Good governance and the dilemma of development: what lies beneath?

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I Ideas unleash human imaginations, as well as hold these imaginations on a leash. However, they are scarcely disarticulated from material realities. Together with these realities, they take on the form of discourses—words, concepts and thoughts that characterize how we live. ‘Good governance’ has come to occupy such a space in the practical and theoretical discussions on development. This paper attempts to put current understanding into perspective, by locating specific trends in government reform and public expenditure. It realizes that the nature of the Indian state, international finance and fiscal prudence, rather than responsiveness to democratic demands of poor people, inform the discourse on ‘good governance’. Such thinking among the key players poses a dilemma to the theory and practice of development, because it reflects the tendency of the state to shy away from responsibility to its citizens. The discourse on ‘good governance’ must articulate democratic aspirations.

Keywords: Institutional political economy; hegemony; self-reliance ratio; development agendas

JEL classification: O20, B5 (B52 Institutional), E6 (E62 Public expenditures, investment, and finance), H7 (H71 State and local taxation, subsidies, and revenue)

We are committed to making the right to development a reality for everyone and to freeing the entire human race from want. We resolve therefore to create an environment—at the national and global levels alike—which is conducive to development and the elimination of poverty. Success in meeting these objectives depends, inter alia, on good governance within each country... We are committed to an open,
equitable, rule-based, predictable and non-discriminatory multilateral trading and financial system (United Nations Millennium Development Goal on Governance, 2000).

India alone has to pay 5 million pounds in tribute for 'good government', interest and dividends of British capital (Karl Marx on British rule in India, 1867)

1. Introduction

One-sixth of the world’s population lives in India. Despite significant achievements in adopting a democratic constitution, achieving macro-level food security and eradicating fatal diseases such as smallpox, many Indians continue to be denied access (or have differential access) to the developmental practices of the Indian state. Thus, human development indices for India are lower than, say, those for China, Indonesia and Sri Lanka—countries that started their post-colonial nation-building with similar ‘initial conditions.’

What causes such divergent paths of development? Many influential social science agencies, such as the United Nations Development Programme, have sought to highlight institutional and political determinants of development (UNDP, 2002). Differences arise partly due to differing allocation of resources to pro-poor development and variations in the efficacy of utilizing these resources, and partly due to differing abilities of governments to make institutional arrangements for communities to be able to participate better in development processes.

The Indian Government’s Approach Paper to the Tenth Five-Year Plan proposes that it should aim at an indicative target of 8% GDP (gross domestic product) growth for the period 2002–2007. While examining its macro-economic implications, it stresses that achieving this target will ‘require that the essential institutional structure necessary for the orderly operation of a market economy be strengthened significantly’ (Government of India, 2001, p. 11). Accordingly, economic growth is concomitant with the creation of a governance mechanism where the market can realize its potential.

1.1 Rationale and scope of the paper

Numerous studies on the political economy of Indian development (see Frankel, 1979; Rudolph and Rudolph, 1987; Weiner, 1989; Patnaik, 1997; Varshney, 1995; Bardhan, 1998) have tended to focus on the ‘core’ sectors and their relation with
either the state or the market. While this is important, the volume of social-sector spending contributes significantly to development (Dreze and Sen, 2002). Side by side, the enhancement of the scope of local self-government institutions makes them impossible to ignore in any analysis of development.

Examining the interaction of social-sector expenditure with development processes has long been neglected. Discussions on development have mostly centred on production and distribution functions of the state. State-led policies have been such that local government bodies did not have much scope in influencing the pattern of development. Today, these have changed, with increasing emphasis on pluralistic, participatory and pro-poor initiatives, and appropriate institutional mechanisms to facilitate these. However, this paper, based on empirical evidence, suggests that current trends in social-sector expenditure at different levels of government do not demonstrate them being informed by a vision of pro-poor and democratic governance, at least in India.

A review of the theoretical evidence of what constitutes ‘good governance’ leads us to debates around public–private efficiencies and the production–distribution priorities. This paper avoids being constrained by these frames of reference. Instead it uses the Institutionalist Political Economy (IPE) approach to unravel the apolitical (if not purely economic) claims of the discourse on ‘good governance’. We will discuss how the political economy of Indian development, international finance capital and fiscal deficit together inform a particular genre of discussion of ‘good governance’. Examining trends in social-sector spending and the nature of development resources available at the disposal of democratically constituted community-based local self-government institutions, enables us to analyze comprehensively the thrust of India’s reforms. The present framework offered allows us to identify clearly that elements of reform, pertaining to State and central governments curtailing their expenditures, are followed consistently. But those elements that would contribute to local units being financially and institutionally strengthened leave scope for improvement.

After reviewing, in Section 2, some of the theories on governance, we explore their implications on development processes in India. In Section 3, we briefly describe the political economy of India’s reforms and global developments that provided a backdrop. We also draw the reader’s attention to the direction of fiscal flows in the Indian economy, so as to contextualize the discussions in Section 4 on social-sector spending and development expenditure at the State, district and village-level. Section 5 concentrates on analyzing the empirical evidence before us, before concluding.

2. Theorizing good governance

The discussions on ‘good governance’ derive from rigorous analysis of the role of state, market and other intermediary formal and informal institutions in civil society. Some of them make a case for a limited role to be performed by the state,
while others advocate more state activism. We will briefly examine them to support our understanding of the trajectory of reforms in India.

2.1 Governance actors

The property rights school focuses on the agency problems of the public sector. Due to diffuse ownership and ill-defined property rights, managers of firms in this sector lack incentives. Furthermore, the fact that these firms are not publicly traded makes them less vulnerable to take-overs. Similarly managers fear bankruptcy less, since they expect public funds to bail them out in crisis.

Public choice theory compliments this approach by highlighting the lack of management focus, given the variety of objectives a public sector firm is expected to pursue, not all of which are calculated to maximize profits. Furthermore, individuals make rational decisions based on calculations of self-interest, and public servants—who are no exceptions—cannot be expected to pursue a public interest that does not combine with their own self-interest. The absence of markets as a disciplinary force on the behaviour of government agencies encourages the over-supply of public goods and the creation of large budgets.

Principles of new public management (NPM) offer solutions. They are concerned with how government steers policy—whether as 'steersman' or as 'oarsman', to borrow the metaphor used by Osborne and Gaebler (cited Traut, 2000, p. 189). NPM principles emphasize that government should not be the only power in society. It should partner with the private sector, including non-governmental organizations (NGOs). This makes government more flexible and more responsive to socioeconomic change. Constricting the scope of a gigantic state is a defining consideration of NPM. Rationalizing public expenditure is a corollary policy prescription.

These propositions—and the case for privatization, state rollback and structural adjustment that they inhere—have not gone unchallenged. On the one hand, new institutional economics (NIE) draws attention to the role of both formal and non-formal institutions 'as critical constraints on economic performance' (Harriss et al., 1995, p. 3). On the other hand, Beetham (cited in Das, 1998, p. 4) finds the assumption in public-choice theory about self-interested disposition of the human nature is too narrow. Lack of incentives does not necessarily inhibit performance, as managers could have broader motives than merely self-seeking ones. Martin and Parker (cited in Ram Mohan, 2002, pp. 4865–71) question the supposed superior performance of private sector firms by underscoring the imperfect nature of markets: transaction costs, information imperfections, diffuse ownership and the failure of take-overs to deliver promised improvements in performance and profit.

In a comprehensive review of existing literature on the evidence pertaining to privatization, Ram Mohan (2002, pp. 4865–71) cites case studies from Britain and China to demonstrate that the theories propelling the privatization process do not
always translate into practice. Diamond and Valdes-Prieto (cited in Huber and Stephens, 2000, p. 16) cite evidence from the privatization of pension funds in Chile to demonstrate that administrative expenses associated with the privatized system exceeded those of the pre-reform period. Huber and Stephens (ibid.) point out how advocates of privatization skirt issues of solidarity and redistribution as key principles of social policy. Other authors have targeted structural adjustment programmes as contributors to ‘increasing poverty through the austerity measures that reduce the state’s capacity to provide essential services’ (Mkandawire and Rodriguez, 2000, p. 5; emphasis added).

On the one hand, we have the evidence that privatization is not a panacea. On the other hand, we have evidence of the positive impact of state activism on development. White and Goodman (cited ibid., pp. 6–7) confirm the significant role performed by the state as regulator and enforcer of welfare programmes in Asian newly industrialized countries (NICs). While these Asian economies were hailed as models of shared growth, equity preceded the economic miracle, being a consequence of major state-led asset-redistribution programmes in the 1950s.

Constraints to long-term growth in developing countries are caused more by demand than by supply. Theorists have identified both fast and stable growth of demand as a solution to poverty and inequality (Singh, 2000). Developing countries will gain from a rightward shift of the negatively sloped demand curve for labour, as opposed to application of the orthodox principle of labour-market flexibility alone. The institutional mechanism of the state will need to effect this shift.

2.2 The Gramscian view and the institutionalist political economy approach

In his writings the Italian Marxist, Antonio Gramsci, attempted to put into perspective the role of the state, political party and civil society. According to him, consent-creation by the state and the education of this consent through the state’s hegemony are crucial to maintaining social order (Gramsci, 1998, p. 259). Gramsci emphasizes that

It must be made clear that ‘laissez faire’ too is a form of state regulation introduced and maintained by legislative and coercive means . . . [it] is a deliberate policy, conscious of its own ends, and not the spontaneous, automatic expression of economic fact. Consequently, laissez faire liberalism is a political programme (Gramsci, 1998, p. 160).

Gramsci’s views are reflected in the institutional political economy (IPE) approach, even as it remains unclear whether the approach itself draws on Gramscian thought or not. Chang (2001a) discusses the salient features of IPE through an analysis of the limits of neo-liberal theory. Arguing that the mode of neo-liberal discourse emphasizing the primacy of private enterprise and laissez faire, is
problematic. IPE highlights the institutional complexity of the market and—like Gramsci—articulates it as a political construct.

IPE critiques the neo-liberal understanding of the market, which is limited to studying property rights and legal infrastructure. Highlighting the limits in such a definition of laissez faire and state intervention, IPE argues that both are actually relative in terms of time and space, and are a function of a rights-obligation framework established in a given society through political struggle.\(^2\) Chang comments that

> It is only because some state regulations (and the rights and obligations that they support, or even create) can be so totally accepted (by those who are making this observation as well as by the participants in the market) that some markets appear to have no 'intervention' at all and therefore appear to be 'free' (Chang, 2001a, p. 6).

Gramsci's postulation that establishment of hegemony through consent-creation is a critical process in all societies, clearly relates to the IPE proposition that the market is a political construct. This paradigm is distinct, therefore, from that advocating statism, since it focuses more on the political institutions (and processes) in civil society that may or may not be antagonistic to state and market. By articulating a rights-obligation framework, IPE enables us to explain how policies themselves are influenced by institutions—whether formal or informal—at the local, national and global level. Pieced together, such analysis provides a holistic picture of how economic actions by state actors are informed by the political nature (and influence) of the institutions that influence them. Good governance thus emerges as a function of the interface of varied institutions articulating myriad socio-economic aspirations in the political sphere, and not simply an outcome achieved through market forces or state intervention. The (political) creation of these institutional structures is therefore crucial to good governance.

2.3 Development processes and determinants

We can see, therefore, that substantial evidence exists in the literature on development to demonstrate that equitable development is a direct outcome of pro-poor and democratic governance.

To achieve this, the UNDP recommends that the level, efficiency and equity of public spending on services such as education, health and family welfare, and

\(^2\) Some typical examples are the legislation pertaining to use of child labour, environmental regulation, slavery and minimum wages, seen as interventionist by employers and industrialists in developing countries today and in the now developed countries prior to them having achieved today's levels of development. It is practically unthinkable in developed countries today to think of the state not intervening to establish these rights and obligations (Chang, 2001a, pp. 4–5).
agricultural and rural development be increased (UNDP, 2003, p. 107). Such spending is known to enhance development outcomes. Where spending on such sectors is constrained by either stagnating and declining public expenditure or the inability to mobilize revenue, the possibilities of equitable development remain stunted.

2.4 Decentralization

For public spending on social services to translate into improved delivery for communities and greater responsiveness to their agendas, without being diverted by corrupt practices and rent-seeking, decentralization of political authority is often identified as imperative. This needs some qualification, though. It has often been argued that decentralization is inimical to development policy, including progressive populist policy (Huber and Stephens, 2001) even in affluent democracies (Pierson and Hacker, 2002). Economic elite tend to be politically strong at the local level, while economically depressed communities derive strength on the basis of national-level organization (Skocpol, 1992). For stratified Asian societies, Chang (2001b) and Wade (1981) in their studies on China and Korea, respectively, have pointed to how authoritarian regimes (and not decentralized ones) were responsible for effectively implementing pro-poor policy. Mookherjee (2001) and Dasgupta and Ray (2001) demonstrate through simulations how state-led coercive land transfers from landlords to cultivators, and state-supported food transfers can be highly potent as regards aggregate output, employment and welfare.

In India, the debate over centralized government and decentralized institutions is as old as the Constituent Assembly debates that accompanied Independence in 1947. Two distinct opinions clearly emerged: the dominant opinion supporting centralization in order to check centrifugal political tendencies, economic de-industrialization and agricultural backwardness, as well as social injustice; and the Gandhian opinion that steadfastly defended decentralized community-based development initiatives, which would enable communities to both exercise their rights and dispense their responsibilities. The Constitution was a compromise of both positions (Austin, 1996). Even experts remain divided on whether India's Government took on too much through centralization (Lewis, 1996) or gave away too much by decentralizing (Frankel, 1979). It is interesting to note that the bitterest arguments against decentralization came from Bhim Rao Ambedkar, pioneer of India's civil rights movement. Ambedkar's studied critique of rural institutions 'from below' (Jodhka, 2003) was reflected in his attempts, as Chairperson of the Constitution's Drafting Committee, to prevent romanticized (usually Gandhian) notions of the rural community from influencing the document.

Yet, the limits of state authoritarianism become obvious when we consider India's size (Lewis, 1996), ethnic heterogeneity (Varshney, 1995) and different
historical experiences (Kulke, 1997; Richards, 1997; and Bose and Jalal, 1999). The anti-imperialist struggle, although dominated electorally by the Indian National Congress after 1937, was by no means ‘hegemonized’ by any single personality or ideology (not even Gandhi or Gandhianism). This contributed to the absence of a uniform mass struggle that could be sustained by a single faction or ethnic group for long (Sarkar, 1987). Nation-building in India was determined by coalition-building right down to the district-level, making it imperative to share political power at all levels.

However, this sharing was more a patronage network, as was evident during the imposition of national emergency during the Congress regime in 1975, when local elite remained stunted in their opposition to blatant aggrandisement of state power. Post-emergency regimes appreciated that power-sharing meant more than just a patronage–client relationship between local and regional elite. For power-sharing to translate into meaningful service-provision and capacity-enhancement legislation, institutionalizing decentralized governance has been passed through the 73rd and 74th Amendments to the Indian Constitution.

Decentralization efforts contribute to what Dreze and Sen describe as local democracy, although they may not in themselves be necessarily conducive to the establishment of this democracy (Dreze and Sen, 2002, pp. 358–9). Especially where state-led reforms in agriculture and society have been prominent, such as in Kerala and West Bengal, decentralized experiences have strengthened democratic planning. In other States, decentralization, along with affirmative action, has contributed to public participation of hitherto marginalized sections. As numerous field studies have pointed out, decentralization remains critical to efficient, effective and relevant service-delivery, accountability of procedures, and a political action and involvement that enhances participants’ dignity and self-respect (Beck, 1994; Ramachandran, 1999).

For India, then, many have argued that decentralization advances democracy. Experiences with decentralization point to three ‘core principles’ (UNDP, 2002, p. 137): (1) plans for making resources available to local bodies; (2) agreeing on functions that need to be decentralized; and (3) the presence of strong egalitarian community-based institutions that facilitate pro-poor and participatory development outcomes. In their absence, ‘dominant groups and narrow interests can hijack’ (ibid., p. 140) the decentralization initiative and, indeed, the entire development process.

2.5 Implications for governance

Clear conceptualization of the developmental process dictates, therefore, that at the level of central government, focus is maintained on comprehensive anti-poverty programmes, such as India’s poverty alleviation programme. Poverty alleviation
instruments integrate distribution with programming, and do not consider it an add-on once stabilization, efficiency and growth have been established (Mkandawire and Rodriguez, 2000, p. 29). Targeted components are funded from additional allocations, and not from existing budgets. Such anti-poverty programmes must be complemented with schemes to strengthen human resources, focusing on education, health and rural development. Constitutionally, India's State Governments are responsible for human resource development. Therefore, the volume that they spend on education, health and rural development is a crucial indicator of the level of India's human resource development. It is critical that anti-poverty programmes and human resource development schemes strengthen one another so that enhanced education and health status are not negated by lack of development in the countryside (where over 70% of India's population continues to live), forcing human capital to migrate.

Similarly, developing human resources as well as micro-level capital resources appropriately is also the responsibility of communities themselves. The implications are that local governments control revenues not only for meeting their education and health requirements, but also for activities such as employment-generation, housing, micro-irrigation and water-resource management, including small-scale hydraulic infrastructure. Democratically constituted community-level governance institutions determine the extent and nature of fund-utilization without interference from the state. Thus the volume, trends and content of public spending at different levels of government reflect how democratic and pro-poor the nature of governance is.

Good governance, therefore, needs to take note of efficient and effective service-delivery, capacity-enhancement of human resources and the creation of enabling environment for empowering people. This needs to be clearly reflected in policy arrangements. Different levels of government must respond to democratic demands, rather than restrict their focus on merely getting the techno-managerial frameworks in order. In other words, we need to focus on some kind of 'political economic populism' rather than merely 'political economic techno-managerialism'. In India, the former is broadly thought to entail a degree of local autonomy and systematic decentralization. The reforms of the 1990s provided an opportunity to bring these ideas into practice. However, the very determinants of reform constrained its scope, as becomes clear in the following section.

3. Political economy of development and reform

The appreciable impact of state action on poverty alleviation (Byres, 1999, p. 25) during most of the 1980s was followed by the widening fiscal deficit and a crisis in the balance of payments faced by the Indian Central Government. Such a trajectory was etched out, not only in the model of top-down development planning, but in the very nature of the Indian state.
The political coalitions engineered by the post-colonial regime in India reflected the class compromise made between the industrial bourgeoisie and landlords (Patnaik, 1997). This alliance implied that the bourgeoisie was unable to completely utilize the state apparatus to its advantage, say, by taxing the agricultural sector.\textsuperscript{3} Such a compromise inevitably burdened state finances, as there existed an extremely constricted tax-base outside these two sectors. So when India embarked on development planning in 1951, deficit financing funded up to 40% of the plan expenditure (Patnaik, 1997, p. 183). India's development planning was financed not through the appropriation by the state of a part of the surplus value accruing to private propertied classes, but merely through a rise in rate of surplus value. The socio-political clout of both large landlords and medium owner-cultivators,\textsuperscript{4} as well as industrial bourgeoisie, together translated into a growing proportion of this total outlay comprising transfers such as subsidies and interest payments.

Obviously, such a source of development financing was unsustainable. Public investment cuts necessitated by the very nature of previous patterns now alienated both industrial and finance capital. These began to press for a more decontrolled and deregulated economy. Simultaneously, even as the powerful farm lobbies faced the threat of input-subsidies and high procurement prices being slashed, they started demanding higher terms of trade for agriculture.

Reforms were initiated very cautiously. According to Varshney, the ethnic tension that characterized the socio-political landscape of India in the early 1990s provided the opportune moment for the state to at least press on with those reforms that did not impact on what he calls 'mass politics' (Varshney, 1999, pp. 227–30). After 1999, as the Bharatiya Janata Party (BJP) took over as the head of a centre-right coalition, it strove to create enabling institutional structures, such as a ministry of disinvestment, to facilitate reforms. In the recently concluded national elections, the two major political parties contested as to who had actually initiated the reforms rather than a critical analysis of their impact. The discourse of economic reforms correlated with 'good governance' appears firmly in place, and is the touchstone of most social and economic policy in India today.

\subsection*{3.1 The reforms of the 1990s: conforming to the Washington Consensus}

Thus, the nature of the post-colonial Indian state determined that the source of development financing in the country was unsustainable, leading to the financial

\textsuperscript{3}The import-substitution strategy of the government and the lowering of terms of trade were intended to favour industry. These were deeply resented by the landlords. However, the concessions made to landed interests through provision of input-subsidies and high procurement prices pre-empted a major backlash.

\textsuperscript{4}A social category created by limited and skewed land reforms and an upward cultural mobilization by agricultural castes or \textit{sudhas}. 

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crisis of the 1990s. Structural adjustment loans from Bretton Woods Institutions—the International Monetary Fund (IMF) and the World Bank—pulled India out of this crisis. Bretton Woods Institutions insisted on loan conditionality, enabling the Indian Government to embark on reforms and institute measures in conformity with the Washington Consensus: i.e. liberalization of trade and foreign investment, financial liberalization and making the rupee convertible on the current account, deregulation and privatization, fiscal discipline taking the form of reducing the fiscal deficit and restructuring public expenditure to priority areas (Reddy, 2000, pp. 505–6). The essential features of the Consensus, thus related to macro-economic stabilization, reducing the role of the state and enhancing that of the market, and seeking closer integration with the global economy through trade liberalization and removal of barriers on international capital flows (Singh, 2000, p. 27).

These national transitions become clearer when we take note of some global developments, such as the growth of international finance and spread of global markets. By the end of 1995, the world’s financial markets stood at US $33.5 trillion, of which the bond market was US $20 trillion (or nearly two-thirds): 60% of these bonds were issued by governments in Organization for Economic Co-operation and Development countries. Net capital flows expanded from US $8.1 billion in 1970 to US $200 billion in 1996. Only about 30 such investment institutions dominate the management of funds flowing through these markets (Bangura, 2000, p. 3). These trends have transformed nation-wide integration into a global phenomenon.

The implications of liberalization for the organization and management of government are critical, and is reflected in the concern among international financial circles for protection of property rights and efficient management of public finance, including accountability and transparency. The growth, and integration, of international finance needs to create a standardized public sector in those countries that are well-integrated, or seek to be integrated, into the global economy. The ease with which funds can be transferred allows financial markets to influence national macro-economic policy.

3.2 Fiscal deficit and good governance

Forty per cent of the bonds issued by OECD governments sought to cover deficit budgets. The need to control budget-deficits became the starting point for debates on how best to reorganize government finances, addressing issues of privatization, restructuring and decentralization. Together with demands for democratization, they have contributed significantly to discussions on reforming government. However, multilateral funding institutions promptly term populist those positions that are explicitly anti-market. There thus exists a dialectical relationship between democracy and good governance.
The analysis of public expenditure (PE) trends reveals the expenditure priorities of the Indian Government. Public expenditure in India constitutes the budget expenditure incurred by both the central government and the State governments, as well as any inter-governmental adjustments: Central budgets usually contribute almost 50% of all aggregate public expenditure (or, simply, aggregate expenditure). In India's development context, given the paramount ideological and financial role appropriated by the government, the annual projection of allocations and revenues represented by the budget statement becomes both an important tool for implementation of policy and an arena of contest for different vested interests to pursue their respective agendas. India's federal bank, the Reserve Bank of India (RBI) classifies budget expenditure as capital and revenue expenditure, plan and non-plan expenditure, and developmental and non-developmental expenditure. It undertakes a similar classification for all allocations and receipts. The analysis below draws on studies pertaining to capital and revenue expenditure, plan and non-plan expenditure, and—most important—development and non-development expenditure.

A classification common to most economies is that made between capital and revenue expenditure. Capital expenditure comprises expenditure on acquisition of assets and investments in shares. In India, it also includes loans extended by the central government to the States. Revenue expenditure, on the other hand, is the expenditure incurred on administration of government departments, service-provision and subsidies, grants and relief during calamities, and interest on debts. In India, all grants and assistance advanced by the central government to the State governments are considered revenue expenditure incurred by the central government, even if some of the assistance is used by the States in acquisition and creation of assets.

The second classification peculiar to Indian public finance since the inception of planning in 1951, is that between plan and non-plan expenditure. Plan expenditure refers to that component of the budget expenditure that represents development and investment outlays arising due to plan proposals. Non-plan expenditure, on the other hand, refers to expenditure incurred by the routine functioning of the government, such as the maintenance of law-and-order, and the administrative costs of service-provisioning and programme management. Given that the Government of India's Five-Year Plans significantly reflect the nature of its commitment to development programming (including governance and reform issues), data on plan and non-plan expenditure offer an insight into the development priorities of the government.

While trends in both capital and revenue expenditure and plan and non-plan expenditure are touched upon in this paper, its focus and inferences relate to data

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5In India, the fiscal year for which a budget is presented follows an annual cycle from April 1 of the current calendar year to March 31 of the following calendar year.
published by the RBI for developmental and non-developmental expenditure. Developmental expenditure is further classified as expenditure on social services and on economic services.

Expenditure on social services comprises expenditure on: education (including elementary education), sports, art and youth; medical and public health, family welfare and nutrition; hitherto 'untouchable' dalits or Scheduled Castes (SCs) and indigenous Scheduled Tribes (STs), agricultural castes of *sudras* or Other Backward Classes (OBCs) and laboring classes; and provision of social security. Likewise, expenditure on economic services comprises expenditure on: agriculture, irrigation, flood control and rural development; energy, transport and communication; industry and minerals; science, technology and environment; economic programmes for specific areas (such as pertaining to island territories and north-eastern States); and general economic services. Sometimes, schemes are introduced with components of both social services and economic services, such as the Basic Minimum Services (BMS) scheme initiated in 1996–97. In addition, both Central and State budgets subsume expenditure on social services, rural development and BMS under social sector expenditure.

Non-developmental expenditure on the other hand includes expenditures on defence, interest payments, tax-collection, police, salaries and pension payments, and other such activities that contribute to the routine functioning of government. It is evident from the RBI's definitions that the volume of capital expenditure, plan expenditure and developmental expenditure, reflect the strength of the government's commitment to spending on items that contribute to creation of capacities and assets and to development programming in general: higher volumes reflecting strength and lower volumes weakness and deterioration.

Deteriorating government finances that have characterized the 1990s are largely due to increase in non-plan expenditure such as wages, pensions and interest payments. For example, in 1994–95, expenditure on pay and allowances of civilian employees accounted for 17.3% of revenue receipts and 12.9% of revenue expenditure of the central government. The scenario is similar in the States. Plan expenditure has fallen from 27% of the States' total expenditure during the Sixth Plan to 19% during the Ninth Plan. Pension liabilities of 14 major States have increased from 2% of revenue receipts in 1980–81 to about 12% in 1995–2000 (Government of India, 2001, p. 14).

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6 For the State governments, the public expenditure includes, in addition to the above classification, grants-in-aid and contributions from central government, compensation and assignments to local bodies, reserves with the department of finance, discharge of internal debt, repayment of loans to central government, and loans and advances taken by them.

7 BMS consists of seven basic services: safe drinking water, primary education, primary health, housing, mid-day meals for primary school students, rural roads and strengthening the public distribution system.
Combined (Central plus State) developmental expenditure as a percentage of aggregate expenditure has been declining from 56.8% in 1987–88 to 47.8% in 1997–98. For each year between 1991–92 to 1992–93 and 1998–99 to 1999–2000 the annual growth rates for non-developmental expenditure has been greater than for developmental expenditure, the only exception being from 1995–96 to 1996–97 (Dev and Mooij, 2002, p. 854).

Taking State government expenditures specifically, we see that Central assistance, which refers to grants extended by the central government to the State governments and is meant to contribute to the developmental expenditure of the States, has registered an increase. It has risen from 37% of total State resources during the Sixth Plan to 45% during the Ninth. Not only is the proportion of Central assistance to total State resources increasing, the share of States in overall Plan expenditure has also fallen, from 52% in the Fifth Plan to 37% in the Ninth Plan (Government of India, 2001, p. 14). Thus, central government resources far outweigh that of State governments in both plan expenditure and developmental expenditure.

The difference between the total budget expenditure and total budget receipts of government (excluding borrowings) reflects the fiscal deficit incurred by that government. Similarly, the difference between revenue receipts and revenue expenditure reflects a revenue deficit and the difference between capital expenditure and capital receipts reflects capital deficits. India’s Central Government’s Gross Fiscal Deficit (GFD) in India for 2001–02 estimated at 5.1% of the GDP, was higher than the budgeted 4.7%. Revenue deficit in the same year was 3.4% of GDP, as opposed to the budgeted 3.2% (Government of India, 2002a, p. 17). In contrast with 1998–9, when the Centre’s deficit of 6.5% of GDP was higher than the budgeted figure of 5.3%, and the revenue deficit increased to 4% of GDP (World Bank, 2000, p. 4), it is clear that India is still borrowing to finance current expenditure (even if present figures are reduced).

The Approach Paper to the Tenth Five-Year Plan highlights the deteriorating fiscal situation of the central government during the Ninth Plan period. The shortfall between revenue receipts and non-plan expenditure approximates 3.6% of GDP (Government of India, 2001, p. 13). The combined Balance from Current Revenues (BCR) of the central government and the States declined from Rs. (-)133 240 million (US $2 775.83 million) in 1996–97 to Rs. (-)929 690 million (US $19 368.541 million) in 1997–2000, that is, from 1% of GDP to 4.8% of GDP (ibid.). This gap has been bridged by the central government through consistently high public borrowings, including borrowings from small savings. Consequently, debt-service payments of

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8 Central assistance is a source of income for States. This is distinct from loans extended to States by the central government, and from Centrally Sponsored Schemes (CSSs) in the implementation of which central government and the State share the expenditure on a 75:25 ratio.
the central government have increased from 30% of tax-revenue in 1980–85 to 70% in 1995–2000. This is a consequence of revenue deficit as a proportion of fiscal deficit increasing from 17% in 1980–85 to 50% in 1995–2000. Nearly half of all current borrowing is being used to finance current expenditure (ibid., p. 14).

Three important trends in the finances of the State governments may be noted. (1) The States’ BCR has deteriorated, declining from Rs. 31 180 million (US $649.583 million)⁹ in 1985–86 to Rs. 2200 million (US $45.83 million) in 1992–93 and then to a negative figure of Rs. (-)323 060 million (US $6 730 million) in 2000–01 (ibid., p. 14). (2) The consolidated revenue deficits for the States in 1999–2000 (revised estimates) is 2.9% of GDP. The GFD of States as a proportion of GDP touched an all-time high of 4.9% in 2000–01, surpassing the 4.2% mark of 1998–99. Revenue deficit accounted for 60% of the GFD in 1999–2000 as against 28.3% in 1990–91. What has resulted is deceleration in the growth of capital expenditure from 37% to 17% between 1980 and 1998 (ibid.). (3) The States’ overall debt has increased manifold from Rs. 536 600 million (US $11 179.16 million) in 1986–87 to Rs. 4 185 830 million (US $87 204.791 million) in 2000–01 (ibid., p. 14).

Increase in total borrowings by the States and deceleration in the growth of capital expenditure, implies that the State governments are only borrowing to finance non-plan expenditures. The Approach Paper apprehends that if the present trends continue, many States might be forced to declare financial emergency by the end of the Tenth Plan period.

3.3 External debt and internal development

India’s total external debt increased from US $20.5 billion in 1980 (World Bank, 1997, p. 246) to US $98.2 billion in 1998–9 (World Bank, 2000, p. xix). Debt-servicing, as a percentage of export of goods and services, increased from 9.35% in 1980 to 27.9% in 1995 (World Bank, 1997, p. 246), and the Debt Service Ratio, as a percentage of current receipts for 1998–99, stood at 24% (World Bank, 2000, p. xix). The share of multilateral debt to total external debt increased from 29.5% in 1980 to 32% in 1995 (World Bank, 1997, p. 246). Multilateral debts are notorious for attendant policy impositions, especially in the form of structural adjustment programmes and the Washington Consensus. Large debt-service outflows divert expenditure from social development, turning the central logic of external borrowing on its head.

Fiscal deficit caused by excess of expenditure (particularly non-plan expenditure) over receipts, when coupled with increasing multilateral debts are accompanied by donor prescriptions on good governance. This compels us to look at discourses on

⁹ All dollar values in this section have been computed on the basis of prevailing dollar–rupee conversion rate of US $1 = Rs. 48/-.
good governance from the viewpoint of repaying loans raised from multilateral economic institutions.

3.4 Legislating on fiscal management

A Bill on Fiscal Responsibility and Budget Management for the Central Government was introduced in Parliament in December 2000, reflecting the commitment to institutionalize fiscal reform. It proposes that central governments aim to reduce the fiscal deficit for any given financial year to not more than 2% of the estimated GDP for that year. It also considers insulating the RBI from pressures of Parliament.

The proposed Bill has been criticized on the ground that in an underdeveloped country; it legitimizes cutbacks in state expenditure. The ceiling of 2% is less than the 3% stipulation of the Maastricht Pact for the European Union (EU). This lower figure for a developing country is intriguing given that Europe’s industrial and capitalist development has been significantly facilitated by active state intervention (Hobsbawm, 1992, pp. 36, 42–43; Chang, 2001b).

The proposal of detaching expenditure decisions from Parliament’s needs-assessment and jurisdiction represents the extreme attempts to separate the economic from the political. Such a separation is partly explained by an economic theory that separates distribution from efficiency issues (Mkandawire and Rodriguez, 2000, p. 28). Amin’s assertion that the ‘capitalist worldview is naturally deterministic’ (Amin, 1999, p. 26) appears to play itself through this particular legislation. This results in what he calls an ‘inversion’ (ibid., p. 27) of the relation between politics and economics so that politics becomes subordinate to economics. In actuality, these measures reflect the attempt by the Indian Government to accommodate international finance (Chandrasekhar and Ghosh, 2001) as well as to provide retrospective justification for further reform (Patnaik, 2001).\(^\text{10}\)

3.5 ‘Reforming’ institutions

Different sectors and departments within government have been targeted for reform. Reforms that aim at a lean civil service have been instituted in some States. The Fifth Pay Commission’s recommendations are in line with incentives and reward-systems envisaged by New Public Management. Right-to-information

\(^\text{10}\)The ‘natural’ tendency of finance to flow back to the metropolis (or where the rate of interest is higher) has to be checked by developing countries where this rate of interest is low. To that end, these countries increase the rate of interest to both attract finance as well as prevent its outflow. Increasing the rate of interest discourages domestic productive investment and undermines the viability of small units, adversely impacting both supply and demand. Not only that, it accentuates the fiscal crisis by raising the cost of servicing government debt.
campaigns by institutions and groups in civil society in different States, such as Rajasthan in the west and Orissa in the east, accompany these. Government agencies such as National Backward Classes Finance and Development Corporation (NBCFDC), are exploring the introduction of market mechanisms in offering credit. Civic authorities are encouraging partnerships between public and private sector players, and by implication, participation of the private sector. User-charges are being recommended for the use of public goods such as power and water and services such as health. Institutional arrangements to facilitate these transitions are also being put into place, albeit with caution. Electrical regulatory authorities in States have been instituted to oversee reforms in the power sector. Legislation pertaining to decentralization of electrical services and political decision-making has already passed.

4. Good governance and spending

4.1 Social sector spending: States

Rationalizing public expenditure and enhancing revenues are thus the two stated concerns of macro-economic policy that emerge clearly from the given fiscal scenario. In this Section we will correlate the policy concerns to rationalize public expenditure with trends in social sector expenditure.

The expenditure on social sector by central government and States as a percentage of GDP declined consistently between 1987–88 and 1992–93. However, it has picked up through the latter-half of the 1990s. The social sector expenditure as a percentage of aggregate expenditure (AE) registered a similar decline between 1987–88 and 1992–93, reached a peak in 1999–2000, and eventually declined by 2000–01.

As a percentage of AE, combined expenditure on education and related activities, public health and water supply and rural development has been fluctuating, but consistently declining after 1999–2000.

Expenditure on Basic Minimum Services (BMS) has, however, recorded a consistent increase from 0.76 in 1996–97 to 0.88 in 2000–01. The proportion of

<table>
<thead>
<tr>
<th>Table 1 Social-sector expenditure ratios (%)</th>
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<tr>
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<tr>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>Social sector/developmental expenditure (DE)</td>
</tr>
<tr>
<td>6.97</td>
</tr>
<tr>
<td>Social sector/aggregate expenditure (AE)</td>
</tr>
<tr>
<td>26.61</td>
</tr>
</tbody>
</table>

Table 2  Social sector components as ratio of PE (%)

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Education &amp; related</td>
<td>11.39</td>
<td>12.28</td>
<td>11.41</td>
<td>10.78</td>
<td>11.2</td>
</tr>
<tr>
<td>activities/PE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health, water &amp;</td>
<td>4.47</td>
<td>4.48</td>
<td>4.39</td>
<td>4.28</td>
<td>4.23</td>
</tr>
<tr>
<td>sanitation/PE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rural development/PE</td>
<td>3.02</td>
<td>3.32</td>
<td>3.69</td>
<td>4.1</td>
<td>3.32</td>
</tr>
<tr>
<td>Basic min. services/PE</td>
<td>0.88</td>
<td>0.76</td>
<td>0.76</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>


Table 3  Rural development as a component of GDP

<table>
<thead>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural development/GDP</td>
<td>0.79</td>
<td>0.88</td>
<td>1.01</td>
<td>1</td>
<td>0.84</td>
</tr>
<tr>
<td>Basic min. services/GDP</td>
<td>0.23</td>
<td>0.18</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>


combined expenditure on BMS to GDP registered a steady increase from 0.18 in 1996–97 to 0.23 in 2000–01. The proportion of combined expenditure (plan and non-plan) of central and State governments on rural development to GDP, registered a marked increase from 0.84 in 1992–93 to 1 in 1993–94. However, it registered an equally marked decline from 1.01 in 1995–96 to 0.88 in 1996–97 and fell to 0.79 in 2000–01: the lowest in 10 years. The BMS was supposed to be funded from additional allocations to the social sector. But the trend in expenditure on BMS has led Dev and Mooij (2002, pp. 855–6) to conclude that governments have reduced expenditure on rural development in order to finance BMS—marking a shift away from comprehensive anti-poverty schemes.

It is interesting to note that while the proportion of expenditure on social services to Developmental Expenditure (DE) increased between 1991–92 and 1999–2000, the proportion of expenditure on economic services fell during the same period. The Annual Average Growth Rate (AAGR) for central government budget expenditure

11The central government’s anti-poverty programme, which comprises rural employment, social security and welfare, and the special rural development programme component under the heading ‘rural development’, urban employment component under the heading ‘urban development’, food subsidy, and welfare of SC/ST and OBCs.
on social services programmes was 8.4%, compared with 5.7% for expenditure on economic services in the decade of the 1990s (Shariff et al., 2002, p. 781, table 10). Similarly, the proportion of central government budget expenditure spent on social services programmes to total budget allocation increased significantly between 1990–91 and 2000–01, while the proportion on poverty alleviation programmes increased only marginally during the same period. Curtailing expenditure on economic services is likely to create a skew in employment and production patterns in a given locality. The case of Kerala on India’s south-east coast is well known. Despite high investments in social services, an absence of investment in economic services has contributed to Kerala becoming a ‘remittance’ economy. Its highly skilled labour is forced to look for opportunities abroad since there are simply no avenues to absorb them within the State (Drez and Sen, 2002).

Certain comparisons with internationally accepted norms, suggested by the UNDP (cited in Dev and Mooij, 2002, pp. 862–3), on public expenditures may be made. Most of these ratios fall short of UNDP-prescribed norms for expenditure on the social sector. India’s Public Expenditure Ratio, which refers to the ratio of Public Expenditure to National Income, is only slightly higher than that recommended by the UNDP (and is fast sliding). The Social Allocation Ratio, which refers to the ratio of expenditure on social sector to PE is unfavourable. So is the Social Priority Ratio, which reflects the expenditure on human priority items, such as elementary education, water and sanitation, public health and maternal and child health, and child nutrition. Obviously, the Human Priority Ratio, which is the ratio

<table>
<thead>
<tr>
<th>Table 4</th>
<th>Proportion of social and economic services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social services/developmental expenditure</td>
<td>57.7</td>
</tr>
<tr>
<td>Economic services/developmental expenditure</td>
<td>42.3</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Table 5</th>
<th>Central government budget allocation components</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2000–01</td>
</tr>
<tr>
<td>Social services/ total budgetary allocation</td>
<td>5.1</td>
</tr>
<tr>
<td>Poverty alleviation programme/ total budgetary allocation</td>
<td>5.8</td>
</tr>
</tbody>
</table>

of the expenditure on human priority items, is much lower that recommended by the UNDP. This coincides with the fact that food subsidy in India averages 0.48% of GDP. This is less than 1.3% of GDP in Sri Lanka, less than 0.63% of GDP in Mexico, and less than 2% of GDP in Tunisia; this is after reforms in these countries are well under way.

We note that underspending in the social sector has been common throughout the last decade. Although fluctuating, the extent of variation between budget estimates and accounts of the central government plan expenditure on social sector indicates that the extent of under-utilization was higher in 1999–2000 than it was at the beginning of the last decade. Dev and Mooij (2002, p. 860) used figures on the extent of variation as evidence that development funds are being inefficiently utilized. They quote studies by Rajaraman (Rajaraman, 2001) on mid-year utilization rates of employment programmes in 2000 where only 21% of annual allocations were utilized.

When we analyze the share of the States’ expenditure to the total social-sector expenditure (including both central government and States), we find a decline from 85.2% in 1990–91 to 80% in 1998–99. A trend common to spending in the three highest-item areas—education, health and rural development—has been that central government spending has been increasing while that of the State government has been falling. Increased central government spending serves as a

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### Table 6  India’s international position in respect to expenditure ratios

<table>
<thead>
<tr>
<th></th>
<th>India (1999)</th>
<th>India (1991)</th>
<th>UNDP-recommended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public expenditure ratio</td>
<td>25.4</td>
<td>37</td>
<td>25</td>
</tr>
<tr>
<td>Social allocation ratio</td>
<td>27.4</td>
<td>20</td>
<td>40</td>
</tr>
<tr>
<td>Social protection ratio</td>
<td>40</td>
<td>34</td>
<td>50</td>
</tr>
<tr>
<td>Human expenditure ratio</td>
<td>2.78</td>
<td>2.5</td>
<td>5</td>
</tr>
</tbody>
</table>

*Source: Dev and Mooij (2002, p. 863).*

### Table 7  Variation in social sector expenditure component (% utilization of budget)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Education and related activities</td>
<td>84.7</td>
<td>88.1</td>
<td>96.5</td>
</tr>
<tr>
<td>Health and family welfare</td>
<td>92.4</td>
<td>104.8</td>
<td>109.2</td>
</tr>
<tr>
<td>Rural development</td>
<td>87.1</td>
<td>84.3</td>
<td>100.3</td>
</tr>
<tr>
<td>Social services</td>
<td>87.5</td>
<td>88.2</td>
<td>95.7</td>
</tr>
</tbody>
</table>

*Source: Dev and Mooij (2002, p. 860, table 14).*
Table 8 Proportion of state and central government expenditure on education, health and rural development

<table>
<thead>
<tr>
<th>Sector</th>
<th>FY</th>
<th>Central</th>
<th>State</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>1998–99</td>
<td>11.9</td>
<td>88.1</td>
</tr>
<tr>
<td></td>
<td>1991–92</td>
<td>8.9</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>1990–91</td>
<td>–</td>
<td>90.3</td>
</tr>
<tr>
<td>Health</td>
<td>1998–99</td>
<td>23.8</td>
<td>89.3</td>
</tr>
<tr>
<td></td>
<td>1991–92</td>
<td>20.7</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>1990–91</td>
<td>–</td>
<td>90.7</td>
</tr>
<tr>
<td>Rural development</td>
<td>1998–99</td>
<td>41.5</td>
<td>64.2</td>
</tr>
<tr>
<td></td>
<td>1991–92</td>
<td>30.1</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>1990–91</td>
<td>–</td>
<td>90.3</td>
</tr>
</tbody>
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Table 9 Central and states social sector expenditure to GDP/NSDP

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<tr>
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</thead>
<tbody>
<tr>
<td>Central govt. exp. (social services)/GDP</td>
<td>1.58</td>
<td>1.67</td>
<td>1.42</td>
</tr>
<tr>
<td>State govt. exp. (social services)/GDP</td>
<td>5.46</td>
<td>5.41</td>
<td>5.98</td>
</tr>
</tbody>
</table>


disincentive to ownership of states over development programmes and, consequently, to popular participation.

It is also evident that the central government’s expenditure on social services as a percentage of GDP has shown an increase between 1990–91 and 1998–99, compared with that of the State government, which is moving in the opposite direction during the same period.

Shariff et al. (2002, p. 771) have computed that the developmental expenditure of the States as a percentage of total expenditure has declined between 1991–92 and 1999–2000, and non-developmental expenditure has increased during the same period. The proportion of non-development expenditure to total State government expenditure has registered an increasing annual growth rate, from 8.9% between 1991–92 and 1992–93 to 22.2% between 1998–99 and 1999–2000. This is a reflection of the poor fiscal health of the States, as has been discussed earlier and, more importantly, the poor condition of development spending.

Data clearly indicate the following.

(a) Decline in social sector expenditure. In India, over the last 15 years a decline in the expenditure on the social sector is evident. This is reflected in the decline of
the ratio of education and related activities, health and family welfare, and rural development, to aggregate expenditure; the decline in the ratio of rural development to developmental expenditure; and increase in the ratio of expenditure on basic minimum services to developmental expenditure (diverted from expenditure on rural development).

(b) Scissors' movement between expenditures on social and economic services. There is a scissors' movement of expenditure on social services and economic services. In other words, while there is an increase in the ratio of expenditure on social service to developmental expenditure, there is a decline in the ratio of expenditure on economic services to developmental expenditure. While the increase in ratio of allocation for social services to total budget allocation is marked, the increase in ratio of allocation for poverty alleviation programmes to total budget allocation is slight.

(c) Under-investment and under-utilization. Under-investment and under-utilization characterize public expenditure, especially on human development in India. India is way behind expenditure ratios recommended by the UNDP. Variations in expenditure on social sector reflect inefficient fund utilization.

(d) Decline in the proportion of the States' spending on education, health and rural development. As a proportion of its social sector expenditure, India's Central Government increased its spending on education, health and rural development. As a proportion of social sector expenditure, States' spending on each of these services fell. As percentage of GDP, central government's expenditure on social services increased while those of the States declined.

(e) Decline in the States' developmental expenditure. As a proportion of total expenditure, the States' developmental expenditure declined, while non-developmental expenditure increased.

4.2 Development spending: districts and villages

After our discussion on expenditure trends we now turn to the second key concern of macro-economic policy, i.e. enhancing revenues to be made available for
development. We will correlate this with the fiscal experience of local government institutions. The 73rd Amendment to the Indian Constitution has made the Gram Sabhas (assemblies of all adult members of a village) the basic unit of governance in rural areas and the Gram Panchayat (hereafter Panchayat) the corresponding representative of the electorate at the base of the three-tiered Panchayati Raj Institutions (PRIs). The Amendment is widely acclaimed as path-breaking, giving as it does constitutional validity to community-based self-government institutions. Moreover, by ensuring affirmative action for marginalized sections of rural society, such as women, indigenous tribes and hitherto 'untouchable' castes, it has sought to adhere to the principle of social justice.

The Amendment provides for the devolution of powers and responsibilities upon Panchayats in relation to 29 items listed in the Eleventh Schedule of the Indian Constitution; for the Governor (executive head) of each State to constitute a Finance Commission for the State that will review the financial position of the Panchayats in the State; and for the constitution of funds for crediting and withdrawal of moneys. Panchayats accrue their funds from three kinds of revenues—own revenues, assigned revenues and shared revenues. In addition, they receive grants from central and State governments in the form of schemes for social services and infrastructure development. Panchayats can also generate loans from government and commercial financial institutions, although these are usually insignificant.

The total expenditure of the Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) as a percentage of GDP, increased to 12.24% in 1997–98 from 5.53% in 1992–93, i.e., a jump of more than 117% in 5 years. In contrast, the total expenditure/GDP ratios for the Union Government and all States was 16.1% and 15.2%, respectively (Oomen, 2000, p. 10). It has been estimated that local bodies are going to be significant in the AE and may outstrip the States and even the central government. In spite of such projections, the transfer arrangement worked out by the Eleventh Finance Commission (EFC) does not consider the fiscal responsibilities of local self-government institutions, even as an analytical theme. Responsibility for expenditure has to be accompanied by the right to raise revenue, particularly own revenue. While the Amendment envisages that arrangement, as we shall see, the ground realities are different, with local bodies continuing to depend upon States for resources.

---

12 Own revenues are assigned to the Panchayats and collected by them. They include tax revenues from house tax and water tax, as well as non-tax revenues from properties, fees and receipts. Assigned revenues are assigned by the State government to the Panchayat, collected by them, and their revenue is passed on to the Panchayat: these include entertainment tax and mineral cess. Shared revenues are assigned to State governments and collected by them, and their proceeds are shared between State governments and Panchayats.
Oomen (2000, p. 8) observes that the percentage of locally raised revenue to local expenditure continues to be low in most States. On the basis of data from the EFC, he calculates the self-reliance ratios of the States. He concludes that these ratios—what he calls Financial Autonomy Ratios (FAR)—for the total of all States has actually reduced since the 73rd Amendment was passed.

According to Oomen (ibid., p. 14) this is ironic, given the improvements in Revenue Decentralization Ratio (RDR) and in Tax Revenue Decentralization Ratio (TRDR). The RDR, which is the ratio of the local government revenues to the total State government revenue, has improved between 1992–93 and 1997–98. The TRDR, which is the ratio of local government tax revenue to the total State government tax revenue, has shown an even more remarkable improvement. FARs have registered a decline despite these improvements.

Furthermore, the proportion of local government tax revenue to total local government revenue is low. The EFC Report (cited in Government of India, 2002c, p. 292) notes that for India as a whole, own taxes as a percentage of own revenues as well as own revenue as a percentage of total revenue have both registered a decline since the passage of the 73rd Amendment—indicating that the financial basis of local self-government had yet to materialize. This is borne out from empirical data from the Panchayats. For example, Roy-Burman (Roy-Burman et al., 2000, pp. 213–4) estimated receipts of Madikonda Gram Panchayat (GP) in Warrangal district of Andhra Pradesh for 1995–96 and concluded that its own revenues were only 11.2% of total local government revenue, with tax revenue even lower, at 8.3%; while grants and assigned revenues constituted 87.7%. In Haryana, Roy (2001, pp. 22–3) calculated the income accruing from own revenues for Balayacha Gram Panchayat in the Mahindergarh district and Dhana and Dhanirwas Panchayats in the Hajjar district as 32.06%, 35.37% and 28.16% of their total local government revenues, respectively.

The Approach Paper (Government of India, 2001, p. 54) recognizes that the ‘near absence of revenue-raising powers with the PRIs is leading to a sense of dependence rather than empowerment’. This concern sharpens as we glance at data on expenditure. Oomen (2000, p. 15) calculated the Expenditure Decentralization Ratio (EDR) for local governments, i.e. the proportion of local government spending to total State government spending. He concluded that the EDR for all Indian States
Table 12 Revenue/expenditure decentralization ratio

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<tbody>
<tr>
<td>Revenue decentralization ratio</td>
<td>15.63</td>
<td>17.81</td>
</tr>
<tr>
<td>Tax revenue decentralization ratio</td>
<td>5.01</td>
<td>3.11</td>
</tr>
<tr>
<td>Expenditure decentralization ratio</td>
<td>87.56</td>
<td>36.11</td>
</tr>
</tbody>
</table>


Table 13 Own tax-own revenue ratios

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<thead>
<tr>
<th></th>
<th>1997–98</th>
<th>1990–91</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own tax/own revenue</td>
<td>61.99</td>
<td>71.53</td>
</tr>
<tr>
<td>Own revenue/total revenue</td>
<td>10.43</td>
<td>16.26</td>
</tr>
<tr>
<td>Core service exp/total expenditure</td>
<td>10.74</td>
<td>9.61</td>
</tr>
</tbody>
</table>

Source: Government of India (2002c, p. 272, table 7.9)

has shown significant improvement since 1992–93. This is true for expenditure on ‘Core Services’ that includes water supply and sanitation and also street lighting.

However, micro-level studies on the specific nature of expenditure have revealed that there is little expenditure on social sector and development activity. Rai (Rai 2000, p. 210), in their study on finances of Panchayats for 1998–99 estimated the expenditure pattern of Tifra GP in the Bilaspur district of Chhattisgarh (then Madhya Pradesh). Local government spending on the social sector constituted only 15.7% of total expenditure, while construction activity comprised almost 50%. In Rajasekhar’s estimates for local government spending in Andhra Pradesh (ibid., pp. 210–1), development activities such as land cultivation, constructing micro-irrigation structures, provision of education, health and nutrition, constitute only 10% of total local government spending, added to 9.3% for water supply and 5% for sanitation, while as much as 24.2% of the expenditure was absorbed under management heads and another 7.9% under IT staff and contingencies.

State governments direct the nature of most of these expenditures. This is because assigned revenues and grants continue to dominate the resources available to the Panchayats. Greater emphasis, as well as investments, on infrastructure development accompanies a decline in the weightage for social sector schemes. For example, while the total fund channelled through the PRIs increased by 426.3% between 1995 and 1998, funds for social-sector schemes increased by only 146.9% in the same period. It has been estimated (ibid., p. 210) that the resources available
to local government schemes for social sector schemes as percentage of total resources fell from 69.11 in 1995–96 to 57.1 in the following year, and even further to 32.42 in 1997–98. The concern that ‘good governance’ will be unable to result in sustainable poverty alleviation measures, given the focus away from generation and mobilization of domestic resources and investments (Mkandawire and Rodriguez, 2000, p. 28) remains high under such circumstances.

A number of institutional limitations characterize the implementation of the 73rd Amendment. The Amendment directs the creation of a District Planning Committee (DPC), the draft plans made by which are required to be forwarded to the State governments. It also calls for merging the district-level bureaucratic agency, called the DRDA, with its legislative counterpart, namely the Zila Parishad. Now, DPCs have not been convened in 13 of the 28 States where the 73rd Amendment is applicable (Government of India, 2002c, pp. 126–8). These have been only partially convened in five other States. Again, in only nine States, the DRDA and ZPs have been merged, and these exclude significant (and prosperous) States such as Andhra Pradesh, Gujarat, Maharashtra, Haryana and the Punjab.

Only one State—Karnataka in the south—has devolved funds, functions and functionaries in respect of all 29 subjects. While 15 States have devolved functions in respect of a majority of items, only four have done so in respect of funds and functionaries. In only five States have all 29 items been devolved. Obviously, the specific subjects that have been devolved remains the topic of detailed scrutiny, which the lack of space here does not permit.

Data clearly indicate the following.

(a) Decline in self-reliance ratios. Percentage of locally raised revenue to local expenditure registered a decline since the passage of the 73rd Amendment, even as ratios of local government revenues to State government revenues have increased. Not surprisingly, the percentage of both own taxes to own revenues and own revenue to total revenue have declined.

(b) Expenditure focus diverted from social sector. Expenditure decentralization has significantly improved. But the focus of expenditure has been on construction activity, rather than social services and rural development.

(c) Poor institutional arrangements. Institutional arrangements conducive to decentralization continue to be constrained, as they are informed by certain structural limitations of the 73rd Amendment.

5. Demystifying good governance

While reviewing the development processes at work in India during the last decade, certain points demand our attention. To begin with, the political coalitions that determined the nature of the post-colonial Indian State implied that 40% of the
Plan expenditure was met by deficit financing. Such an unsustainable course of development financing led to the financial crisis of the 1990s. In addition to this crisis was the growth of international finance and the spread of global markets that has caused unprecedented levels of centralization. We noted that only 30 financial investment institutions dominate the management of funds that flow through the global market. Excessive concentration and centralization of financial holdings provides the backdrop of government restructuring at all levels. Recognizing this trend in the concentration of finance enables us to appreciate the tremendous efforts being made to discipline both the State and market through instruments such as the Washington Consensus.

The discourse on good governance also disciplines civil society. Democracy becomes a function of these disciplining efforts by multilateral funding institutions.\textsuperscript{13} The World Bank’s distinction between populism and democratization sometimes becomes difficult to reconcile with: coalition governments tend to spend more, but in India they are associated with heightening democratic consciousness and empowered communities.

In India, while expenditure trends on social sector are optimistic, those on economic services continue to drop. Non-developmental expenditure continues to increase. Funds are still under-utilized. The share of States in developmental expenditure has also registered a decline. On the one hand they indicate an unfavourable position of India \textit{vis-à-vis} the rest of the world in terms of human resource indicators. On the other they imply a renewed dependence of States on central government.

Similarly, while the extent of devolution of funds, functions and functionaries is disappointing, the nature of revenues and expenditures accruing to local government bodies is appalling. Panchayats have only nominal control over revenues and expenditures. Evidently, States seek to determine the flow of funds to the Panchayats, and yet attempt to pass on their expenditures to local governments. We do not yet have data on expenditures of local governments to compare with the State or central government, but the little that we have seen is evidence that the spirit of local government has yet to be realized. Decentralization looks more apparent to be a function of the States’ requirement for fiscal adjustment than a response to demands for accountable and responsible government from communities.\textsuperscript{14}

\textsuperscript{13}It is hardly surprising, therefore, that poverty alleviation was made a condition for loans from the World Bank’s Public Sector Management (PSM) portfolio in only 10 countries. In contrast, expenditure reforms were the condition in 126 countries, streamlining budgetary processes and accounts in 42, and privatization and marketization in 43 (Bangura, 2000, p. 11).

\textsuperscript{14}On the contrary, Roy-Burman (1997) is of the opinion that GPs were ‘empowered’ by the Federal government as a ‘counterpoise’ to the growing influence of States. Jenkins (2002) supports this contention that the 73rd Amendment was introduced with the purpose to ‘recentralize’.
Contradictions emerge in ‘good governance’ discourse when the rights-obligation framework of Institutionalist Political Economy are invoked. Rights of citizens to state spending on provisioning goods in the social sector and of communities to access, control and manage resources for development are recognized (as the existence of policy points to). However, the government’s obligations are not practised, as decline in social-sector expenditure and self-reliance ratios indicate. Using an IPE approach persuades us to recognize that the Indian State consciously supports some reforms and shies away from others.

The role performed by the Indian state (in the face of stiff political opposition) in establishing private sector participation, user-charges and civil service reform, contributes to the perception that ‘good governance’ is institutionalized merely to narrow the fiscal deficit. The systematic cutbacks in public expenditure, especially developmental expenditure, is further indicative of the state attempting to rationalize spending. Good governance does not seem to translate into effective and efficient provisioning of social-sector goods and services such as health, education and rural development. Similarly, the slackness towards ensuring institutional arrangements conducive to strengthening local government, indicates that a good governance that contributes to empowerment of communities, measured by their ability to control and manage financial resources to meet the development agendas identified by these communities, may not be a priority.

From the trends, we realize that State and Federal governments enthusiastically rationalize public expenditure (mostly developmental expenditure) perhaps to repay multilateral debts, or perhaps simply to encourage private sector participation. However, they are not too enthusiastic about devolving revenue-raising powers or strengthening the institutional framework of decentralization, perhaps because any gains from that will not accrue to these State and Federal units. These contradictions emanate from the state’s attempt at political consent-creation to establish a specific economic mindset. What we see is not a rollback or minimalization of the state, rather a transformation in the very nature of its intervention. Faced with a transformative rather than a minimalist state, the practice of good governance appears more closely aligned with political economic techno-managerialism, rather than political economic populism.

5.2 Towards identifying institutions that matter

Trends in social-sector expenditures and experiences of decentralized governance persuade us to raise pertinent questions. For instance, what causes such a pattern of fiscal flows? Furthermore, what are the institutional implications of this type of flow?

To tackle the second query first, the scissors’ movement between spending on social services and economic services de-links social progress from economic development, as the case of Kerala shows. Furthermore, under-utilization of
budget and increase in non-development expenditure both indicate the stranglehold of bureaucracy, the rhetoric of state minimalization notwithstanding. Institutions in civil society, especially democratically elected local self-government institutions, and communities' assemblies such as the Gram Sabha, are inhibited by the absence of decision-making and resource-raising powers being vested upon them. When these democratically elected village-level institutions fail to deliver, due to them having little or no control over funds, resources and authority, the disillusionment with their lack of performance (which is easier to grasp than the causes for it) is exploited by the informal, 'traditional' and often undemocratic caste- and kinship-based institutions of the locality, village and hamlet. In a social milieu, as characterized by India's social and economic inequities, even democratically elected institutions become the stage for politicking along these 'traditionalist' factions. We recognize that politics is essential for a democracy to mature and that mature democracies may (need to) organize along ascriptive divisions so that hitherto marginalized groups may be politically empowered to be able to access socio-economic resources. But the splintering of politics along ascriptive competition for the sake of traditionally ascribed privileges is unhelpful, and indeed undesirable.

The trends in expenditure and decision-making flows that are taking place in India thus have a disempowering impact upon democratically elected local self-government institutions. After all, these are the only legitimizing instruments for such institutions, since ascriptive institutions would draw upon traditions and customary laws to buttress their socio-economic position.

But, more important is our first question: what are the reasons for such trends in India's public finance? What explains the specific contours that the concept of good governance has assumed in the light of the structural adjustment package? The answers to these questions need more in-depth study of the institutional political economy of the Indian State, with a focus on the national elites who are able to mould policy, either in conjunction with, or in opposition to, multilateral institutions.

Establishing a Ministry of Disinvestment and introducing a Bill on fiscal management have demonstrated the government's commitment to reform. However, even as the central and state governments make desperate (but sure) attempts to bridge the fiscal gap by instituting cutbacks in public expenditure (political opposition to which is not unsubstantial), they are unable to, or unwilling to, push through reforms in decentralization and community-level institution strengthening. It is clear through our analysis of expenditure patterns and decentralization that the States' expenditure on social-sector and rural development have not been enhanced neither have community-based self-government institutions been empowered (or created in the first place in some areas). To claim that there exists opposition within government is perhaps too simplistic, since there is likely to be
greater opposition to the right-sizing and privatization that is such a serious component of policy-making. Strengthening these institutions is possible through a state-led institutionalization that is sadly lacking.

However, to what extent the perusal of some reforms is caused by international pressures and to what extent by national actors remains a subject of detailed scrutiny. We have presented cursory evidence that can link debt situation with the need to cut expenditure. Yet, the fact that the debt situation is no longer as precarious (India’s Government proudly proclaims that it is a net aid-giver)—but the reforms are consistent—complicates this aspect of our case, and opens up further research avenues. Moreover, the analysis is constrained by lack of systematic comparison with the period prior to reforms and emergence of ‘good governance’ as a catchword. Such a comparative analysis will be crucial for a more elaborate criticism of the present conception of good governance.

The relationship of the good governance discourse with public finance in India emerges as fairly dialectical from our discussion. The need to ensure that property rights, contracts and investments are protected prompts support for government reform; procedural delays that obstruct these result in demands for complete restructuring, including reforms in the civil services and public sector. A clearer understanding of how articulation of frameworks, regulations and contracts reifies the concept of good governance will help us to present more fully the nature of this relationship, and its impact on democracy.

6. Conclusions

Through an analysis of government reform and public expenditure we have been able to identify certain trends in social-sector spending and unravel the nature of resources available to local self-government institutions for community-based development. The Indian experience of declining social-sector expenditures and self-reliance ratios demonstrates that some reforms are followed through more forcefully than others. When this is read alongside the market-friendly prescriptions for good governance by agencies such as the UN and Government of India, then we are tempted to explore linkages. However, at this stage, given the scanty material at our disposal, and the lack of space, we can only offer some directions for further investigation.

The discourse of good governance has been instrumental in introducing specific fiscal trends. But what cannot escape scrutiny is the limited and limiting scope of this discourse. The governance agenda comes across as top-driven, rather than a response to grassroots demands. The government’s commitment to social sector and people’s participation has to be demonstrated by both the nature of fiscal flows and the establishment of institutions conducive to community-level decision-making.
References


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