging to see that all the middle income states of Kerala, Karanataka, Tamil Nadu and West Bengal. All the low income states had growth rates in the range of 2-5 percent.

States are also showing varying performance around their own mean measured by the coefficient of variation of the state's income over time. This indicates the consistency of performance of states. We can see from the given table that amongst the states showing the highest coefficient of variation, most of them belong to the low income category i.e. Bihar, Assam, Orissa, Madhya Pradesh. Noticeable exception is however Punjab.

The probable reason could be deceleration in agriculture and slow down of industrial growth in the nineties as compared to the eighties. As the coefficient of variation is decreasing, the level of income of the states is increasing. Karnataka, West Bengal and Kerala fall in this category. High income states like Maharashtra, Gujarat, Andhra Pradesh have the lowest coefficient of variation. States like Rajasthan and Uttar Pradesh which have low income also have low coefficient of variation pointing towards their consistently poor performance.

Table 2.3: Coefficient of Variation of State Net Domestic Product

State	Coefficient of Variation
Bihar	71.7
Assam	65.7
Orissa	60.4
Punjab	42.4
Madhya Pradesh	37.1
Kerala	37.1
Haryana	35.4
West Bengal	34.5
Karnataka	32.9
Rajasthan	31.9
Gujarat	31.8
Uttar Pradesh	31.1
Tamil Nadu	21.1
Maharashtra	25.0
Andhra Pradesh	15.7

Source: Calculated from the data on NSDP as reported in Economic Survey.

We can also measure how regional disparities as has been changing in recent years. Table 2.4 shows that regional disparities in India declined upto 1984-85, thereafter they have been steadily rising. Regional disparities increased at a much slower rate in the during the eighties as compared to the nineties. Between 1980-1 and

1989-90, coefficient of variation changed by 1.6 percent whereas between 1980-91 and 1998-99, coefficient of variation increased by 4 percent.

Table 2.4: Coefficient of Variation of NSDP across states for selected Years

Year	Coefficient of Variation
1981-82	49.82
1982-83	49.93
1983-84	49.59
1984-85	49.2
1986—87	50.07
1989-90	52.50
1990-91	52.50
1992-93	53.66
1996-97	55.58
1997-98	56.40
1998-99	60.83

Source: Same as Table 2.3

2.4 TRENDS IN POVERTY AND UNEMPLOYMENT OF INDIAN STATES

(i) *Estimates of Poverty*

Estimates of poverty in India are typically based on a normative minimum calorie intake. The calorie norms are fixed at 2400 Calorie per person per day for rural areas and 2100 Calorie per person per day for urban areas.

The specific calorie norms are then weighed by the corresponding composition (by age and sex) of urban and rural populations separately to derive the rural and urban average uniform calorie norms.

This is the direct method and does not involve the use of any income notion. The second method may be called the income method and involves the calculation of minimum income at which the specified minimum nutritional needs are satisfied, given the consumption patterns of the population.

While the Planning Commission has used the income method to measure poverty in India, an estimate of poverty by the direct method allows for an independent check on how well the intake method is doing in capturing the calorie intake at the poverty line.

The table below presents the head count ratio for different states of India at two points for time 1993-94 and 1999-2000. Among the high income states, Punjab, Andhra Pradesh, Gujarat, Haryana had the lowest percentage of poor population in India. Maharashtra being a high income state, however has the second largest percentage of poor population in India. The low income states of Orissa, Madhya Pradesh, Assam, Bihar had 40-50 percent of population below the poverty line.

In 1999-2000, two states have been able to improve their head count ratio between 1993-94 and 1999-2000 i.e. Maharashtra and Rajasthan. Amongst the states that were able to reduce their head count ratio significantly, three belonged to high income category (Maharashtra, Gujarat and Haryana). However, Karnataka, Kerala, Tamil Nadu and Rajashtan have also reduced their poor population significantly. Amongst the poorer states, Bihar showed a significant reduction in HCR though in absolute terms, still 42.6 percent of its population lies below the poverty line.

Other poor states of the country like Orissa, Madhya Pradesh and Assam could achieve significant gains at improving their HCR.

Table 2.5: Success of States in Reducing Poverty (1993-94 to 1999-2000) on basis of Head Count Ratio

States	% of Persons 1993-94	% of Persons 1999-2000	Decrease in % of Persons
Andhra Pradesh	22.19	15.77	6.42
Assam	40.86	36.09	4.77
Bihar	54.96	42.60	12.36
Gujarat	24.21	14.07	10.14
Haryana	25.05	8.74	16.31
Karnataka	33.16	20.04	13.12
Kerala	25.43	12.72	12.71
Madhya Pradesh	42.52	37.43	5.09
Maharashtra	36.86	25.02	11.84
Orissa	48.56	47.15	1.41
Punjab	11.77	6.16	5.61
Rajasthan	27.41	15.28	12.13
Tamil Nadu	35.03	21.12	12.91
Uttar Pradesh	40.85	31.15	9.7
West Bengal	35.66	27.02	8.64

Source: Calculated from data given in Economic Survey.

(ii) Employment Indicators of Indian States

The level of employment, its composition and the growth in employment opportunities is a critical indicator of the process of development in any economy. It is also an indicator that in most cases, directly captures the economic attainments and hence the well being of individuals.

The employment statistics relate to the labor force, growth in employment and incidence of unemployment. In India, because of the nature of labor market, the data on employment is not entirely adequate or even reliable of the total employment is not entirely adequate or even reliable of the total employment in the country, 40 percent is in the unorganized sector or informal sector where the data on the magnitude and composition of employed is available only through surveys that are periodically mounted.

During the period 1983 to 1999-2000, the percentage of persons in the labour force at the national level declined from 66.5 percent in 1983 to 61.8 percent in 1999-2000. For males this declined from 87.1 percent to 83.5 percent and for females it was 44.4 percent to 38.5 percent during this period. While the labor force participation rates are excitedly higher in rural areas in comparison to urban areas, in both cases there has been a decline in this period.

The growth in employment for persons employed in the age group 15 years and above on the usual principal and subsidiary status has declined significantly in the nineties vis-à-vis the eighties. For the period 1983 to 1993-94, the growth in employment was 2.1 percent on the whole, 1.8 percent in rural areas and 2.9 percent in urban areas. For the period 1993-94 to 1999-2000, the corresponding growth rates were 1.6 percent, 1.3 percent and 2.4 percent respectively. The decline in the employment growth in employment growth for females has been significantly higher than that for males.

Given the increase in the labour force, a decline in the growth of employment in the nineties vis-à-vis eighties has increased that incidence of unemployment. The incidence of unemployment, defined as the percentage persons unemployed in the age group of 15 years and above on the usual principal and subsidiary status has increased from 2 percent in 1983 to 2.3 percent in 1999-2000. This ratio increased for both males and females and in particular for urban areas. In case of urban areas there has been a sharp decline between 1983 and 1993-94 from 5.1 percent, which has been somewhat eroded by a subsequent increased to 4.8 percent in 1999-2000.

The table below gives the compound annual growth in the persons employed in the age group 15 years and above on the usual principal and subsidiary status.

Table 2.6: Compound Annual Growth Rate of Employment

(Percent per annum)

States	1983 to 1993-94			1993-94 to 1999-2000		
	Male	Female	Persons	Male	Female	Persons
Andhra Pradesh	2.1	2.7	2.4	1.6	0.3	1.1
Assam	1.3	3.2	1.6	2.5	2.3	2.5
Bihar	1.8	1.7	0.9	2.3	3.0	2.5
Gujarat	2.4	1.6	2.1	2.1	2.2	2.1
Haryana	2.5	4.7	3.1	1.9	-3.1	0.6
Karnataka	2.2	2.4	2.3	2.0	0.8	1.6
Kerala	2.0	-1.2	0.9	1.6	1.4	1.6
Madhya Pradesh	2.4	1.7	2.2	1.9	1.5	1.8
Maharashtra	2.1	2.3	2.2	1.8	-0.2	1.0
Orissa	1.8	2.9	2.1	1.5	1.0	1.3
Punjab	1.8	-1.4	1.0	1.5	6.1	2.6
Rajasthan	2.6	2.4	2.5	2.2	0.5	1.5
Tamil Nadu	1.6	2.0	1.8	1.4	-0.3	0.8
Uttar Pradesh	2.3	1.1	2.0	1.7	1.4	1.7
West Bengal	2.4	2.1	2.4	1.6	-0.8	1.1
All India	2.2	1.7	2.1	1.9	0.9	1.6

States of Rajasthan, West Bengal and Andhra Pradesh had an employment growth higher than the national average during 1983 to 1993-94. In the second period, among the major states, only Punjab, Bihar and Assam have not only had growth rates higher than national average but have also succeeded in significantly improving their performance over the previous period.

Table 2.7:Relation Between growth of Income and Employment, 1993-94-1999-2000

	Growth in employment > than national average	Growth in employment less than the national average
High Income States	Gujarat, Punjab	Haryana, Maharashtra
Middle Income States	Karnataka, Kerala	Tamil Nadu, West Bengal, Andhra Pradesh
Low Income States	Bihar, Uttar Pradesh, Madhya Pradesh	Rajasthan, Orissa

It is interesting to see from the above table that there is not systematic relation the income of states and growth in employment. States that have shown high rate of growth in employment than the national average are from all categories high income, low income and middle income.

Next we study the incidence of unemployment prevalent in Indian states. Among the major states, Kerala has the highest incidence of unemployment at nearly 8 percent in each of the three years. In case of Haryana and Karnataka, there is secular decline in the incidence of unemployment during this period but for others there is no clear trend and in most cases (except Punjab and Tamil Nadu) the incidence of unemployment is higher in 1999-00 than in 1983.

Table 2.8: Incidence of Unemployment – Combined

(As a percentage of labour force)

States/Uts	1983			1993-94			1999-2000		
	Male	*Female*	*Persons*	*Male*	*Female*	*Persons*	*Male*	*Female*	*Persons*
Andhra Pradesh	1.8	0.5	1.3	1.3	0.6	1.1	1.8	0.9	1.4
Assam	2.2	2.4	2.2	4.6	9.5	5.6	3.7	8.0	4.6
Bihar	1.7	0.3	1.3	2.6	1.3	2.3	2.9	0.9	2.4
Gujarat	1.8	0.6	1.4	1.8	1.1	1.6	1.1	0.3	0.8
Haryana	3.3	1.1	2.7	1.9	0.9	1.6	1.5	0.4	1.2
Karnataka	1.8	1.2	1.6	1.5	1.3	1.4	0.3	1.2	1.4
Kerala	7.5	8.6	7.9	5.8	12.1	7.7	1.8	15.1	8.6
Madhya Pradesh	0.9	0.1	0.6	1.7	0.5	1.3	1.5	0.3	1.1
Maharashtra	2.6	0.7	1.9	2.4	1.1	1.9	3.4	.8	2.9
Orissa	1.9	0.6	1.5	2.5	1.2	2.1	3.2	1.5	2.6
Punjab	2.5	2.0	2.4	1.8	1.9	1.9	2.4	1.2	2.1
Rajasthan	1.1	0.2	0.8	0.8	0.2	0.5	1.1	0.3	0.8
Tamil Nadu	3.7	2.1	3.1	2.6	2.0	2.4	2.9	1.9	2.6
Uttar Pradesh	1.4	0.3	1.1	1.4	0.1	1.1	1.7	0.7	1.4
West Bengal	3.9	3.9	3.9	3.0	5.0	3.5	3.9	4.3	4.0

2.5. LITERACY DIFFERENCES ACROSS STATES IN INDIA

Education is perhaps the single important means for individuals to improve personal endowments, build capability levels, overcome constraints and in the process, enlarge their available set of opportunities and choices for a sustained improvement in well-being.

The level and spread of education has not only been an important precondition for sustained economic growth, both in the developed and developing countries, but it has also played a critical facilitative role in the demographic, social and political transition of these societies. Creation, application and adaptation of new technologies, lower fertility, infant and child mortality rates, better nutritional, hygiene and health status of children, reproductive health and empowerment of women, social mobility and political freedom, all have visible linkages with educational attainments of people.

It is undoubtedly, the basic component of human development. It is the best social investment, given the synergies and the positive externalities that it generates for people in their well-being.

The Census of India currently defines the literacy rate as proportion of literates to total population in the age group 7 years and above. It was 18.5 percent in 1951, 43.6 percent in 1981 and 65.2 percent as per the census 2001. In the decade 1991-2001 the number of illiterates decline for the first time since census of 1951 by almost 32 million in absolute terms.

There are large inter-state differences in literacy rates in the country. At one end, proportion of literates was highest in Kerala at over 90 percent and it was less than 50 percent in Bihar for the year 2001.

The table shows the trends in literacy for different states between 1981 and 2001. The maximum increase in literacy has been obtained in the middle and low income states of the country i.e. Rajasthan, Madhya Pradesh, Andhra Pradesh, Uttar Pradesh and Orissa.

Productivity benefits from education – some cross country evidence
In agriculture, UNDP's study (1992 HDR) covering 31 countries concluded that if a farmer had completed four years of elementary education, his productivity was on an average, 8.5 percent, higher than that of a farmer who had no education at all. Incase of India, there is evidence that adoption and spread of green revolution in the earlier years was faster among educated farmers.

In industry most evidence suggests that at enterprise level educated workers are more productive. More strikingly, the skill and knowledge intensive sectors have been the fastest growing services sector in India.

Education affects growth as well. A study of 88 countries for the period 1960-73 found that an increase in literacy from 20 percent to 30 percent were associated with an increase in real GDP of between 8 and 16 percent. Another study of 29 low income and 37 middle income countries indicated that a 1 percent difference in the primary enrolment ratio was associated with 0.0355 difference in per capita income growth rates.

Education increases equality as well. A study of 49 countries showed that about a fifth of income inequality could be explained by educational inequality. Another has shown that an increase in literacy rate from 10 to 60 percent has been associated with a 2.8 percent increase in the income share of the poorest 40 percent of the population.

In case of India, as per one study, the private rate of return per year of education increases as the level of education increases upto the secondary level. The returns to primary education were rather low.

Table 2.9: Percentage Change in Literacy Levels Across States

States	1981 (Persons)	1991 (Persons)	2001 (Persons)	Percent change in literates (1981-2001)
Andhra Pradesh	35.66	44.09	61.11	25.45
Assam	-	52.89	64.28	-
Bihar	32.05	38.48	47.53	15.48
Gujarat	51.21	61.29	66.43	14.22
Haryana	43.88	55.85	68.59	24.71
Karnataka	46.21	56.04	67.04	20.83
Kerala	81.56	89.81	90.92	9.36
Madhya Pradesh	36.63	44.20	64.08	27.45
Maharashtra	55.83	64.87	77.27	21.44
Orissa	40.97	49.09	63.61	22.34
Punjab	48.17	58.41	69.95	14.39
Rajasthan	30.11	38.44	61.03	30.92
Tamil Nadu	54.39	62.66	73.47	29.08
Uttar Pradesh	33.35	41.60	57.36	24.01
West Bengal	48.65	57.70	69.22	20.57
All India	43.57	52.21	65.20	21.63

Source: Census of India – Social and Cultural Tables various issues

Among high income states, Gujarat and Punjab showed moderate increase in the percentage of literates.

Table 2.10: Relation Income and Literacy Different States, 2001

	High literacy levels (greater than national average)	**Low literacy levels (below national average)**
High Income States	Gujarat, Haryana, Maharashtra, Punjab	
Middle Income States	Karnataka, Kerala, Tamil Nadu, West Bengal	Andhra Pradesh
Low Income States		Bihar, U.P. Rajasthan, Orissa, Madhya Pradesh

The above table clearly shows a direct relation between state domestic product and literacy levels. All high income states have literacy levels greater than the national average whereas all low income states have literacy levels below the national average. It is encouraging to see that except for Andhra Pradesh, all middle income states have high literacy levels*.

Intensity of Formal Education

The National Human Development Report, 2001 devised a special indicator, 'The Intensity of Formal education' which values education in early years of an individuals life, structured formal system of education, and weighs progressively the capacity of the system to retain enrolled students over successive classes. In constructing this indicator, a weighted average of the share of class – wise enrolment in the total enrolment in classes I-XII is taken, the weighs increasing over successive classes from 1 to 12. This is then adjusted by the gross enrolment ratio 6-18 years, to correct for the children in the school going age group which are not enrolled.

The indicator has a higher value for states that are able to retain children in schools for a longer duration without dropping out and at the same time have a larger proportion of children, of school going age group, enrolled in schools.

At the national level, the intensity of formal education was 4.03 years for students enrolled in 1978 and 4.64 years in 1993. The adjusted indicator was 2.04 years in 1978 and 2.70 years in 1993. As expected this indicator had higher values for urban areas and boys.

The value of the indicator varies considerably across states. In 1993, among the major states, the unadjusted indicator varied between 3.97 years for Bihar to 5.44 years for Kerala. However the range for adjusted indicator increased from 1.69 years

* States that were previously considered educationally backward made significant progress in their literacy levels due to a number of successful development initiatives and improvement in governance by State Governments. Significant achievements have been achieved through Education Guarantee Scheme, 1997, Madhya Pradesh; Shiksha Karmi (1987) and Lok Jumbish (1992), Rajasthan; Amchi Shala (1998), Maharashtra; Shishy Shiksha Karma Suchi, West Bengal

for Bihar to 3.94 years for Kerala. This was on account of there being a large proportion of children in age group 6-18 years not enrolled in schools in Bihar unlike in Kerala.

Table 2.11: Percentage change in the Intensity of Formal Education, 1978-93 (years)

State	IFE, 1993	IFE, 1978	Percent Change (1978-93)
Andhra Pradesh	4.43	3.66	21.04
Assam	4.36	3.80	14.74
Bihar	3.97	3.28	32.92
Gujarat	4.83	4.13	16.95
Haryana	5.07	4.36	16.28
Karnataka	4.53	3.95	14.68
Kerala	5.44	4.94	10.12
Madhya Pradesh	4.57	3.92	16.58
Maharashtra	4.83	3.90	23.85
Orissa	4.25	3.80	11.84
Punjab	5.00	4.16	20.19
Rajasthan	4.32	4.10	5.36
Tamil Nadu	5.26	4.27	23.18
Uttar Pradesh	4.67	4.44	5.18
West Bengal	4.23	3.56	18.82
All India	4.64	4.03	15.14

Source: Calculated from the data given in NHDR, 2001.

The above table shows that school enrolment and continuing education was maximum in the states of Kerala, Punjab, Tamil Nadu, Haryana and lowest in Bihar, Rajasthan, West Bengal and Orissa. The percentage changes were highest in case of Tamil Nadu, Andra Pradesh, Punjab and Maharashtra. They were lowest for Rajasthan, Utter Pradesh, Orissa, Bihar has shown a large percentage increase in IFE but it started from a very low base. Kerala, on the other hand has shown only 1.10 percent increase but it has the highest value of IFE in India showing little scope for improvement.

2.6 HEALTH ATTAINMENT: INFANT MORTALITY INDICATORS

It would not be entirely incorrect to suggest that India's approach to health sector development has not been sufficiently integrated with the overall process of development. There are significant rural-urban and inter-state variations in mortality, mortality and nutrition indicators.

There are various indicators of infant and child mortality. Infant mortality rate, q(1) and under 5 infant mortality rate, q(5) are amongst the most commonly used indicators, they refer to the probability of child dying before reaching the age one and age three. Unlike indicators on life expectancy that are relatively stable and slow moving the infant and child mortality indicators are likely to be more sensitive to changes that have a bearing on the quality of life, particularly to the health and longetivity of people. These could be sudden adversities or non availability of critical public health measures and life support systems. They are, thus more useful from the point of policy targeting and tracing changes in health attainment of a population at more frequent intervals, particularly when the population is yet to complete its demograpic transition.

As per the 1981 census, IMR is estimated at 115 per thousand live births. It was 122 for male and 108 for females. The IMR declined to 77 by 1991. Under 5 mortality was 152 per thousand live births in 1981 as compared to 94 children per thousand live births in 1991. The decline in q(1) of male was from 147 to 91, for female from 157 to 101, during this period.

Much like other health indicators, there are large inter state variations. The major states, IMR varied between 52 per thousand live births for Kerala to 150 per thousand live births in Madhya Pradesh for the 1981 for the other states, it was well above 100. In 1991, The IMR decline to 42 in Kerala. A number of states with IMR close to 80 in 1981 brought it down to around 50 per thousand life births. These include Andhra Pradesh, Haryana and Tamil Nadu. It was still close to 100 for Uttar Pradesh and continued to be well above 100 for Madhya Pradesh an Orissa.

Table 2.12: Mortality Rates for Children

States	1981		1991	
	q(1)	q(5)	q(1)	q(5)
Andhra Pradesh	91	139	55	67
Assam	-	-	92	116
Bihar	94	141	75	89
Gujarat	115	124	78	101
Haryana	126	138	52	73
Karnataka	81	142	74	90
Kerala	54	80	42	60
Madhya Pradesh	150	197	133	147
Maharashtra	119	145	74	91
Orissa	163	179	125	133
Punjab	127	111	74	92
Rajasthan	141	176	87	110
Tamil Nadu	104	132	54	67
Uttar Pradesh	130	190	99	134
West Bengal	95	124	62	94
All India	115	152	77	94

Source: NHDR 2001

Much like other health indicators, there are large inter state variations. The major states, IMR varied between 52 per thousand live births for Kerala to 150 per thousand live births in Madhya Pradeshn for the 1981 for the other states, it was well above 100 for Orissa, Rajasthan and Uttar Pradesh. In 1991. The IMR decline to 42 in Kerala. A number of states with IMR close to 80 in 1981 brought it down to around 50 per thousand life births. These include Andhra Pradesh, Haryana and Tamil Nadu. It was still close to 100 for UP and continued to be well above 100 per MP an Orissa.

The under 5 mortality, q(5) varied between 80 per thousand live births for Kerala and 175-200 for Madhya Predesh, Rajasthan, Orissa, and Uttar Pradesh. During the period 1981-91, there has been a visible transition from higher to lower mortality in most states. By 1991 q(5) declined to 60 in Kerala and was in the range of 130-150 per thousand live births for Madhya Pradesh, Orissa and Uttar Pradesh.

Table 2.13: Transition in Infant Mortality Rate

Range per Thousand	Persons		Males		Females	
	1981	1991	1981	1991	1981	
30-60	Kerala	A.P., Haryana, Kerala, Tamil Nadu	Kerala	Haryana, Kerala, Tamil Nadu	Kerala, West Bengal, Tamil Nadu	A.P. Haryana, West Bengal
60-90	Gujarat, Karnataka, Punjab, Tamil Nadu	Bihar, Gujarat, Punjab, Tamil Nadu	Gujarat, Haryana, Karnataka, Punjab, Tail Nadu	A.P., Bihar, Gujarat, Karnataka, Maharashtra, Punjab, Tamil Nadu, West Bengal	A.P. Gujarat, Karnataka, Maharashtra, Punjab, Tamil Nadu	Assam, Gujarat, Maharashtra
90-120	A.P., Bihar, Haryana, Orissa, Maharashtra, Rajasthan, West Bengal	Assam, Uttar Pradesh	Bihar, A.P., Maharashtra, Orissa, Rajasthan, West Bengal	A.P., Assam, Rajasthan, Uttar Pradesh	Bihar, Haryana, Orissa, Rajasthan	Orissia, Uttar Pradesh
>120	Madhya Pradesh, Uttar Pradesh	M. P., Orissa	M.P., Orissa	M.P., U.P.	M.P., U.P.	M.P.

CHAPTER 3
AN ANALYSIS OF GOVERNANCE IN INDIA

3.1 INTRODUCTION

Good governance is one of the most important requirements if the targets of rapid economic growth are to be achieved. It is also this factor or rather the lack of it, which could be the cause of immense disappointment and missed development opportunities.

The universally accepted features of good governance are the exercise of legitimate political power; del formulation and implementation of policies and programmes that are equitable, transparent, non discriminatory, socially sensitive, participatory and above all accountable to the people at large.

In India, there are a number of areas and regions where development outcomes do not match with the available resources and the inherent potential of the people. States that are rich in minerals are not necessarily industrially developed, and those with rich cultivable lands and assured irrigation are often lagging behind in agriculture development. Even in states where development has been relatively better, there are instances of loose or poor governance. These are manifested in:-

(i) Poor management of economies, persisting fiscal imbalances, disparities in pace and level of development across regions and districts.

(ii) Denial of basic needs of food, water and shelter to a substantial proportion of population.

(iii) Threat to life and personal security in the face of inadequate state control on law and order.

(iv) Marginalisation, exclusion or even persecution of people on account of social, religious, castes or even gender affiliations.

(v) Lack of sensitivity, transparency and accountability in many facets of the working of state machines.

(vi) Lack of credibility in the gap between the intent and actions of some institutions in society.

(vii) Inadequate system of incentives/disincentives for people, subversion or rules, evasion of taxes, and failure in getting timely justice.

(viii) Existence of a significant number of voiceless poor with little opportunities for participating even in the institutions of local self-governance.

(ix) Deterioration of physical environment.

All such outcomes can be easily related to the failure of one or more aspect of governance – political, economic or civic. The Indian experience shows that there are attainments in all aspects of governance that one could legitimately be proud of and yet there are as many challenges. Even in states where development has been relatively better, there are instances of loss or even poor governance that have contributed to gaps between inherent potentialities of people and actual realizations. We discuss below some of these achievements and challenges.

ECONOMIC GOVERNANCE India is among the ten fastest growing economies in nineties. There has been substantial forward movement in policy reforms. Tax reforms have taken the form of rationalization of tax rates, exemptions and simplification of tax administration. Inflation is under control with reasonable price stability. Balance of payment position in quite comfortable with growing foreign exchange reserves. There has been a significant decline in incidence of poverty and steady improvement in most social indicators. Indian's economic governance is showing results, yet there are many concerns and challenges.

Growth disparities across states have increased in nineties as compared to eighties. Implementation problems remain in many areas and parallel action is needed in most states. Less than 0.5 percent of population pays income tax, under reporting of income is widespread resulting in stagnating tax – GDP ratio. The Central and state government are running into huge deficits. 26 percent of our population still lies below the poverty line and pockets of hunger and deprivation are still an unfortunate reality.

POLITICAL GOVERNANCE India has turned out to be a resilient democracy supporting the emergence of a multiparty polity at various tiers of government. Politics of coalition and consensus is beginning to find its feet. There is a broad consensus on nature and direction of economic reforms and national foreign policy. The country has moved to decentralization of power from the Centre to States, district and villages. The judiciary has become independent and practice on issues of larger public interest.

Yet the flipside is dark enough. The recourse to competitive populism and use of money power compromises on decisive political action. Excessive compartmentalization of the executive into ministers resulting in a narrow development perspective, vested interests and bloated bureaucracy. Cuminalisation of public life, politics of vote bank, communal violence and corruption are major challenges for improving the governance in the country.

CIVIL GOVERNANCE In India there is privacy of basic human and civil rights and the rule of law prevails. There is freedom of expression, free press and electronic media. There are considerable non governmental and civil society initiatives in various pheres of social and public life.

Yet civic problems are rampant in the country. Inspite of privacy being given to basic rights, in practice, some like women and deprived are less equal than others, particularly, in their social and economic rights. Law and order problems persist in 80 percent areas. The judiciary has been very active at higher levels, yet poor conviction rates, delayed justice, backlog of cases are very common at the level of subordinate judiciary. The civil services have distorted, pressure incentive structures encouraging mediocrity and corruption.

A fundamental issue concerning good governance is the appropriate role of the state in relation to the market. Recent global and national events have led to serious search for a definition of good governance which will blend economic growth and social justice. It is now realized that states actuaries should match its capability. There is greater recognition that governments should concentrate on public functions, which will create an enabling environment for civil society and the private sector to function efficiently and equitably. We analyze below some of the key indicators of economic governance.

3.2 SIZE OF PUBLIC SECTOR IN INDIA

The state governments in India are getting bigger by the day. They have extended themselves into production and trade and provision of goods and services for consumption, through the focus was originally on developing basic industries and infrastructure where the private sector could offer limited assistance.

States are becoming giants in terms of the number of people they employ, the expenditures they undertake and the pervasive influence they exercise on economic activities. Table 3.1 shows the trend of predominance of the public sector relative to the private sector in the organized sector in India. The physical size of the government apparatus puts lot of pressure on budgetary allocations as wages and salaries of government employees.

The table shows that for all the states, the ratio of public to private sector employment was greater than 50 percent. In poorer states like Bihar, Uttar Pradesh and Madhya Pradesh, the ratio was a high as 80 percent. However this ratio has shown a decline in several states during the nineties implying a reduction in state's massive involvement in production. The size of the public sector has increased in the poorer states of Rajasthan, Orissa and Madhya Pradesh.

Table 3.1: Ratio of Public Sector to Total Employment in the Organized Sector *

States	1991	2000	Percent Change
Andhra Pradesh	0.78	0.72	-7.7
Assam	0.48	0.49	+2.0
Bihar	0.85	0.84	-1.2
Gujarat	0.58	0.54	-6.9
Haryana	0.66	0.65	-1.5
Karnataka	0.70	0.60	-14.3
Kerala	0.55	0.53	-3.6
Madhya Pradesh	0.85	0.86	+1.1
Maharashtra	0.62	0.61	-1.6
Orissa	0.86	0.89	+3.5
Punjab	0.72	0.69	-4.2
Rajasthan	0.72	0.80	+11.1
Tamil Nadu	0.69	0.63	-8.7
Uttar Pradesh	0.80	0.79	-1.3
West Bengal	0.69	0.65	-5.8

* Public Sector employment refers to total employment in government and quasi government establishments of both central and state governments and local bodies.

Table 3.2: Public Expenditure Ratio in India*

States	1991	2000	Percent change
Andhra Pradesh	19.74	19.23	-0.51
Assam	25.32	20.50	-4.82
Bihar	23.52	18.37	-5.15
Gujarat	19.54	18.76	-0.78
Haryana	17.58	19.65	-2.07
Karnataka	21.37	16.48	-4.89
Kerala	23.95	16.86	-7.09
Madhya Pradesh	19.36	17.60	-1.76
Maharashtra	16.72	12.09	-4.63
Orissa	27.98	24.12	-3.86
Punjab	18.00	19.87	1.87
Rajasthan	22.83	21.81	-1.02
Tamil Nadu	21.13	16.98	-4.15
Uttar Pradesh	22.05	18.32	-3.73
West Bengal	17.32	15.59	-1.73

The size of the public sector can be judged from the trend in total public expenditure as a proportion of state domestic product.

The public expenditure ratio is highest in the poorer states of India i.e. Orissa, Rajasthan and Assam whereas Maharashtra has the lowest public expenditure ratio. This shows that the states with poor levels of development have their governments increasing in size but shrinking in effectiveness, whereas the need of the hour is a small but effective government. While only two states Punjab and Haryana have shown a rise in public expenditure ratio for the nineties, for all other states there has been a fall in public expenditure ratio.

3.3 THE STATE AND SOCIAL AND ECONOMIC INFRASTRUCTURE

3.3a Social Infrastructure

Despite this overextended role of governments, they have an appallingly poor record in the delivery of basic social services. Though the past five decades have seen

* Public Expenditure in this table includes debt services and repayment of loans to state government. PER is the total Public expenditure as a proportion of Gross State Domestic product.

improvements in several social indicators yet there exist huge challenges of providing an overwhelming number of people with the means to meet even the most basic needs of shelter, health, safe drinking water, primary schooling facilities and sanitation. The poorer states have not been able to adequately provide these services whereas the economically well off states have been able to provide for these facilities in India.

Table 3.3: The State and the Social Sector, 1991

States	**% of HHS with Access to Electricity safe Drinking water & Toilet**	**Index of Healthcare**	**Access to Education**	**Child Immunisation**
Andhra Pradesh	12.30	1526	95.57	17.50
Assam	9.30	1968	80.20	43.60
Bihar	7.10	2969	77.51	53.50
Gujarat	26.60	706	97.90	18.90
Haryana	20.30	2584	96.71	17.50
Karnataka	17.60	1283	93.47	15.20
Kerala	9.00	391	84.07	11.40
Maharashtra	25.80	1023	93.06	24.40
Madhya Pradesh	12.00	3770	89.23	7.50
Orissa	5.40	2314	79.07	28.80
Punjab	30.50	1509	98.51	17.50
Rajasthan	15.70	2347	88.01	48.50
Uttar Pradesh	12.70	1120	98.81	3.30
Tamil Nadu	15.60	2593	73.15	43.30
West Bengal	20.50	1351	84.19	22.40
All India	16.10	1498	85.50	30.00

Note: Index of health care is measured by population per hospital bed, 1992. Access to education is measured by percentage of population with access to primary schools within habitation, 1995. Child Immunization is measured by percentage of children aged 12-23 months not vaccinated.

3.3b Economic Infrastructure

Road Connectivity. A good road connectivity of habitations particularly of rural areas, with sub divisional towns and district head quarters is often the primary means of supplementary the public effort directed at providing basic health and educational services as well as infrastructural support for production, trade and commerce at the local village level. Road connectivity is, therefore a useful indicator of inclusionary aspect of development process and perhaps, reach of the market as well. It is particularly relevant in the Indian context where over 50 percent of the villages with population of less than 1000 are yet to be connected by roads.

The following two tables give as an indication of interstate disparities in road connectivity which we have measured in terms of

(i) Percentage of villages connected by roads.

(ii) Road length in kilometers per 100 sq. km/million population.

The Planning Commission has been tabulating data on state level coverage of roads. The coverage of all categories of roads in terms of areas as well as population covered has been improving in the nineties.

The road length per hundred square kilometers has increased at the national level from about 45 kms in 1981 and 61 kms in 1991 to about 75 kms in 1997. During the same time, road length per million population has increased from 21.68 kms to 25.82 kms. There are wide inter state differences. Kerala has the highest road length per hundred square kilometers. It was 268 kms in 1981 and 375 kms in 1997. Tamil Nadu closely followed by Punjab with about 35 percent of the road coverage were the next best states. Kerala's road coverage has created a rural urban link that has been often cited as factor behind its unique attainments on human and other indicators of development. Orissa and Maharashtra have signified improved their road coverage in the nineties. In Bihar and West Bengal there was a decline in coverage of road per million population during this period.

The road connectivity at the village level with population less than 1000 was under 50 percent at the nation level in 1996-97. Madhya Pradesh and Rajasthan with 22 percent and 30 percent of their villages connected by roads, respectively were at the bottom whereas Kerala, Karnataka, Haryana, and Punjab had near 100 percent connectivity of such villages by roads. Except for states like Bihar and West Bengal most of the village with population more than 1500 have been connected by roads. The data however, doesnot suggest the level of maintenance or roads. Quite often due to lack of public funds particularly for the district and village level roads, the road conditions are often poor.

Table 3.4: State Level Coverage of Roads (Road Length Per Hundred Sqkm/Million Population.

States	1981		1991		1997	
	100 sqm KM	*Million Pop*	*100 Sq Km*	*Million Pop*	*100 Sq Km*	*Million Pop*
Andhra Pradesh	43.38	22.28	54.32	22.50	64.72	24.25
Assam	75.33	29.07	83.57	29.39	87.23	27.04
Bihar	48.08	11.96	49.12	9.90	50.81	9.28
Gujarat	29.63	17.04	41.26	25.22	46.37	19.59
Haryana	52.00	17.79	59.85	16.23	63.70	15.65
Karnataka	57.31	29.6	68.75	29.35	75.09	28.63
Kerala	268.24	40.96	348.84	46.75	374.92	46.26
Maharashtra	57.38	28.12	72.07	28.14	117.62	40.98
Madhya Pradesh	23.62	20.07	31.58	21.18	45.13	26.33
Orissa	76.98	45.45	125.84	62.20	168.72	75.77
Punjab	91.18	27.35	107.74	26.86	127.78	27.04
Rajasthan	19.65	19.62	35.08	27.91	37.89	25.43
Uttar Pradesh	49.84	13.23	68.21	14.45	86.77	15.90
Tamil Nadu	93.23	25.05	151.23	35.37	158.78	34.25
West Bengal	64.03	10.41	69.05	9.07	85.00	9.91
All India	45.13	21.68	61.27	23.88	74.93	25.82

Source: Basic Road Statistics of India various issues

Table 3.5: Road Connectivity at Village Level

(Percentage of villages connected by roads)

States	Population less than 1000			Population between 1000 & 1500			Population above 1500		
	1991-92	1994-95	1996-97	1991-92	1994-95	1996-97	1991-92	1994-95	1996-97
A.P.	32.43	32.79	81.83	58.19	59.30	100.00	95.16	96.51	85.72
Assam	60.51	64.22	69.80	100.00	100.00	67.98	100.00	100.00	72.45
Bihar	27.16	27.72	40.72	50.58	55.37	61.97	64.82	70.60	99.39
Gujarat	75.02	81.74	89.16	94.58	100.00	98.19	99.19	99.64	99.52
Haryana	97.98	98.60	97.57	99.91	100.00	99.96	99.96	99.96	99.96
Karnataka	34.34	34.64	99.41	68.88	74.46	99.95	83.30	86.14	100.00
Kerala	100.00	100.00	83.33	100.00	100.00	100.00	100.00	100.00	99.35
Maharashtra	25.47	25.73	58.51	89.89	95.35	90.95	98.63	99.68	98.52
M.P.	2200	22.13	22.31	64.42	65.91	92.44	91.75	94.33	58.49
Orissa	27.78	29.73	44.12	79.94	88.93	77.51	99.24	99.85	82.69
Punjab	98.72	99.29	95.45	100.00	100.00	100.00	100.0	100.0	100.0
Rajasthan	24.11	24.87	38.36	70.21	78.52	76.79	93.67	99.09	93.79
U.P.	35.19	35.57	53.11	61.94	65.62	39.79	95.85	97.13	48.90
Tamil Nadu	60.38	60.73	40.92	95.76	105.45	89.06	98.95	99.95	100.00
W. Bengal	39.80	41.06	42.01	63.53	66.76	67.98	61.04	62.36	61.50

Source: Same as table 3.4

3.4 THE FISCAL DILEMMA

The recurrent dilemma in India is that while governments are trying to do too many things, they are failing to discharge their most essential role – that of managing their finances prudently. In modern times maintaining a stable macroeconomic environment is considered as important a public good as maintenance of law and order and provision of social services.

Over the past couple of decades not with standing periodic adjustments efforts*, the conduct of fiscal policy in India has been characterized by a strong deficit bias evident of public sector imbalance of 10 percent of gross domestic product, this is attributable to both central and state governments.

* The central government has passed the Fiscal Responsibility Bill in the Parliament. The key features of this bill are reduction of fiscal deficit to be 2% of GDP by 2006, revenue deficit to be 0 by 2006, total internal and external liabilities at 50 percent of GDP by 2011, prohibition of borrowings by central government from RBI after 2004 except under special circumstances, expenditure cuts, whenever there is a shortfall of revenues vis-à-vis the budgeted expenditure.

3.4a Fiscal and Revenue deficits of state governments

Public sector deficits have been symptomatic of a number of adverse factors: a mounting wage bill, subsidies, tax concessions and rising interest costs. These developments have been aggravated by weaknesses in the system of inter government relations, including insufficient incentives for revenue raising and expenditure control at the state and local level.

The secular decline in the fiscal balances of the economy that had set in during the eighties marked a transition from a revenue surplus to a deficit economy, has not only persisted but got accentuated in the closing years of the nineties with some of the key deficit indicators climbing to unprecedented heights.

Table 3.6 shows the alarmingly high levels of revenue deficit and the rate at which they have grown during the nineties. The growth in revenue deficit was highest for Orissa (7.4 percent), Rajasthan (4.16 percent), Haryana (3.43 percent) and Madhya Pradesh (2.95).

Table 3.6: Revenue Deficit of Indian States*

States	1990-91	1992-93	1996-97	1998-99	Increase in RD(%)	Rank
Andhra Pradesh	-0.46	-0.28	-3.80	-2.70	2.24	10
Assam	-1.31	1.24	1.43	0.39	-0.92	1
Bihar	-2.87	-2.16	-1.24	-3.69	0.82	2
Gujarat	-1.06	-0.74	-0.77	-2.91	1.85	9
Haryana	-0.14	-0.01	-2.11	-3.57	3.43	13
Karnataka	-0.34	-0.51	-1.00	-1.64	1.30	4
Kerala	-2.99	-1.69	-1.73	-3.99	1.00	3
Madhya Pradesh	-0.66	0.78	-2.23	-3.61	2.95	12
Maharashtra	-0.08	-0.80	-0.93	-1.90	1.82	8
Orissa	-0.18	-0.90	-3.58	-7.58	7.40	15
Punjab	-2.28	-2.42	-2.97	-4.65	1.77	6
Rajasthan	0.81	-0.40	-2.29	-4.97	4.16	14
Tamil Nadu	-1.76	-3.55	-1.41	-3.45	1.69	5
Uttar Pradesh	-2.21	-1.44	-2.69	-5.12	2.91	11
West Bengal	-2.93	-0.01	-2.69	-4.74	1.81	7

Source: State Finances, RBI.

* Revenue Deficit = (Revenue Receipt – Revenue Expenditure) expressed as a Percent of GDSP.

Maharashtra and Karnataka were the only states that had a revenue deficit of less than 2% in 1998-99.

The story is the same if use see fiscal deficits which are presented in the table below. Gujarat and Assam have shown a reduction in their fiscal deficit in the nineties. Though Bihar has also shown a decline, but it started from a very high level (6.29) and its fiscal deficit still stands at 5.95%.

The levels of fiscal indiscipline can be judged from the fact that six states had a fiscal deficit of more than 6 percent (Punjab, Orissa, Uttar Pradesh, Rajasthan, Uttar Pradesh and West Bengal) and only two states had fiscal deficit less than 5 percent (Gujarat and Karnataka)

Table 3.7: Fiscal Deficit of Indian States*

States	1990-91	1992-93	1996-97	1998-99	Increase in FD(%)	Rank
Andhra Pradesh	2.79	3.55	3.34	5.74	2.95	13
Assam	5.29	1.59	0.37	1.45	-3.84	1
Bihar	6.29	4.12	2.71	5.95	-0.34	3
Gujarat	4.69	2.86	3.08	3.47	-1.22	2
Haryana	2.83	2.56	3.23	5.19	2.36	11
Karnataka	2.40	4.20	3.35	4.20	1.80	8
Kerala	5.66	3.67	4.15	5.91	0.25	5
Madhya Pradesh	3.35	2.40	2.96	5.18	1.83	9
Maharashtra	2.50	2.84	2.89	3.61	1.11	6
Orissa	5.65	4.89	6.90	9.76	4.11	14
Punjab	6.58	4.76	3.28	6.68	0.10	4
Rajasthan	2.63	4.28	5.74	8.55	5.92	15
Tamil Nadu	3.58	4.07	3.13	4.84	1.26	7
Uttar Pradesh	5.53	5.25	5.05	7.92	2.39	12
West Bengal	4.70	2.34	4.28	6.94	2.24	10

* Fiscal deficit =[Total Expenditure] – [Total revenue receipts (including Loans not of recovery) + Non debt capital receipts] expressed as a percent of GSDP. Higher percentage reflects higher incremental debt burden to income capacity of state governments.

The combined results of revenue and fiscal deficit can be judged from Table 3.8. Such fiscal indiscipline is favourable to neither growth nor human development. Unsustainable defaults can easily turn an economic regress into a human regress.

Table 3.8: Frequency Distribution of States According to Size of Revenue/Fiscal Deficit

Deficit as a % of GSDP	1990-91		1995-96		1999-2000	
	Revenue	*Fiscal*	*Revenue*	*Fiscal*	*Revenue*	*Fiscal*
Surplus	8	2	9	0	4	0
0 to 1	7	0	5	0	1	1
-1 to –2	4	0	7	3	7	0
-2 to –3	5	6	2	5	2	0
-3 to -4	1	5	1	10	7	8
-5 to –7	0	6	1	3	2	3
7	0	6	0	4	2	13

Source: Calculated from data in State Finances, A study of budgets, RBI

This is because official response for deficit reduction often course down hard on people. Some obvious manifestations are rising inflationary finance that hampers private investment and taxes poor people; tax rate increases on a narrow base that reduce the purchasing power of ordinary people; and frequency cutbacks in development expenditure that worsen the unemployment situation.

Unless the present fiscal crises is resoled properly, both economic growth and human development would continue to receive major set backs. In particular, the way these deficits are financed has an important bearing on state economies.

3.4b Worrying Debt Profile

Indian states have fast accumulated a large stock of debt. The internal debt in India as a percentage of Gross Domestic Product has grown by more than 42 percent in India since 1980. The total outstanding debt of state governments have been presented below:-

Table 3.9: Total Outstanding debt of State Governments

End of March	1995		1995		2000	
	Amount	*% of Total Debt*	*Amount*	*% of Total Debt*	*Amount*	*% of Total Debt*
Market Loans	31200	17.06	61593	18.40	71720	17.86
Loans from Banks	3458	1.89	10661	3.19	17294	4.31
Loans from Centre	115238	63.01	199007	59.46	236696	58.94
Provident Fund	32991	18.04	63405	18.95	75860	18.89
Total	**182887**	**100**	**334666**	**100**	**401570**	**100**

Source: Report of the XI Finance Commission

Total debt of the States including short term debt is estimated to have risen from Rs. 400754 crore as on 31st March 1999 to Rs. 473677 crore as on 31st March 2000. Loans from the central government accounted for about 50 percent of the outstanding debt at the end of financial years 1998-99 and 1999-2000. The share of market loans (including ways, means, advances and loans from banks, and of provident funds etc.) came to 19.5 and 15.8 at the end of 1998-99 and 20.1 and 16.0 percent at the end of 1999-2000. On the whole, the long term debt of the states has been shifting towards costlier sources.

Table 3.10 clearly shows that the debt problem is taking its toll on the development of states. In all the low income states, except Madhya Pradesh , the debt burden is much higher than the national average. Kerala and Tamil Nadu also have high debt burdens among the middle income states. In the high income category, Punjab has exceptionally high levels of debt ratio. The growth of public debt has been highest incase of Bihar, Rajasthan and West Bengal. Many states were also able to reduce their debt burden: Gujarat, Punjab, Tamil Nadu, Assam, Bihar and Madhya Pradesh.

Table 3.10: Debt Burden of States*

States	1993	1995	1997	1998	1999	2000	Growth rate (1993-00)	Rank
Andhra Pradesh	6.59	6.99	7.03	7.04	7.06	6.86	0.42	10
Assam	2.92	2.51	2.82	2.08	1.85	1.81	-6.53	1
Bihar	8.14	7.69	7.18	7.03	6.69	6.77	-2.950	2
Gujarat	6.28	2.32	5.93	6.09	6.18	6.08	-0.20	6
Haryana	2.31	4.78	2.42	2.44	2.54	2.58	1.48	13
Karnataka	4.48	4.25	4.70	4.72	4.65	4.66	0.19	9
Kerala	4.00	5.60	4.30	4.37	4.33	4.26	0.96	11
Madhya Pradesh	5.84	10.00	5.55	5.43	5.48	5.27	-1.33	4
Maharashtra	9.97	4.08	10.42	10.60	10.69	10.88	1.30	12
Orissa	4.04	5.75	4.17	4.14	4.12	4.11	0.17	8
Punjab	5.70	5.75	5.53	5.40	5.42	5.19	-1.46	3
Rajasthan	5.18	5.46	5.84	5.82	6.03	6.24	2.49	14
Tamil Nadu	6.02	6.16	5.96	5.85	5.75	5.56	-1.28	5
Uttar Pradesh	15.74	15.92	15.97	15.96	15.65	15.19	0.09	7
West Bengal	6.82	7.00	7.36	7.57	7.98	9.12	3.59	15

Source: Same as Table 3.7.

3.4c Debt Sustainability

The significant levels of domestic debt has tremendously effected the debt servicing obligations. Interest payments have become the single largest expenditure head in many state governments. Servicing past debt is also becoming burdensome. Moreover much of the rise in these interest payments come from reliance on costly short term debt.

The question arising is that at what level should debt be stabilized as a percent of GSDP and what are the conditions under which these can be sustained.

The question of desirable level of debt GSDP ratio can be addressed in terms of the current burden of interest payment. The table below gives the ratio of interest

* Debt burden all includes source of debt i.e. market loans, loans from banks, loans from Centre, provident Funds etc. Growth rate is measured as compound annual growth rate.

payments to total revenues. The ratio has increased from 7.7 percent to 17.6 percent – 10 percent in seventeen years. The states of Uttar Pradesh, Orissa are facing acute problems as the ratio has increased by 17 percent in seventeen years. The increase in less for Bihar because it has not tried to maintain the level of plan expenditure or development. Even the rich states are facing problems. Punjab, for example has the largest increase in interest ratio. Madhya Pradesh, Tamil Nadu, Kerala, Haryana, and Maharashtra are in reasonably good position. Haryana is the only state in India where the burden of interest payment has declined during the nineties.

Thus we see that total revenues of state governments are stagnant relative to state domestic product and continuous resort to borrowing has led to steadily rising interest burden and lesser ability to finance development expenditure.

Table 3.11: Ratio of Interest Payments to Total Revenues*

States	1980-81	1990-91	1996-97	% Change	Rank
Andhra Pradesh	6.45	11.02	16.42	15.42	6
Bihar	10.84	17.44	17.62	1.03	2
Gujarat	6.68	15.76	16.65	5.64	3
Haryana	8.04	12.64	11.83	-6.4	1
Karnataka	6.54	11.19	12.55	12.15	5
Kerala	7.11	14.17	17.95	16.95	7
Madhya Pradesh	6.82	11.28	13.74	21.80	8
Maharashtra	5.41	10.12	12.7	25.49	9
Orissa	8.1	16.79	25.17	8.38	4
Punjab	--	16.81	29.,35	74.59	11
Rajasthan	10.59	13.66	20.54	50.36	12
Tamil Nadu	7.11	14.17	17.95	22.67	10
Uttar Pradesh	8.29	15.38	25.33	64.69	13
West Bengal	9.97	15.28	23.58	54.32	12
All 14 States	7.74	13.12	17.56	33.84	

Source: Same as table 3.7.

* The ratio indicates how much of the total revenue generated by state governments is used to service debt obligations.

3.4d Origin of the Crises

What produces these persistently high fiscal deficits that has led to a lower growth and worsening debt profile? The answer is straight forward: India's fiscal matrix is an amalgam of sharp inequities and inefficiencies, both in its patterns of resource mobilization and allocation. Any commencing review of India's unjust fiscal policy must first analyze how resources are raised and spent.

(i) A Weak Tax Effort

Attempts to collect and raise taxes in India are inadequate, regressive, inefficient and lack uniformity as well as transparency. Tax to state domestic product ratios which indicate the ability to tap resources from a growing economy are less than 10 percent of state domestic product inmost of the India states – lower than the developing country average of 15 to 20 percent and than average of 24 percent for high income countries, several European countries have tax revenues between 35 to 40 percent of GDP.

Table 3.12:Own tax Revenue as a percent of SDP*

States	1991-92	1994-95	1997-98	Mean	Rank
Andhra Pradesh	6.58	7.73	11.27	8.55	5
Assam	4.03	4.58	6.07	5.17	15
Bihar	3.68	5.21	5.90	5.38	14
Gujarat	3.37	9.39	10.50	7.83	8
Haryana	1.07	9.41	9.92	7.94	7
Karnataka	5.13	11.01	13.36	10.63	3
Kerala	10.51	11.06	15.16	12.01	1
Madhya Pradesh	14.43	5.97	8.34	9.26	4
Maharasthra	0.01	8.84	10.63	7.19	10
Orissa	4.64	5.57	8.01	6.64	12
Punjab	6.21	9.33	9.60	8.57	6
Rajasthan	5.22	6.90	8.63	7.22	9
Tamil Nadu	8.19	10.32	12.87	10.88	2
Uttar Pradesh	4.64	5.97	7.24	6.18	13
West Bengal	5.67	7.18	7.02	6.68	11

Source: Calculated for data given in State Finances, RBI

* Higher percentage reflects higher yield from respective tax bases of the state governments

However the tax SDP ratio has been increasing over the nineties for all major states except Madhya Pradesh. This indicates that the tax systems has shown some elasticity to the growth of the economy.

Karnataka, Kerala and Tamil Nadu had the highest percentage of tax SDP ratio. Orissa, Uttar Pradesh, Bihar and West Bengal had only 7 percent of tax revenue generated out of SDP.

Other problems that plague the collection efforts are equity, efficiency, lack of transparency and complex rules.

(ii) Public Expenditures: Misplaced Priorities

The real concern for human development is not the level of public expenditure but their composition, not the size of spending but its effectiveness.

There has been a shrinkage in development and social sector expenditure ratios specially in the nineties. Most of the public spending today is directed towards non priority and low return investments. Governments spend a large proportion of their of their expenditures on secondary activities, where opportunities for rent seeking and power strengthening may be greater than the core activities that the governments should be involved in.

Expenditure on social services remain inadequate. For every dollar that the central governments spends on social sectors, defence and debt service receive $3.12 in India. The average interest bill for Indian state has risen by 0.5 percent of GDP since the start of nineties. Out of every rupee of revenues that the State governments receive, nearly 60 paisa are consumed on Wages and salaries of state employees. Devoted mainly to the agriculture sector, subsidies account for 1.5 percent of GDP in

India. They are known to create micro economic distortions by encouraging over exploitation of natural resources, and benefiting relatively affluent sections Public corporations are also large in size but small in efficiency taking a significant claim on budgetary resources.

We shall examine some of these anomalies below. Table 3.13 gives us shrinking development and social expenditures during the nineties. It is very disturbing to see that in all states, these has been a decline in development expenditure. This decline is characteristic of not just the poor states like Bihar and Uttar Pradesh but also of rich states like Haryana, Punjab and Maharashtra. The social sector development expenditure has also shown a decline except in five states i.e. Maharashtra, Karnataka, Rajasthan, Orissa and Madhya Pradesh.

Table 3.13: Shrinking Development and Social Sector Expenditure
(in Percent)

States	Development Expenditure*			Social Sector Expenditure**		
	1990-91	1998-99	Change in DER	19908-91	1998-99	Change in SSE
Andhra Pradesh	72.70	66.11	-6.6	34.40	33.89	-0.51
Assam	64.75	62.39	-2.36	30.80	39.07	8.27
Bihar	67.13	57.80	-9.33	32.94	32.82	-0.12
Gujarat	74.36	71.50	-2.86	31.40	31.20	-0.2
Haryana	69.64	63.31	-6.33	28.68	26.20	-2.48
Karnataka	70.98	67.05	-3.93	31.81	35.41	-3.6
Kerala	64.79	62.45	-2.34	39.91	33.31	6.6
Madhya Pradesh	71.01	64.61	-6.4	34.03	36.11	2.58
Maharashtra	71.78	61.56	-10.22	30.33	32.89	2.56
Orissa	68.66	59.94	-8.72	29.48	32.70	3.22
Punjab	69.55	46.64	-2.91	26.99	25.09	1.9
Rajasthan	64.88	63.83	-1.05	34.47	30.12	4.65
Tamil Nadu	61.56	61.74	-9.82	40.41	38.15	-1.99
Uttar Pradesh	67.86	54.96	-12.9	29.39	29.27	-0.12
West Bengal	67.78	60.61	-7.17	40.04	33.86	-6.18
All India	69.57	61.76	-7.81	32.89	33.07	0.18

Source: Same as Table 3.7

* Total development expenditure includes expenditure on economic and social services expressed as a percent of total public expenditure.

** Social sector expenditure includes expenditure on education, health, amenities (water supply and sanitation, housing and urban development) and other social services expressed as a percent of total public expenditure.

3.5 PUBLIC SECTOR ENTERPRISES

Public corporations in India are large in size but low in efficiency. Decades of protectionist policies have made these organizations non competitive, reliant on subsidies, corrupt and significantly over staffed. Many of these corporations do not have the financial capacity to discharge their key liabilities relating to taxes, debt servicing, transfer of dividends and in same cases, even wages and salaries. Public money that is regularly pumped into such enterprises yields low or negative returns. In India, the real rates of return on public sector manufacturing were five times less than those in private manufacturing.

Financial Performance of state electricity boards

The electricity supply act, 1948 enjoins State Electricity boards to ensure a minimum return of 3 percent of the value of fixed assets in use. Based on provisional figures inclusive of credit for subsidy reimbursement, only two of eighteen state electricity boards (Karnataka and Orissa) have reached this target in 1995-96. The losses are as high as 30 percent for Punjab, 19 percent for Bihar, 17 percent for West Bengal and 14 percent for Rajasthan. The rate of return of Capital is given in the following table.

Table 3.14: Rate of Return on Capital with Subsidy of SEB

States	1992-93	1995-96	% change in rate of return	Rank
Andhra Pradesh	-0.20	-11.3	-11.1	12
Assam	-43.30	-27.2	2.4	1
Bihar	-20.00	-19.1	0.9	6
Gujarat	3.40	-13.8	-17.2	14
Haryana	-23.80	-9.1	14.7	3
Karnataka	3.30	3.0	0.3	7
Kerala	-4.50	-4.8	-0.3	9
Madhya Pradesh	0.90	-5.8	-6.7	11
Maharashtra	3.10	2.2	-0.9	10
Orissa	2.60	8.7	6.1	4
Punjab	-19.90	-29.3	-17.6	15
Rajasthan	2.90	-13.5	16.4	2
Tamil Nadu	3.20	-9.2	-12.4	13
Uttar Pradesh	-16.80	-12.0	4.8	5
West Bengal	-16.60	-16.5	0.1	8
Average	-6.60	-10.3	-3.7	

3.6 INFLATION RATE

The assessment of monetary policy and fiscal policy can be done through the rate of inflation. The table below studies the movement of General Consumer price Index Number for industrial workers during the nineties.

Table 3.15: General CPI for Industrial Workers 1991-2001

States	1991	1999	2001	Percent Change
Andhra Pradesh (Haryana)	203	395	438	115.76
Assam (Guwahati)	208	436	471	126.44
Bihar (Janshedpur)	204	397	419	105.39
Gujarat (Ahmedabad)	218	422	460	111.09
Haryana (Faridabad)	201	435	469	133.33
Karnataka (Bangalore)	204	405	438	114.7
Kerala (Thiruvanthpuram)	213	468	504	136.62
Madhya Pradesh (Indore)	222	425	570	111.71
Maharashtra (Mumbai)	226	468	528	133.63
Orissa (Rourkela)	194	396	407	109.79
Punjab (Amritsar)	204	379	403	97.55
Rajasthan (Jaipur)	210	390	423	101.43
Tamil Nadu (Chennari)	208	446	487	134.13
Uttar Pradesh (Kanpur)	222	428	447	101.35
West Bengal (Calcutta)	218	437	492	125.65

We can see that prices have most than doubled for all Indian states during the nineties. The CPI rose especially for developed states like Maharashtra and Haryana as well as developed states like Kerala, Assam, Tamil Nadu and West Bengal.

3.7 DECENTRALIZATION FOR ECONOMIC GROWTH

Decentralization refers to the transfer from the national capital, whether by delegation of duty to officers, or by devolution to local authorities or local bodies. It is specifically the transfer of authority, judicial or administrative from a higher level of government to the lower level. The process of deconcentration stands for delegation of authority adequate for the discharge of specific functions to a staff member while devolution is the legal conferring of powers to discharge specified or residual functions upon formally constitution local authority.

The conception of decentralization is thus one of power sharing. Decentralization of power aims at better and faster communication, involvement and commitment of the people in development, mobilization of support and utilization of resources in a better manner for national development, reduction in delay in decision making, greater equity in the allocation of resource and investments as well as reduction in apathy of administration to clients. These grass root institutions are responsive to the felt needs of the people of a limited geographical area, endowed with autonomy: legal, political, administrative, functional and financial, thus enjoying the powers of decision making. Decentralization results in better efficiency in resource allocation, because the provision of public goods become more responsive thereby to local conditions and preferences. Decentralization on resolve the size of nation trade off between economies of scale and heterogeniety of preferences (Alisna and Spolare, 1997).

For decentralization to yield efficiency benefits, the fiscal resources for local public goods need to be raised from within the beneficiary space, even if only partially. Given the difficulties of levy and collection, local bodies will seek low cost options for the performance of the assigned function. They will work for countryside and plan an overall balanced development of the rural areas thereby raising the standards of living of the rural people[*].

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[*]The Government of India has provided constitutional status for village Panchayats under 73rd Amendment Act, 1992 in order to improve the participation of the rural people in the process of their development and involvement in decision making and decentralized planning directly affecting their life. The Act provides reservation for women & weaker section to ensure their participation at all levels of Panchayati Raj Institutions

The Panchayat Fiscal Domain

On April 23, 1994, the panchayats became a part of the constitution of India. India stands at a point of historic transition. But legislative enhancements do not ensure effectiveness and success of panchayati raj institutions. What is more important is their operationalisation. It is the political will of the state governments that is the important precondition for the success of panchayati raj institutions.

Setting up of State finance Commissions in five yearly cycles is one of the mandated requirements of the new constitutional provisions and has been largely compiled with. However state finance commission have not substantially expanded upon presetting fiscal domains. The rudely accepted conviction is that of panchayati inability to enforce compliance.

To see the effort of the panchayati raj institutions we give below per capita Panchayats own revenue. This indicator tells us about their capacity to generate own revenue from the population. We can see that Rajasthan had a negative growth rate during 1990-98 and states like Orissa, Assam, Bihar, Uttar Pradesh, West Bengal and Gujarat had slow rates of growth.

(PRI's). It has granted PRI's constitutional status and some sort of uniformity in PRI's by making 3 tier system a permanent feature. It has regularized the electoral process by making elections an imperative following the termination of the PRI's after every 5 years under the supervision of the State Election Commission. The provision for setting of the State Finance commission guarantees fiscal autonomy/Financial devolution to the PRI's, this provision empowers the PRI's to levy, collect and appropriate such taxes, duties, tolls & fees as may be decided by the state legislative, assigning to these bodies such taxes, duties etc, levied and collected by the state government and for such purposes; providing grants-in-aid to the PRI's, constitution at each level of the Panchayat's of a fund into which all moneys collected on their behalf shall be credited and all withdrawals shall be met there from. Tribal areas get additional benefits through the transfer of resources from the consolidated fund of India which is meant specially for the welfare and administration of scheduled areas. As regards financial devolution, specific legal transfer of powers and responsibilities have been entrusted to the PRI's to prepare plans for economic development and social justice and also implement the schemes for economic development and social justices as may be assigned including any matter listed in the 11th scheduled (29 subjects) to the constitution of India.

Kerala, Punjab, Andhra Pradesh, Tamil Nadu and Madhya Pradesh have achieved considerable success in raising tax revenue relative to other states.

Table 3.16: Panchayat Own Revenue (Per Capita)

States	1990-91	1997-98	Growth Rate	Rank
Andhra Pradesh	10.74	21.89	12.15	5
Assam	1.03	1.05	2.00	12
Bihar	0.00	0.00	0.00	1
Gujarat	7.52	10.14	6.47	7
Haryana	23.68	35.97	8.77	6
Karnataka	5.58	8.69	8.22	7
Kerala	14.62	43.45	17.89	1
Madhya Pradesh	2.30	4.64	12.77	4
Orissa	2.15	2.30	2.45	19
Punjab	12.71	28.78	14.24	2
Rajasthan	4.93	3.33	-3.07	13
Tamil Nadu	2.81	6.50	13.96	3
Uttar Pradesh	0.30	0.29	2.02	11
West Bengal	1.74	2.34	6.06	9

Source: Calculated from the data reported in the Eleventh Finance Commission.

These fiscal outcomes underline the need for embodying incentives for fiscal autonomy and functional devolution of revenues. Transfer to the local fiscal domain of the right to tax agriculture will-

- Simultaneously raise panchayat own revenue, and total revenue in the system as a whole, since agriculture is a severely undertaxed sector, and
- With a new emphasis on jurisdictional retention, will provide for resources for within – sector productivity enhancement. Jurisdictional retention holds the key to success in inducing voluntary compliance with such a tax.

Thus, a panchayat taxation of agriculture can achieved a convergence of allocative efficiency and poverty – reducing growth.

Yet another indicator of the operations of panchayati raj institutions is the per capita expenditure on core services. In 1997-98, the highest per capita expenditure was shown in Andhra Pradesh, Kerala, Tamil Nadu, Karnataka and Maharashtra. West Bengal, Rajasthan, Orissa and Gujarat showed the lowest proportion. Punjab, West Bengal, Orissa, Assam actually showed a decline during the nineties.

Table 3.17: Expenditure on Core Services of Panchayati Raj Institutions Per Capita*

States	1990-91	1994-95	1997-98	CARG	Rank
Andhra Pradesh	11.38	2.52	55.38	25.36	4
Assam	0.00	5.96	4.28	-6.60	13
Gujarat	2.12	2.57	3.48	7.20	9
Karnataka	23.38	42.52	71.85	16.69	5
Kerala	10.86	17.60	28.15	14.57	7
Madhya Pradesh	1.19	2.25	7.32	29.47	3
Maharasthra	12.88	23.29	37.52	16.51	6
Orissa	3.12	3.33	2.26	-4.51	12
Punjab	19.45	32.46	17.01	-1.89	11
Rajasthan	0.01	1.67	2.24	122.73	1
Tamil Nadu	11.89	13.51	27.23	12.56	8
Uttar Pradesh	0.17	0.44	3.09	51.43	2
West Bengal	0.28	0.26	0.25	-1.47	10

Source; Calculated from the data reported in the Eleventh Finance Commission

3.8 EFFECTIVENSSS OF WELFARE PROGRAMMES

The effectiveness of government initiatives can also be judged from the way welfare programmes are implemented. The Integrated Rural Development Programme is one of the major poverty alleviation welfare programmes initiated by the government of India in the mid seventies. The main focus of the programme was to provide productive assets or to raise productivity of the existing assets of the poor households. The aim was to raise economic viability of the households.

* Expenditure on core services measures the expenditure incurred by PRI's on water supply, street lighting, sanitation and roads.

The funding pattern of subsidy was to be equally shared between the center and the states. The funds are allocated by the center to the states in accordance with the extent of poverty in the states i.e. the relation to the percentage of families below the poverty line in the states.

The success of these programmes depends crucially on the way these are implemented. We analyze below the coverage of the programme by considering the number of beneficiary households in relation to the number of poor households. The effectiveness of the programme may be measured by percentage of utilized resources allocated to the states by the centre because lesser utilization is indicative of a weak administration and lack of coordination at different levels of implementation of the programme. The results are given for two time periods – 1987-94 and 1994-98.

Table 3.18: Coverage and Utilization under IRDP

States	% of HHS below poverty line covered by IRDP, 1987-94	% of HHS below poverty line covered by IRDP, 1993-98	% Change 1987-98	%utilization of resources 1987-94	% utilization of resources 1994-98	% Change 1987-88
Andhra Pradesh	63	35	-28	84	83	-1
Assam	22	12	-10	39	72	33
Bihar	35	12	-13	53	49	-4
Gujarat	44	19	-19.6	81	77	-4
Haryana	70	15	-55	105	109	4
Karnataka	40	25	-15	53	70	17
Kerala	38	17	-21	74	81	7
Madhya Pradesh	45	19	-26	66	73	7
Maharashtra	32	19	-13	58	73	15
Orissa	27	16	-11	54	67	13
Punjab	76	16	-60	115	95	-20
Rajasthan	42	19	-23	67	70	+3
Tamil Nadu	32	27	-5	78	89	11
Uttar Pradesh	42	18	-24	74	65	-9
West Bengal	27	14	-13	56	60	+4

The above table reveals that as far as coverage of households below the poverty line is concerned, there has been a decline in all the states. The maximum coverage was in the Southern States of Andhra Pradesh, Karnataka and Tamil Nadu. The least coverage was in Assam and Bihar closely followed by Haryana, Punjab and Rajasthan.

The percentage of utilized resources shows varying trends across states. Only for five states Uttar Pradesh, Punjab, Andhra Pradesh, Bihar and Gujarat, there has been a decline. For all other states, percentage of utilized resources has been increasing.

CONCLUSION

In this chapter we have analyzed various indicators of economic governance, and their movements over time. Most of the trends show a disturbing picture. The Indian public sector is growing in size but reducing in terms of effectiveness. The state governments have been experiencing fiscal stress as evident from large and increasing fiscal and revenue deficit. The consequential accumulation of debt and debt service obligations has put constraints on the states ability to undertake development activities. As a result social and economic infrastructure expenditure are reducing. There exist divergence between states in this regard. The fiscal crises is a result not only of a weak tax effort but also misplaced priorities given to public expenditures. The performance of public sector enterprises, specially state electricity boards has been putting lot of pressure on state government budget.

The decade of the nineties have seen some improvement in poverty and social indicators which we are proud of, yet there are many challenges. Welfare programmes initiative by the Centre have to be made more effective.

Perhaps the key to this effectiveness lies in decentralization and devolution of economic and financial powers to local bodies and Panchayati Raj Institutions. Their performance is very effective in some states, yet this force has to be fully tapped.

The summary of indicators of economic governance in terms of ranks earned by various states is given in the table below.

Table 3.19: Rank of different states on various indicators of governance 1990-99.

States	Increase in Revenue Deficit	Growth rate of debt burden	Decrease in ratio of interest payments to total revenue	Own tax revenue as a % SDP	Rate of return on capital with subsidy	Per capita Panchayat own Revenue	Exp. On core service by PRI's	% of HHS BPL covered IRDP
A.P.	10	10	6	5	12	5	4	1
Assam	1	1	-	15	1	12	13	14
Bihar	2	2	2	14	6	-	-	14
Gujarat	9	6	3	8	14	8	9	4
Haryana	13	13	1	7	3	-	-	12
Karnataka	4	9	5	3	7	6	5	3
Kerala	3	11	7	1	9	7	7	9
M. P.	12	4	8	4	11	1	3	4
Maha.	8	12	9	10	10	4	6	4
Orissa	15	8	4	12	4	10	12	10
Punjab	6	3	14	6	15	2	11	10
Rajasthan	14	14	11	9	2	13	1	4
T. N.	5	5	10	2	13	3	8	2
U. P.	11	7	13	13	5	11	2	8
W. B.	7	15	12	11	8	9	10	13

CHAPTER 4

COMPOSITE INDEX OF GOVERNANCE IN INDIA

4.1 CONSTRUCTION OF COMPOSITE INDICES OF ECONOMIC GOVERNANCE

In the last chapter we have conceptualized and analysed certain aspects of governance within the given framework of economic dimensions. A crucial stage in the analysis is that of contracting a large number of variables into a smaller number of indices so that geographical units can be easily compared with each other. This involves construction of composite index of governance for each state.

For operational purposes, we have to choose indicators that articulate various aspects of governance. In the study, the following indicators of economic governance have been analysed.

(i) Fiscal Stability Measured by (a) Gross Fiscal Deficit; (b) Debt Burden of States; (c) Own tax revenue as a percent of total revenue; (d) Development Expenditure ratio.

(ii) Economic Infrastructure measured by (a) Road Connectivity (Road length per hundred square kilometer); (b) Irrigation (Percentage of area irrigated by government canals).

(iii) Social Infrastructure measured by (a) Availability of medical facilities (Number of hospital beds per person); (b) Education infrastructure (Number of primary schools per thousands population); (c) Availability of safe drinking water, electricity and toilet.

(iv) Effective Decentralization measured by (a) Own tax as a percent of own revenue; (b) Own revenue as a percent of total revenue; (c) Core Services Expenditure as a percent of total expenditure.

(v) Performance of Public Sector Enterprises measured by rates of return on capital with subsidy of state electricity boards.

(vi) Rate of inflation as an indicator of monetary policy.

(vii) Effectiveness of welfare programmes measured income increment per beneficiary.

(viii) Peoples participation in Governance on measured by percentage of votes polled in the election to the Lok Sabha.

These variables chosen for construction of composite indices are measured in different units and hence in general, cannot be directly added. It therefore becomes necessary to convert them into some standard units so that initial scale chosen for measurement does not bias the results.

We have used the UNDP method of conversion into the discrete scale.

For any value L_i, the transformed value L_i is defined as $\frac{L_i - L_l}{L_n - L_l}$

Where L_l is the lowest value

L_n-L_l is the range of series (Maximum value – Minimum value).

Once the bias of unit of measurement is removed from the observations, we have to assign appropriate weightages to the chosen variables. We have assigned equal weightages to all variables implying equal importance to all variables.

Before finding the composite index of governance we find indices of components of economic governance. We begin with index of fiscal stability.

4.2 INDEX OF FISCAL STABILITY

In view of fiscal deterioration of states in recent years, emphasis on fiscal reforms at the state level has gained significance. A summary index of fiscal position of different states and its changes over time world reveal the urgency of the needed reforms..

Table 4.1 gives the transformed value of the indicators on a scale of zero to one and the composite index of fiscal stability for 1990-91

Table 4.1: Composite Index of Fiscal Stability, 1990-91

States	GFD[1]	DB[2]	OTX[3]	DE[4]	CIFS[5]	Rank
Andhra Pradesh	0.907	0.681	0.455	0.827	0.718	2
Assam	0.307	0.954	0.278	0	0.385	13
Bihar	0.694	0.565	0.254	0.247	0.284	14
Gujarat	0.452	0.704	0.233	1	0.597	6
Haryana	0.897	1	0.074	0.509	0.619	5
Karnataka	1	0.838	0.355	0.648	0.719	1
Kerala	0.220	0.874	0.728	0.604	0.457	9
Madhya Pradesh	0.773	0.737	1	0.651	0.690	3
Maharashtra	0.976	0.429	0	0.731	0.534	7
Orissa	0.222	0.871	0.321	0.407	0.455	10
Punjab	0	0.747	0.429	0.499	0.419	12
Rajasthan	0.945	0.786	0.361	0.014	0.526	8
Tamil Nadu	0.718	0.723	0.567	0.708	0.679	4
Uttar Pradesh	0.252	0	0.321	0.324	0.223	15
West Bengal	0.449	0.664	0.392	0.315	0.455	10

Source: Calculated from the data given in Budget Documents of State Governments.

Andhra Pradesh, Karanataka, Tamil Nadu and Haryana showed high degree of fiscal stability and flexibility. Though Madhya Pradesh also had a high value of index it is because it is not fulfilling the plan requirements.

[1] GFD : Transformed indicator of gross fiscal deficit.
[2] DB ; Transformed indicator of Debt Burden of States
[3] OTX: Transformed indicator of own tax revenue as a percentage of state domestic product
[4] DE : Transformed indicator of development expenditure as a percentage of total public expenditure
[5] CIFS : Composite index of fiscal stability.

Table 4.2: Composite Index of Fiscal Stability, 1998-99

States	GFD[1]	DB[2]	OTX[3]	DE[4]	CIFS	Rank
Andhra Pradesh	0.484	0.622	0.579	0.783	0.617	7
Assam	1	1	0.018	0.633	0.663	5
Bihar	0.458	0.649	0	0.449	0.389	13
Gujarat	0.757	0.686	0.496	1	0.735	2
Haryana	0.549	0.95	0.434	0.670	0.651	6
Karnataka	0.669	0.797	0.806	0.821	0.773	1
Kerala	0.463	0.820	1	0.635	0.729	3
Madhya Pradesh	0.551	0.737	0.263	0.723	0.569	8
Maharashtra	0.740	0.359	0.510	0.600	0.552	9
Orissa	0	0.835	0.228	0.535	0.399	11
Punjab	0.371	0.741	0.399	0	0.378	14
Rajasthan	0.146	0.697	0.294	0.691	0.457	10
Tamil Nadu	0.592	0.717	0.753	0.607	0.667	4
Uttar Pradesh	0.221	0	0.144	0.335	0.175	15
West Bengal	0.339	0.555	0.121	0.562	0.395	12

Source: Calculated from the data given in Budget Documents of State Governments

Table 4.2 shows that except for Assam, Gujarat, Haryana, Karanataka and Kerala, most of the states have deteriorated in terms of fiscal performance. Gujarat, Kerala and Assam have been able to improve their ranking whereas Punjab and Andhra Pradesh have slipped down significantly.

4.3 INDEX OF SOCIAL AND ECONOMIC INFRASTRUCTURE

There exist wide inter state differentials in infrastructure facilities in social and economic sector available in India. This is a clear reflection of differences in governance achievements across states. Although infrastructure is a widely inclusive term, we have selected medical facilities, education facilities, access to electricity, toilet and safe drinking water and road connectivity. Table 4.3 gives the transformed

[1] GFD : Transformed indicator of gross fiscal deficit.
[2] DB ; Transformed indicator of Debt Burden of States
[3] OTX: Transformed indicator of own tax revenue as a percentage of state domestic product
[4] DE : Transformed indicator of development expenditure as a percentage of total public expenditure

value of valuables for 1990-91 and 1998-99 and gives us changes in ranks and values of different states vis-à-vis index of social and economic infrastructure.

Table 4.3: Index of Social and Economic Infrastructure

States	HB[1]	PS[2]	EST[3]	RC[4]	CISEIN 1990-91	Rank	CISEIN 1998-99
Andhra Pradesh	0.664	0.516	0.275	0.071	0.382	8	0.385
Assam	0.533	0.720	0.155	0.164	0.393	7	0.472
Bihar	0.237	0.289	0.068	0.055	0.162	15	0.157
Gujarat	0.907	0.102	0.844	0.030	0.471	5	0.506
Haryana	0.351	0.020	0.593	0.089	0.263	12	0.387
Karnataka	0.736	0.242	0.486	0.116	0.395	6	0.422
Kerala	1	00	0.143	1	0.536	2	0.567
Madhya Pradesh	0	0.704	0.263	0	0.242	14	0.280
Maharashtra	0.813	0.325	0.813	0.127	0.519	3	0.566
Orissa	0.431	1	0	0.297	0.332	10	0.416
Punjab	0.669	0.413	1	0.240	0.580	1	0.579
Rajasthan	0.431	0.333	0.410	0.013	0.294	10	0.343
Tamil Nadu	0.784	0.321	0.406	0.377	0.472	4	0.521
Uttar Pradesh	0.348	0.24	0.290	0.115	0.249	13	0.254
West Bengal	0.715	0.489	0.601	0.119	0.381	9	0.434

Source: Calculated from the data given in Budget Documents of State Governance

The top three states in the provision of social and economic infrastructure are Punjab, Kerala and Maharashtra whereas the worst three states were Bihar, Madhya Pradesh and Uttar Pradesh, Bihar was the only state where the value of the index declined between 1990-91 and 1998-99.

[1] HB: Indicates availability of population per hospital bed.
[2] PS : Number of schools per thousand population.
[3] EST: Measures households with electricity, safe drinking water and toilet.
[4] RC ; Road connectivity measured by road length per hundred square kilometers. Road coverage refers to all category of roads (both surfaced and un-surfaced) including national highways, state highways, district roads, other district roads and rural roads.

4.4 DECENTRALIZATION INDEX

Effective decentralization is an important means to achieve rapid economic growth starting at the grass roots level. We measure effective decentralization through three indicators- (a) Own Tax/Own Revenue; (b) Own Revenue/Total Revenue; (c) Core Services Expenditure/Total Expenditure.

Table 4.4 and 4.5 gives the values of transformed indicators and the composite index of decentralization for 1990-91 and 1997-98 respectively. In 1990-91 the top three states in this regard were Kerala, Tamil Nadu and Assam whereas the bottom three were Bihar, Rajasthan, Uttar Pradesh. The results remained more or less same for 1997-98 except that Kerala slipped down two places whereas Haryana improved its position by three places at number seven in 1997-98.

Table 4.4: Index of Effective Decentralization, 1990-91

States	Own tax/own Revenue	Own Rev/ Total Rev	CS Exp/Total[1]	CIDC[2]	Rank
Andhra Pradesh	0.736	0.062	0.192	0.327	6
Assam	1	1	0	0.66	2
Bihar	0	0	0	0	15
Gujarat	0.646	0.027	0.021	0.228	9
Haryana	0.034	0.635	0	0.220	10
Karnataka	0.858	0.013	0.222	0.361	5
Kerala	0.913	0.324	0.811	0.676	1
Madhya Pradesh	0.248	0.051	0.089	0.128	12
Maharashtra	0.716	0.032	0.178	0.305	7
Orissa	0.607	0.033	0.141	0.258	8
Punjab	0.030	0.221	1	0.413	4
Rajasthan	0	0.032	0.012	0.015	14
Tamil Nadu	0.950	0.056	0.766	0.585	3
Uttar Pradesh	0.276	0.053	0.014	0.113	13
West Bengal	0.388	0.197	0.040	0.026	11

Source: Calculated from the data given in Report of the Eleventh Finance Commission

[1] CS: Core services Include water supply, street lighting, sanitation and roads
[2] CIDC: Composite Index of Decentralization

Table 4.5:Index of Effective Decentralization, 1997-98

States	Own tax/own Revenue	Own Rev/ Total Rev	CS Exp/Total	CIDC	Rank
Andhra Pradesh	0.585	0.088	0.482	0.381	6
Assam	1	0.358	0.798	0.711	1
Bihar	0	0	0	0	15
Gujarat	0.773	0.029	0.022	0.272	9
Haryana	0.086	1	0	0.358	7
Karnataka	0.868	0.013	0.292	0.387	5
Kerala	0.891	0.162	0.357	0.465	3
Madhya Pradesh	0.368	0.029	0.94	0.162	11
Maharashtra	0.671	0.545	0.223	0.313	8
Orissa	0.667	0.017	0.037	0.238	10
Punjab	0.013	0.639	0.734	0.458	4
Rajasthan	0	0.032	0.023	0.018	14
Tamil Nadu	0.976	0.129	1	0.695	2
Uttar Pradesh	0.187	0.084	0.167	0.145	13
West Bengal	0.404	0.064	0.010	0.158	12

Source: Calculated from the data given in Report of the Eleventh Finance Commission.

4.5 COMPOSITE INDEX OF GOVERNANCE

On the basis of indicators of governance given above, we finally construct the composite index of governance for 1990-91 and 1998-99.

The best performing states in 1998-99 were Maharashtra, Karnataka, Kerala and Haryana. The worst performing states were Bihar, Uttar Pradesh, Rajasthan and Orissa. The states for which the value of the index has fallen are Andhra Pradesh, Gujarat, Punjab, Orissa, Tamil Nadu and Rajasthan. Maharashtra, Kerala, Haryana, Bihar and Assam have been able to improve their governance indicators. Karnataka, Uttar Pradesh, West Bengal and Madhya Pradesh showed only marginal improvement.

The above analysis shows that the economically better of states are also better governed and the relatively poor states have low values of governance indicators.

Governance, in general, has deteriorated for many states during the nineties. However the significant fact is that most of the states where governance has deteriorated are the economically better off states. The middle income and poor income states are either stationary or have only marginally improved/deteriorated in terms of governance.

Table 4.6: Composite Index of Governance, 1990-91 and 1998-99

States	CIG, 1990-91	Rank	CIG, 1998-99	Rank	Change
Andhra Pradesh	0.539	4	0.482	10	-0.057
Assam	0.283	14	0.551	7	0.268
Bihar	0.246	15	0.359	13	0.113
Gujarat	0.537	5	0.485	9	-0.052
Haryana	0.472	10	0.603	4	0.131
Karnataka	0.517	6	0.607	3	0.09
Kerala	0.582	3	0.726	2	0.144
Madhya Pradesh	0.482	9	0.563	5	0.081
Maharashtra	0.648	1	0.776	1	0.128
Orissa	0.318	13	0.287	15	-0.031
Punjab	0.517	6	0.452	12	-0.065
Rajasthan	0.385	12	0.329	14	-0.056
Tamil Nadu	0.587	2	0.561	6	-0.026
Uttar Pradesh	0.444	11	0.446	11	0.002
West Bengal	0.483	8	0.508	8	0.025

4.6 CORRELATION BETWEEN DOMESTIC PRODUCT AND DIFFERENT INDICATORS OF GOVERNANCE

Next we analyze the links between indicators of governance and indicators of economic development. Though the domestic product of an economy depends on a large number of factors – economic variables, political stability, governance issues etc, we bring to light the correlation coefficient between net state domestic product and certain aspects of governance.

The correlation coefficient determines the relationship between two properties. The equation of correlation coefficient is

$$\rho_{x,y} = \frac{\mathrm{Cov}\,(X, Y)}{\sigma_z \cdot \sigma_y}$$

where $-1 \leq \rho_{x,y} \leq 1$

and $\mathrm{Cov}\,(X, Y) = \frac{1}{n}\sum_{j=1}^{n} (x_j - \mu_x)(y_j - \mu_y)$

The fiscal stability of an economy is an important public good that a government must deliver. It has repercussions on all aspects of economic performance particularly net state domestic product. The table below gives us the value of correlation coefficient between these indicators.

Table 4.7: Correlation Coefficient of NSDP with selected indicators of Governance

States	Revenue Deficit	Fiscal Deficit	Development Expenditure
Andhra Pradesh	0.499	0.936	-0.086
Assam	0.732	0.740	0.875
Bihar	0.569	0.291	0.738
Gujarat	0.752	0.761	0.959
Haryana	0.748	0.928	0.910
Karnataka	0.861	0.912	0.836
Kerala	0.865	0.931	0.915
Madhya Pradesh	0.831	0.877	0.656
Maharashtra	-0.707	-0.453	0.014
Orissa	0.954	0.941	0.882
Punjab	0.919	0.863	0.533
Rajasthan	0.629	0.768	0.920
Tamil Nadu	0.655	0.813	0.854
Uttar Pradesh	-0.192	-0.236	-0.492
West Bengal	0.907	0.915	0.334

Source: Calculated from the data used in Chapter 3.

The above table tells us about the relation of NSDP with fiscal and revenue deficit of state governments. For most of the states, as the state domestic product increases, the fiscal deficit is also increasing. The correlation is positive and nearly perfect for Andhra Pradesh, Haryana, Karnataka, Kerala, West Bengal, Orissa and

Madhya Pradesh. This indicates that the problem of high fiscal deficit plagues not just the poor states but also the economically better off states. Bihar is the only state where correlation is less than 0.3 the possible reason could be that this state is not maintaining the level of plan expenditure that it should. The same reason explains the low but negative correlation for Uttar Pradesh. Maharashtra also has a negative correlation between fiscal deficit and NSDP indicating improvement in fiscal performance with increases in state income.

The correlation between revenue deficit and NSDP shows the same trend but the strength of the relation is weaker than with fiscal deficit. This is because fiscal deficit is decomposed into revenue deficit, capital outlays and net lending.

The development expenditure of state governments are positively correlated with domestic product except for Uttar Pradesh and Andhra Pradesh. The coefficient is very small for Madhya Pradesh and West Bengal.

CONCLUSION

In this chapter we have constructed composite indices of fiscal stability, decentralization, social and economic infrastructure and finally of economic governance on the basis of selected indicators. The results show that the problem of effective governance plagues not just the poor states but also the economically better off states of the country. This poses serious problems and policy implications and demands rethinking in, terms of future growth performance of these states.

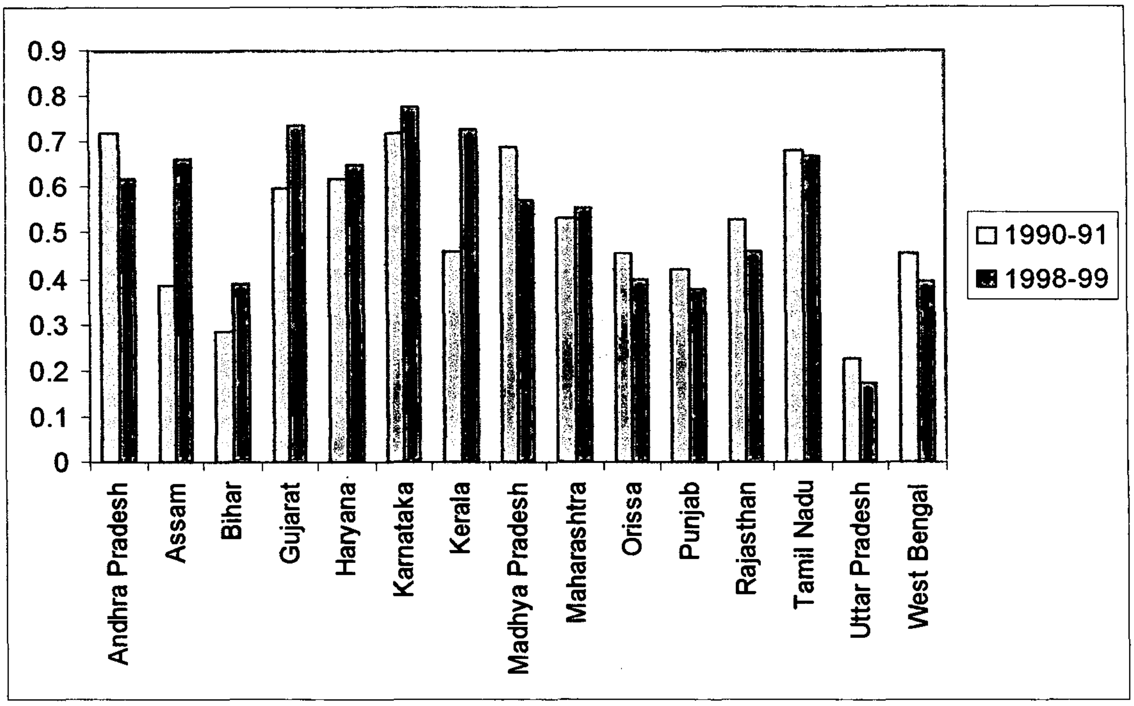

Figure 1: Index of Fiscal Stability

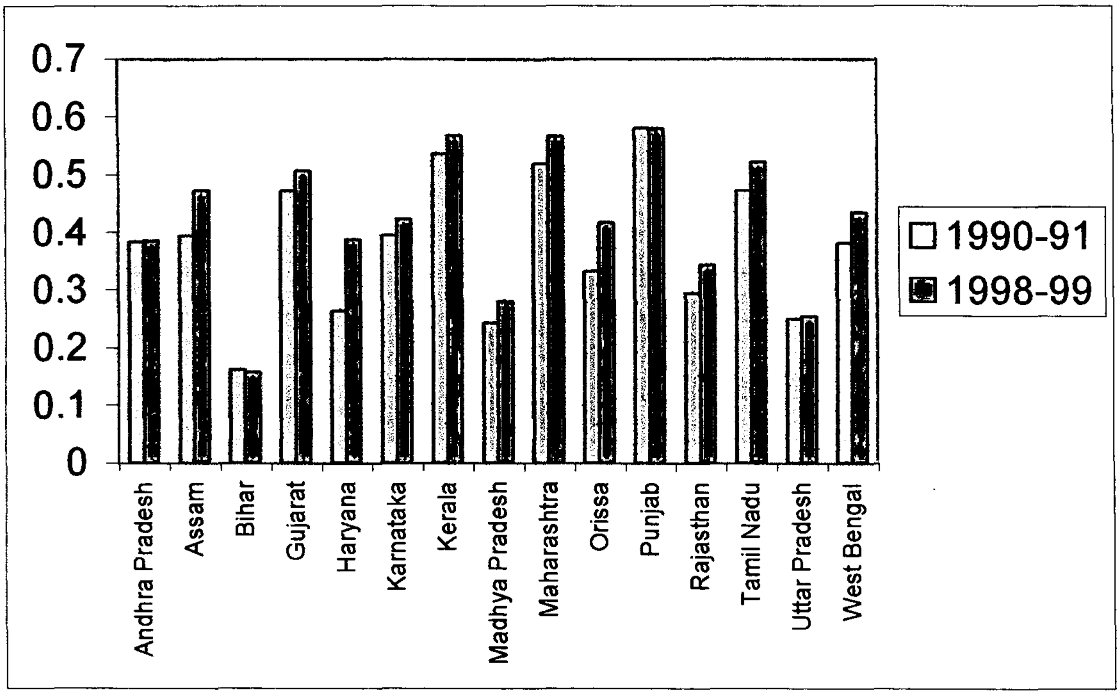

Figure 2: Index of Economic and Social Infrastructure

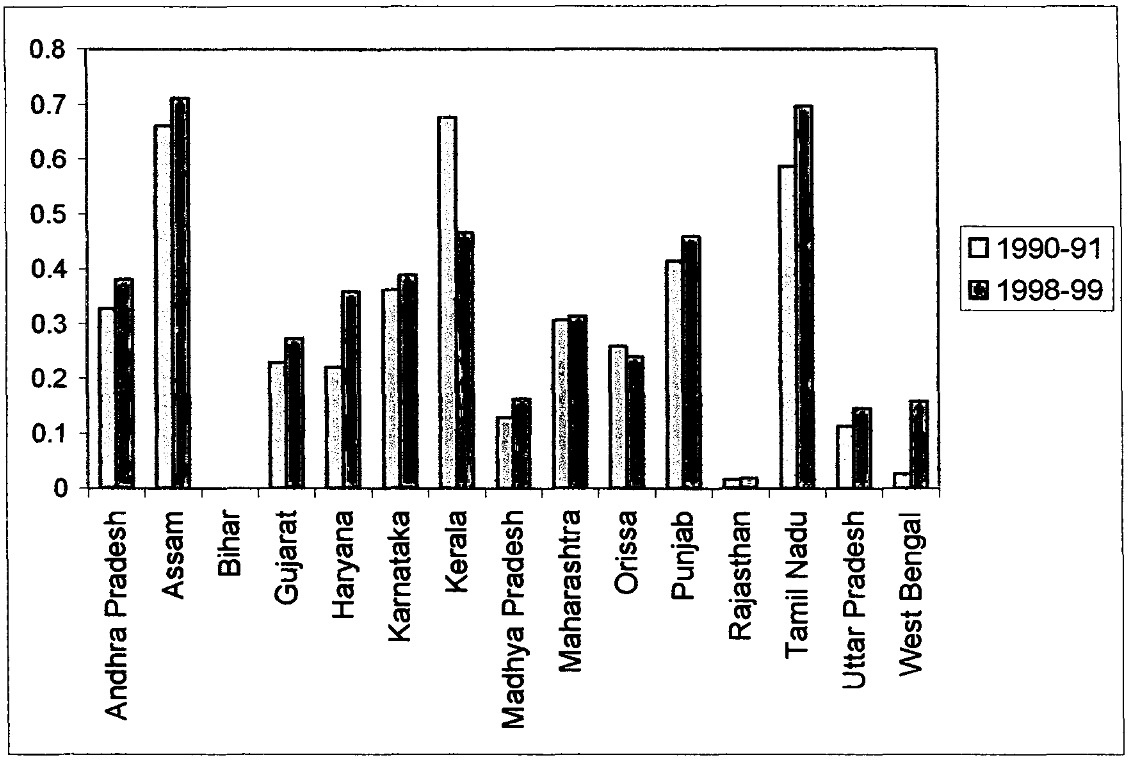

Figure 3: Index of Effective Decentralization

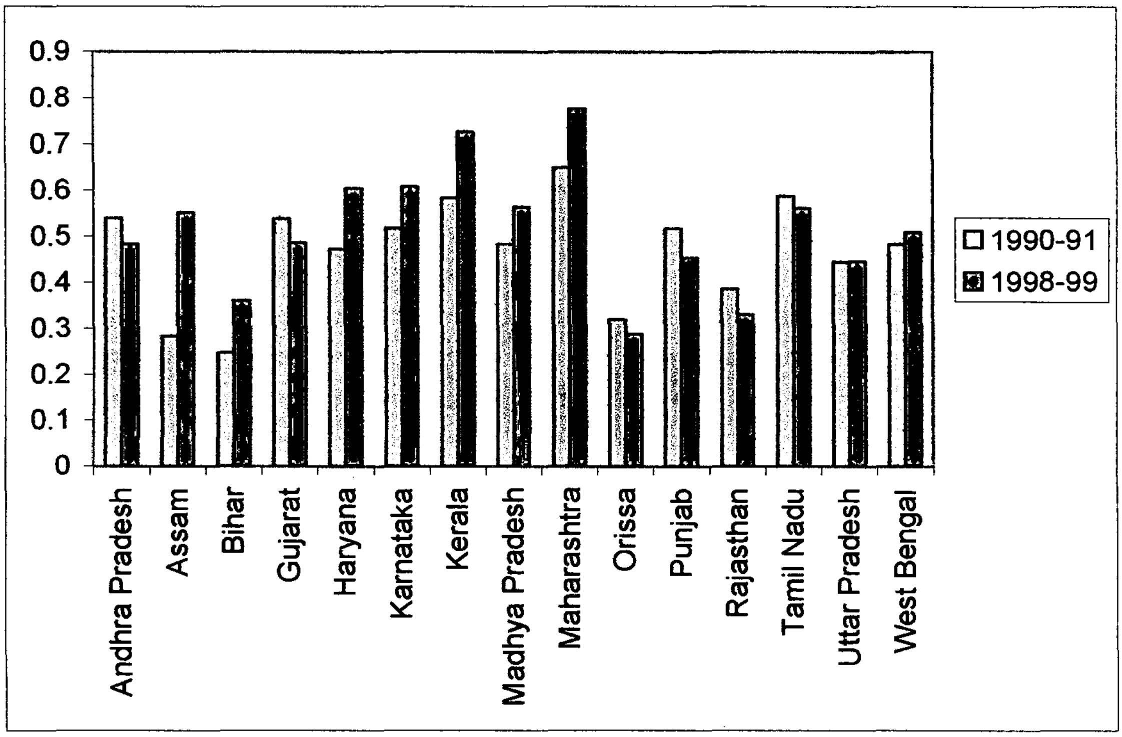

Figure 4: Index of Economic Governance

CHAPTER – 5
SUMMARY AND CONCLUSIONS

Good governance is one of the most important requirements if the targets of rapid economic growth are to be achieved. It is also this factor or rather the lack of it which could be the cause of immense disappointment and missed development opportunities. The universally accepted features of good governance are the exercise of legitimate political power, formulation of efficient policies and programmes that are equitable, transparent, non discriminatory, socially sensitive and above all accountable to the people at large.

The Indian experience shows that there are attainments in many aspects of economic performance that one could legitimately be proud of and yet there are as many challenges. Regional disparities have been widening though India is amongst the top ten fastest growing economies in the world today. There has been significant reduction in poverty levels across states. States like Gujarat, Punjab, Andhra Pradesh, Tamil Nadu and Haryana which recorded high growth rates of net state domestic product were also able to reduce their poverty levels significantly. On the other hand Orissa, Madhya Pradesh, Assam and Bihar recorded low reduction in poverty as well as low growth rate of domestic product. However there is no systematic relation between the income of states and growth in employment. States that have shown high rate of growth in employment (Gujarat, Punjab, Karnataka, Kerala, Uttar Pradesh, Madhya Pradesh etc.) are from all categories – low , high and middle income. There are large inter state differences in literacy rates in the country. At one end, proportion of literates was highest in Kerala at over ninety percent, it was less than fifty percent in Bihar. During the nineties the maximum increase in literacy has been obtained in the middle and low income states i.e. Rajasthan, Madhya Pradesh, Andhra Pradesh, Uttar Pradesh and Orissa.

There are a large number of areas and regions in India where development outcomes do not match the available resources and the inherent potential of the people. Even in states where development has been relatively better, there exist gaps between inherent potentialities of people and actual realizations. To some extent these differences are a result of loose or efficient governance across states.

The public sector in Indian states have been growing in size but reducing in terms of effectiveness. The fiscal situation has deteriorated in not just poor states but high income states as well. As a result development and social sector expenditures are reducing. A weak tax effort, misplaced public expenditures, poor performance of public sector enterprises are putting lot of pressure on state governments. The right kind of environment to business has to be provided, at the same time welfare progammes initiated by the centre have to be made more effective. Perhaps, effective decentralization is the key to above challenges.

The composite index of fiscal stability for different states shows that Andhra Pradesh, Karnataka, Tamil Nadu and Haryana had high degree of fiscal stability and flexibility. During the nineties except for Assam, Gujarat, Haryana, Karnataka and Kerala, most of the states have deteriorated in terms of fiscal performance.

The top three states in the provision of social and economic infrastructure are Punjab, Kerala and Maharashtra whereas the worst three states were Bihar, Madhya Pradesh and Uttar Pradesh.

The composite index of decentralization shows that the Panchayati Raj Institutions in Tamil Nadu, Assam and Kerala have been very effective in generating revenue and providing core services whereas Panchayati Raj Institutions of Bihar, Rajasthan and Uttar Pradesh showed the worst performance in India during the nineties.

The value of Composite Index of governance varies from 0.776 for Maharashtra to 0.287 for Orissa. The best performing states were Maharashtra, Karnataka, Kerala and Haryana whereas the worst performing states were Bihar, Uttar Pradesh, Rajasthan and Orissa. It turns out that the economically better off states are also better governed and the poor states exhibit instances of loose governance. However governance has deteriorated for many states during the nineties.

The role of governance cannot be undermined as it has crucial bearing on the level of development and well being of the country. With each swing of the pendulum in this regard, major transformation can take place in economic and social orders. Perhaps successful governance is the key to reduce wide regional disparities across various states in India.

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