

Politics, Governance & Growth

MCRHRDI, Hyderabad
12th March, 2024

“The **purpose of a government** is to make it easy for people to do good and difficult to do evil.”

– *William Gladstone*

Core Functions of the State

Rule of Law

Public Order

Justice

Basic Amenities

Infrastructure

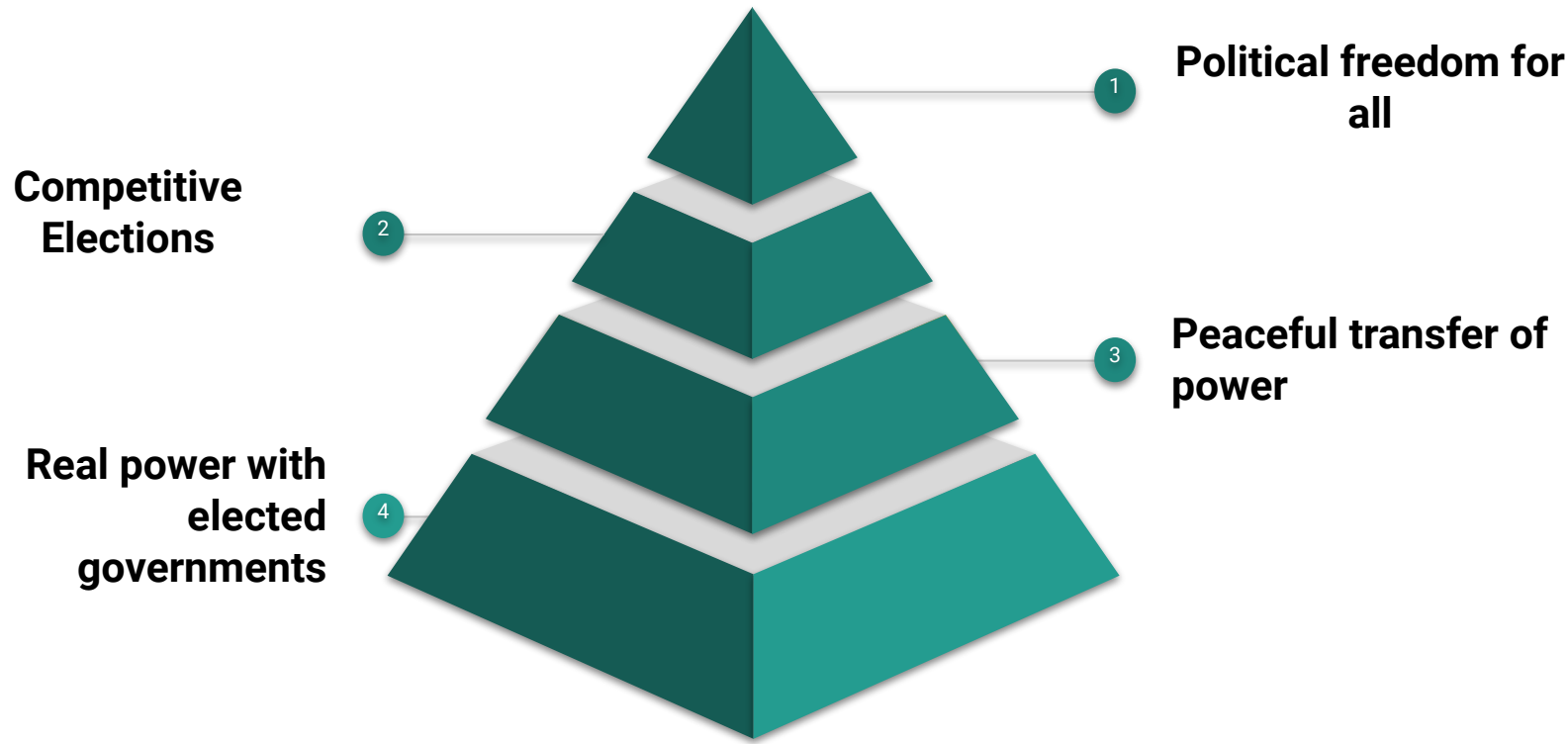
Education

Healthcare

**Sustainable
Natural Resource
Development**

Journey So Far: Significant Successes

A Functioning Democracy – Four Conditions by Myron Weiner



Successes of Indian Democracy

- *Peaceful integration of Princely States*
- *Deft handling of linguistic diversity*
- *True Federalism*
- *Regular elections and peaceful transfer of power*
- *Green Revolution and food security*
- *Fundamental Rights and Constitutional institutions that have stood the test of time*
- *Dismantling of the License-Permit-Quota raj and modest economic growth*
- *Preservation and strengthening of Unity - Order - Liberty*

Still a lot of angst..

Unfinished Tasks

**Third tier of
governance**

Rule of Law

Healthcare

**Agriculture
sector
reforms**

Urbanisation

**Civil service
reforms**

Education

**Service
delivery**

**Electoral
reforms**

**Political
reforms**

**Sound public
finance**

Infrastructure

Comparison of Various Development Indicators Among 56 Large Economies											
Rank	GDP Per Capita 2022	Life Expectancy at birth (2022)	IMR (2021)	MMR (2020)	Out-of-Pocket Expenditure on Healthcare (2019)	EYS (Expected Years of Schooling, 2019)	MYS (Mean Years of Schooling, 2020)	HDI (Human Development Index, 2022)	Power Consumption (Kwh Per capita, 2019)	Employment in Agriculture (% of total employment, (2021)	LFPR (Labor Force Participation Rate - female, 2022)
1	Norway	Hong Kong	Hong Kong	Norway	South Africa	Australia	Ireland	Switzerland	Norway	Hong Kong	Vietnam
2	Ireland	Japan	Norway-	Poland	Thailand	New Zealand	South Korea	Norway	Qatar	Singapore	New Zealand
3	Switzerland	Australia	Sweden	Czechia	France	Greece	United States	Hong Kong	Sweden	Israel	Peru
4	Qatar	Switzerland	Finland	Spain	Netherlands	Belgium	Germany	Australia	Canada	Belgium	Singapore
5	Singapore	South Korea	Singapore	Israel	Cuba	Sweden	Singapore	Denmark	UAE	United Kingdom	Qatar
6	United States	Norway	Japan	Australia	United States	Finland	Switzerland	Sweden	Finland	Qatar	Sweden
7	Denmark	Spain	Italy	Hong Kong	Ireland	Ireland	Australia	Ireland	United States	Germany	Kazakhstan
8	Australia	Sweden	Czechia	Germany	New Zealand	Denmark	Canada	Germany	Taiwan	Canada	Norway-
9	Netherlands	Italy	Switzerland	Netherlands	Qatar	Netherlands	Czechia	Netherlands	South Korea	United States	Switzerland
10	Sweden	Singapore	Australia	Japan	UAE	Turkey	United Kingdom	Finland	Saudi Arabia	UAE	Australia
11	Canada	Canada	Denmark	Italy	Germany	Norway	Hong Kong	Taiwan	Australia	Sweden	Netherlands
12	Israel	France	Ireland	Austria	Japan	Spain	Japan	Singapore	Singapore	Denmark	Canada
13	UAE	New Zealand	Germany	Belgium	Norway	Argentina	Taiwan	Belgium	France	Switzerland	Israel
14	Austria	Israel	Belgium	Ireland	Sweden	United Kingdom	Norway	New Zealand	Belgium	Netherlands	China
15	Finland	Finland	Korea, rep	Denmark	Czechia	Hong Kong	Israel	Canada	New Zealand	Norway	Thailand
16	Belgium	Ireland	Israel	Sweden	Denmark	Germany	Poland	United Kingdom	Israel	Australia	Denmark
17	Hong kong	Belgium	Austria	Switzerland	Colombia	Portugal	Malaysia	Japan	Japan	France	Ireland
18	Germany	Netherlands	France	New Zealand	Canada	Chile	Sweden	Korea, rep	Czechia	Czechia	United Kingdom
19	New Zealand	Austria	Greece	Singapore	Australia	Singapore	France	United States	Russia	Saudi Arabia	Finland
20	United Kingdom	Denmark	Portugal	Finland	Saudi Arabia	South Korea	Greece	Israel	Austria	Japan	Austria
21	France	Taiwan	Spain	France	Turkey	Switzerland	Netherlands	Austria	Switzerland	Austria	Germany
22	Italy	Portugal	Taiwan	Greece	United Kingdom	Canada	Kazakhstan	UAE	Netherlands	Italy	United States
23	Taiwan	United Kingdom	Netherlands	Qatar	Finland	United States	Denmark	Spain	Germany	Spain	Russia
24	Japan	Germany	New Zealand	UAE	Belgium	Italy	Cuba	France	Ireland	Finland	Korea, rep
25	Korea,rep	Greece	Canada	United Kingdom	Romania	Czechia	Russia	Italy	China	Ireland	Portugal
26	Saudi Arabia	Qatar	United Kingdom	Romania	Austria	Saudi Arabia	Belgium	Czechia	Kazakhstan	Portugal	Japan
27	Spain	Chile	Poland	Canada	Poland	Israel	Italy	Greece	Spain	South Korea	UAE
28	Czechia	Thailand	Russia	Portugal	Israel	Poland	Spain	Poland	Denmark	Russia	Brazil

Comparison of Various Development Indicators Among 56 Large Economies											
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29	Portugal	UAE	Cuba	Kazakhstan	Spain	Austria	Romania	Saudi Arabia	Greece	New Zealand	Hong Kong
30	Greece	China	United States	Taiwan	Italy	Thailand	Nigeria	Portugal	Malaysia	Chile	Spain
31	Poland	Czechia	UAE	Russia	Brazil	France	Finland	Chile	Italy	Argentina	France
32	Romania	United States	Qatar	Chile	Switzerland	Russia	New Zealand	Qatar	Portugal	Taiwan	Indonesia
33	Chile	Saudi Arabia	Romania	Saudi Arabia	Argentina	Kazakhstan	Chile	Argentina	Hong Kong	Poland	Czechia
34	Russia	Poland	China	Egypt	Peru	UAE	South Africa	Turkiye	Poland	Malaysia	Malaysia
35	Argentina	Turkey	Saudi Arabia	Turkiye	Taiwan	Brazil	Austria	Russia	United Kingdom	Brazil	Nigeria
36	China	Argentina	Chile	United States	Hong Kong	Peru	Colombia	Romania	Chile	Greece	Belgium
37	Malaysia	Malaysia	Argentina	Malaysia	Singapore	Japan	Mexico	Kazakhstan	Turkey	Mexico	Poland
38	Mexico	Romania	Malaysia	Iran	South Korea	Mexico	Peru	Malaysia	Iran	Kazakhstan	Colombia
39	Kazakhstan	Iran	Thailand	China	Portugal	Iran	Argentina	Thailand	South Africa	Colombia	South Africa
40	Turkiye	Cuba	Turkiye	Thailand	Chile	Cuba	Saudi Arabia	Iran	Argentina	Iran	Chile
41	Cuba	Vietnam	Kazakhstan	Cuba	Kazakhstan	Colombia	Iran	China	Brazil	Turkey	Argentina
42	Brazil	Colombia	Iran	Argentina	Malaysia	China	UAE	Cuba	Romania	Cuba	Mexico
43	Peru	Brazil	Peru	Vietnam	Indonesia	Romania	Portugal	Peru	Mexico	Romania	Philippines
44	Thailand	Bangladesh	Mexico	Mexico	Greece	Taiwan	Philippines	Mexico	Thailand	Iraq	Taiwan
45	South Africa	Peru	Colombia	Peru	China	Egypt	Thailand	Brazil	Vietnam	Egypt	Greece
46	Colombia	Iraq	Brazil	Brazil	Russia	Indonesia	Indonesia	Colombia	Iraq	South Africa	Romania
47	Iraq	Egypt	Egypt	Colombia	Iran	South Africa	China	Egypt	Egypt	Philippines	Italy
48	Indonesia	Mexico	Vietnam	Iraq	Mexico	Malaysia	Qatar	South Africa	Cuba	China	Cuba
49	Iran	Russia	Indonesia	Philippines	Vietnam	Philippines	Turkey	Indonesia	Peru	Peru	Bangladesh
50	Egypt	Kazakhstan	Philippines	India	Philippines	Vietnam	Vietnam	Vietnam	Colombia	Indonesia	Turkiye
51	Vietnam	Philippines	Iraq	Korea, rep	Iraq	Qatar	Iraq	Philippines	India	Vietnam	Saudi Arabia
52	Philippines	Indonesia	Bangladesh	Bangladesh	Pakistan	Bangladesh	Egypt	Iraq	Indonesia	Thailand	India
53	Bangladesh	India	South Africa	South Africa	India	Iraq	Brazil	Bangladesh	Philippines	Nigeria	Pakistan
54	India	Pakistan	India	Pakistan	Egypt	India	India	India	Pakistan	Bangladesh	Egypt
55	Nigeria	South Africa	Pakistan	Indonesia	Nigeria	Nigeria	Bangladesh	Pakistan	Bangladesh	Pakistan	Iran
56	Pakistan	Nigeria	Nigeria	Nigeria	Bangladesh	Pakistan	Pakistan	Nigeria	Nigeria	India	Iraq

- **Inefficient** state apparatus →
 - Substandard **public amenities**
 - **No decent education** in government schools
- Red Tapism & **unresponsive** bureaucracy →
 - **Poor health care**
 - All **pervasive corruption**
- Failure of **Rule of Law** →
 - **Criminalisation** of Politics
- **Money & muscle-power** in elections
 - Vicious **cycle of corruption**
 - Even honest public servants are **passive and helpless**

Positive power restricted — Negative power unchecked

A system of alibis — Victims of a vicious cycle

Change of players — No change in the rules of the game

***Political process ought to be the solution;
But has become the **problem** itself***

Political Crisis in India: Interlocking Vicious Cycles

Inexhaustible demand for illegitimate funds

Direct and indirect cost of political activity driven up by informal political machinery

Most expenditure incurred for vote buying

Poor service delivery and vote delinked from consequence

Rise of political fiefdoms

Entry barriers as money, caste and local clout become critical

Vote delinked from public good

Centralised polity drives voter to maximise short-term gain

Taxes delinked from services

Deeper fiscal crisis as raising taxes or de-subsidizing or reducing public sector wages is disincentivized

Political survival and honesty incompatible

Dependence on legislator support for survival makes corruption and misgovernance endemic

Social divisions are exacerbated

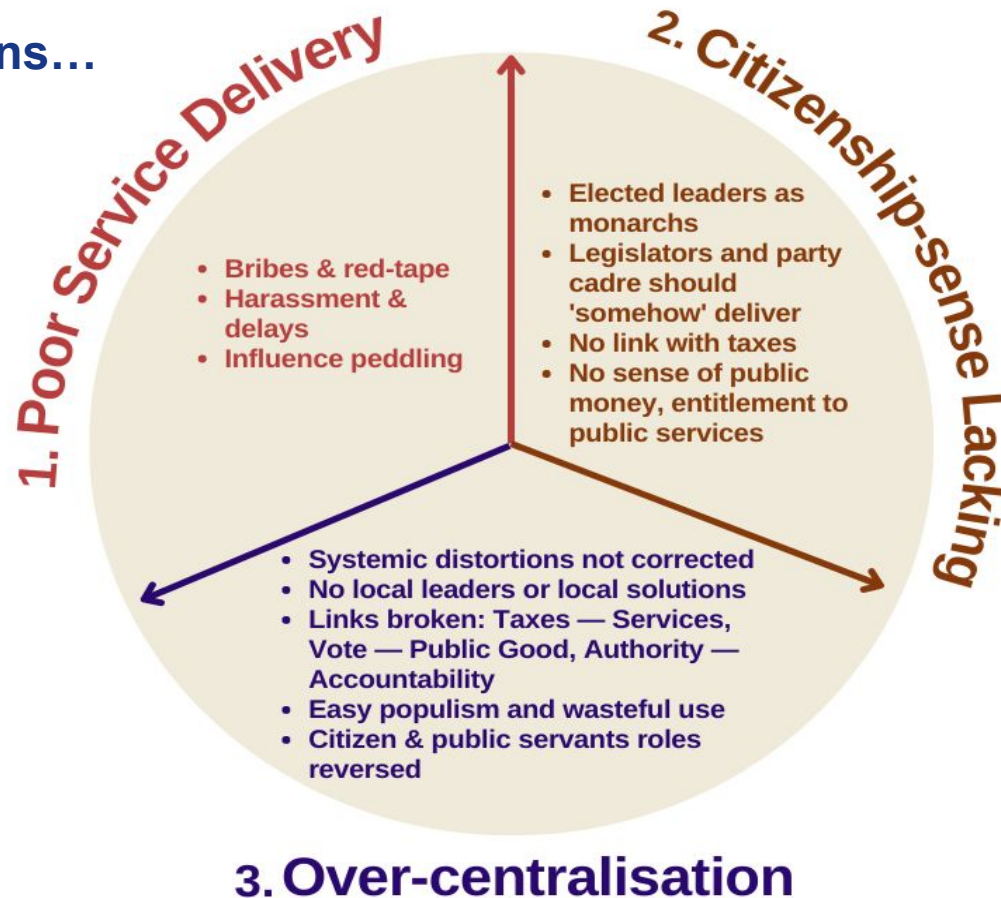
Vote bank politics – marginalisation and ghettoisation based on primordial loyalties

Competence & integrity excluded

Need for money & caste-clout excludes competent elements from public policy & governance

How did we get here?

The initial conditions...



How did we get here?

& choices made at the time of independence...

**System of Rule of
Law**

Weak instruments

**First-past-the-post
System**

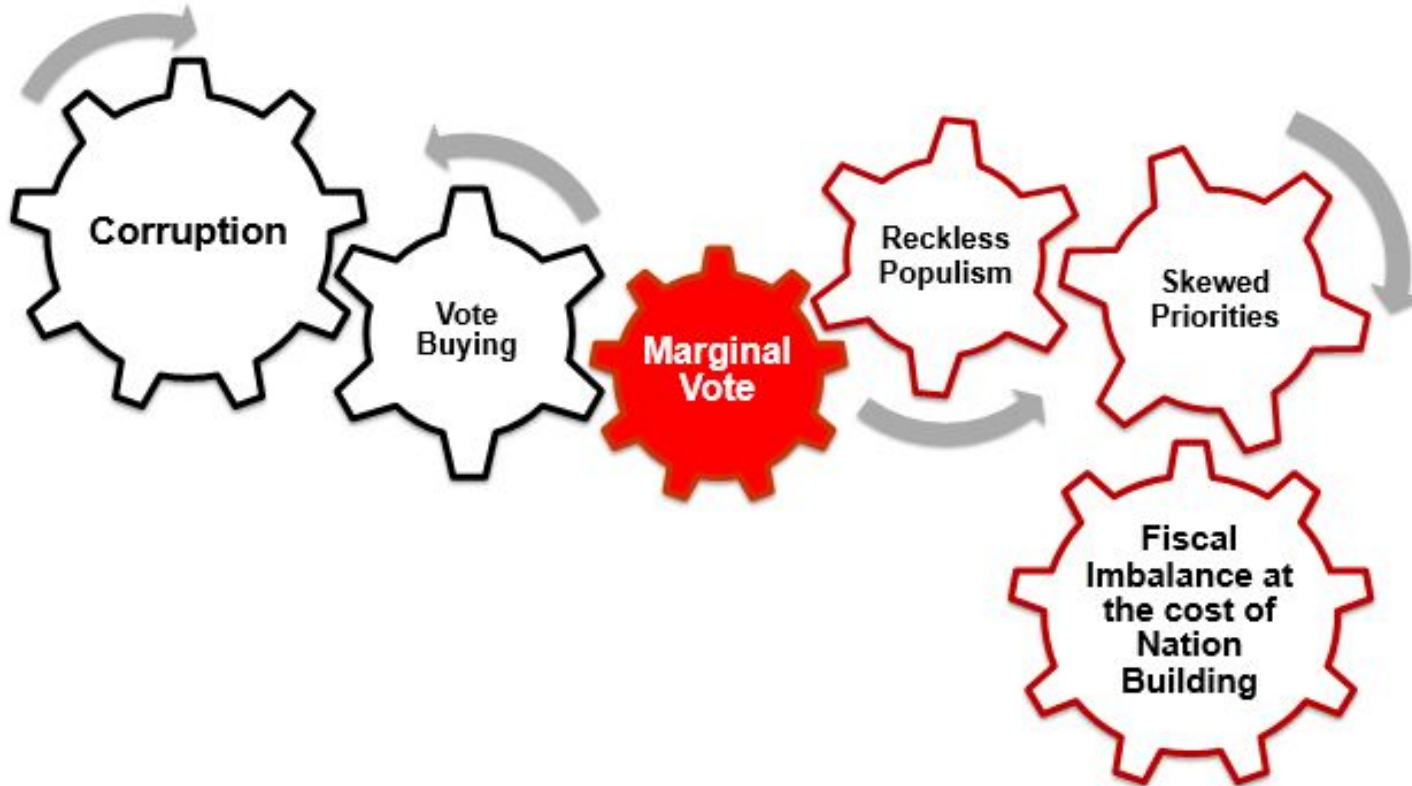
**Unsuitable for poor
societies**

**Economic
Socialism**

**Embracing state
monopoly**

**The challenge then is to alter incentives
to alter behaviour...**

Consequences of **Marginal Vote** in the Current System



Altering Incentives – Proportional Representation

First-past-the-post (FPTP) system

Winner-take-all system

Leading to **divisiveness** and **political fragmentation**

Dominance of zero-sum-game issues like *reservations*

Vs.

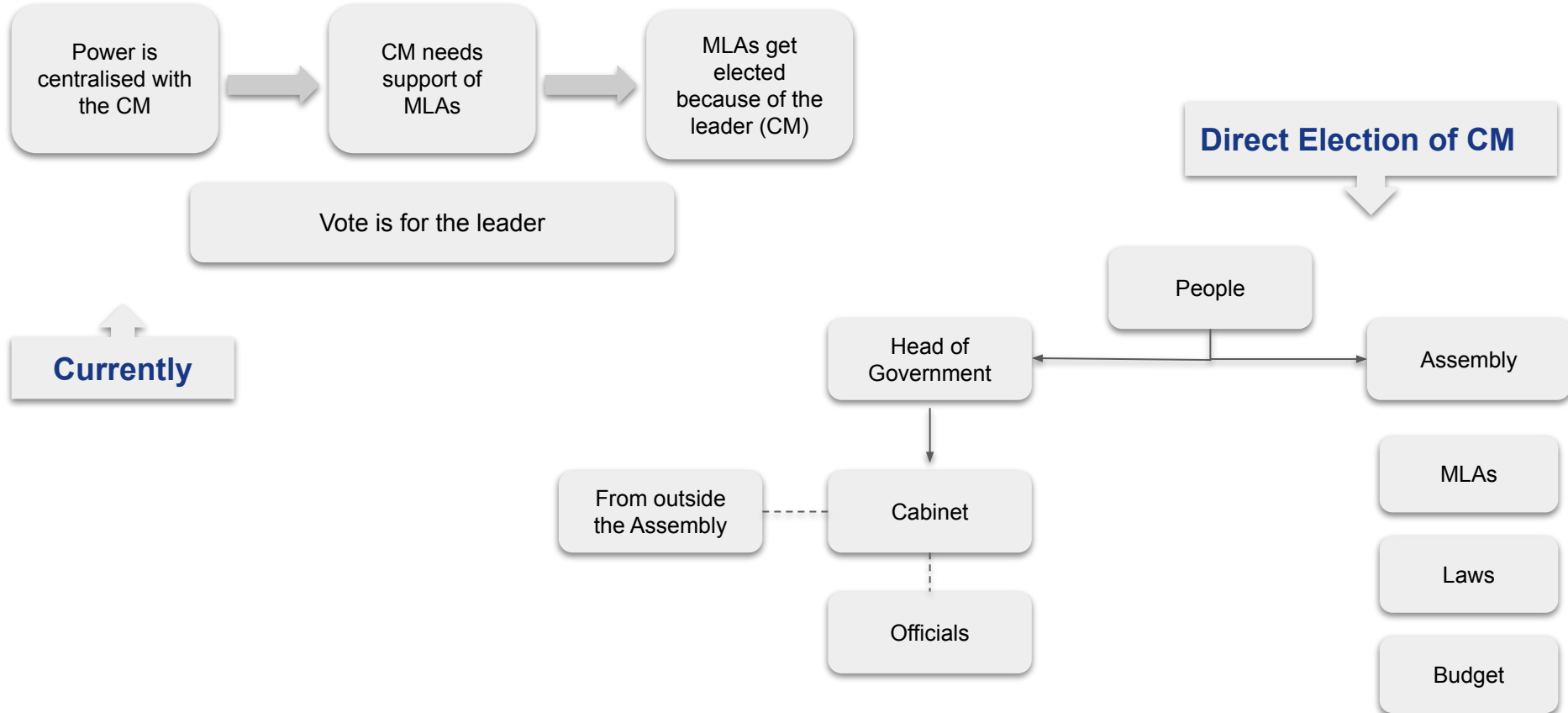
Proportional Representation

Marginal vote no longer all-important – no incentive to buy votes

Reduction in **competitive populism**
Political fiefdoms will disappear

Representation to small parties, scattered minorities and legitimate reform groups, not money power

Altering Incentives – Separation of Powers



How will Direct Election of the CM help?

From a vicious cycle to a virtuous cycle...

- **Stability of government** is assured as it is not dependent on MLAs' support
- Executive is **free from vested interests**; no scope for interference in general governance by MLAs
- Can appoint **competent ministers** from a wide pool, excluding legislators
- **Increased democratisation** as tenure of a Chief Minister can be limited to two terms
- **Local governments** can be strengthened
- **Illegitimate expenditure** during election will come down
- Appeal of the MLA office will fade.
 - MLA has **no 'disguised executive' role**; political fiefdoms become irrelevant
 - Those with merit and ambition will become **leaders in the local governments**

Emerging **fault lines** in electoral politics

- The most important faultline ***emerging*** in our electoral politics is **long-term growth vs individual, short-term welfare measures (ISW)**.
- In a country with large numbers of poor, **ISW has a strong political appeal**. Even in wealthy, mature democracies voters are attracted to ISW. Hence, challenge is to **balance ISW and pro-growth expenditure in a manner that the public finances remain healthy and economic growth prospects are not hindered**.
- A frontal clash between ISW and growth may be **counterproductive**.

Why growth matters?

- The difference between sustained 7% growth rate versus 8% growth rate over ten years for an economy of India's size would mean **a difference in GDP of \$600 billion or about Rs. 50,00,000 crores of GDP lost per year after 10 years.**
- Our Tax-to-GDP ratio is about 18-19%, this implies that the **Union and states lose over Rs. 9 lakh crores revenue every year**, which could have been deployed for more ISW promoting welfare, and better infrastructure to promote further higher growth and employment.
- Hence, to ensure the right **balance** between short-term welfare and long-term growth, a **minimalistic, pragmatic framework** is vital to preserve the growth momentum of the economy
- However, **fiscal profligacy** has gripped various states and the situation is **alarming!**

Telangana:

The projected additional expenditure on electoral promises, including guarantees, is approximately ₹ **1.2-1.3 lakh crore annually.**

Recurring Annual Expenditure	~ ₹ 60,000 crore
Farm Loan Waiver	~ ₹ 10,000 crore
₹ 12 lakh each to SC/ST households	~ ₹ 2.7 lakh crore over a period of five years

Constituting **60% of the projected State's revenue (FY 2023-24)**, this additional expenditure, when added to current spending, drives **overall cost to unsustainable levels.**

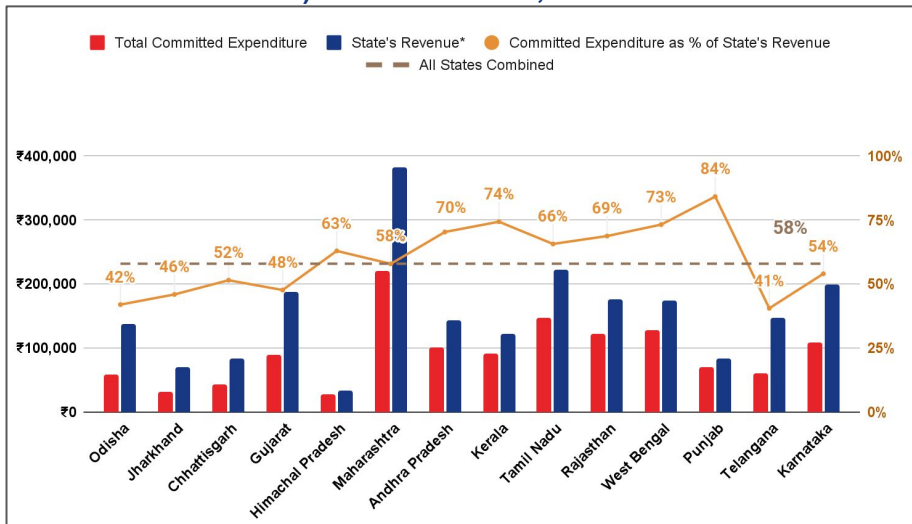
Karnataka:

The estimated annual expenditure of electoral guarantees stands at
~ ₹ 52,000 crore, of which ₹ 39,825 crore has **been earmarked for the current year** (July 2023 - March 2024).

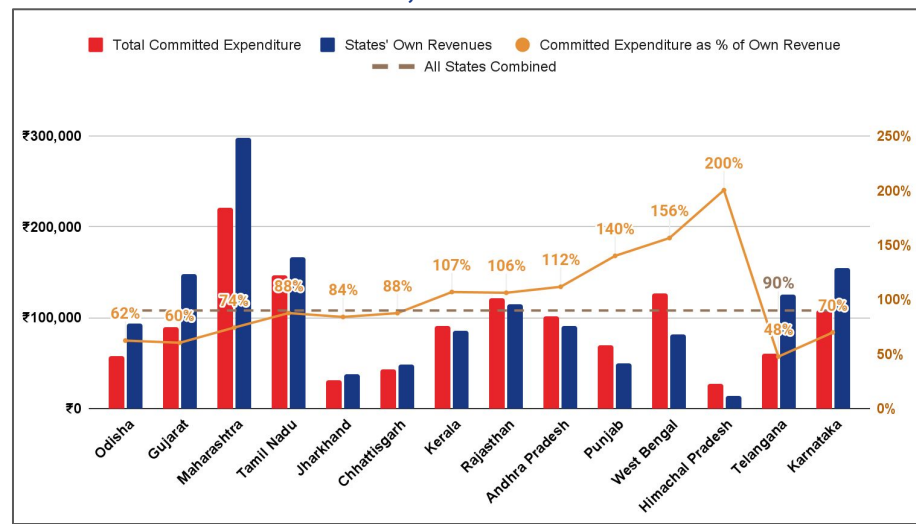
The current year's expenditure accounts for **16.7% of the projected State's revenue** (FY 2023-24).

High Committed Expenditures*

Committed Expenditure vs. States' Revenues (including Transfers) in Select States, FY 2022-23 RE



Committed Expenditure vs. States' Own Revenues in Select States, FY 2022-23 RE



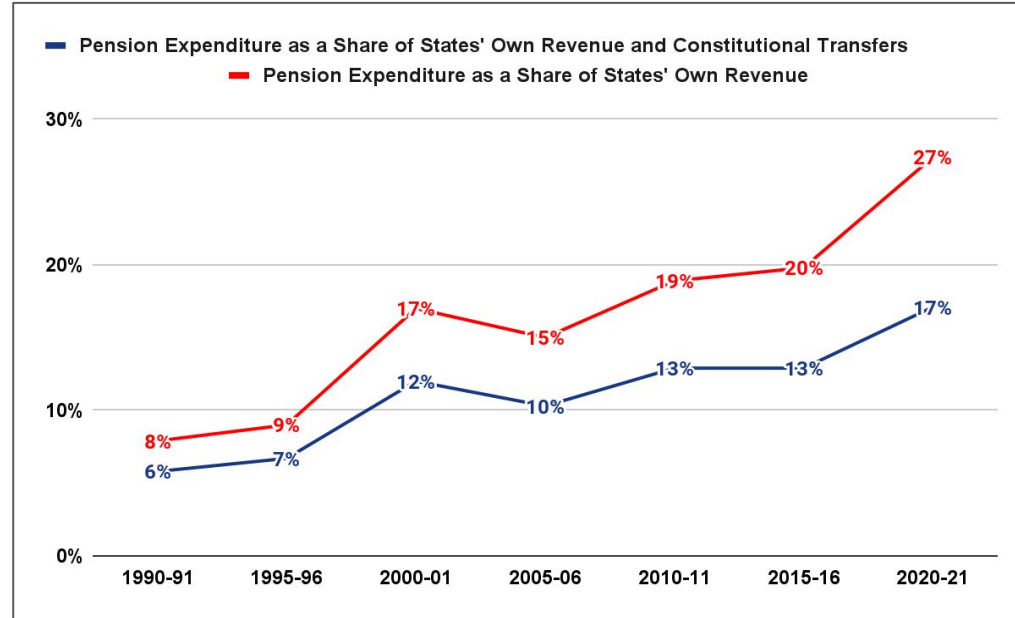
Committed expenditure accounts for **58%** of **total revenues of states including Union transfers**, and **90%** of the **states' own revenue receipts**, leaving little room for core governance functions

*committed expenditure includes salaries & wages, pensions and interest payments

Rising Pension Burden

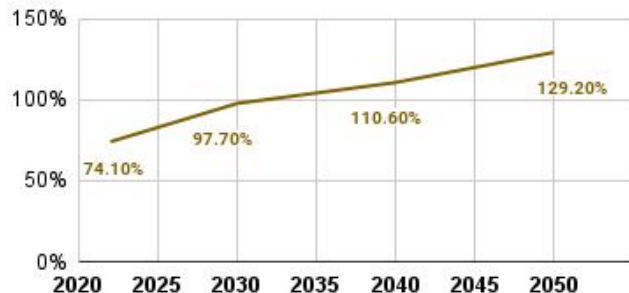
- The pension liability of state governments has more than **trebled in three decades from FY1991 to FY21**, which is **17% as a share of all state revenue receipts**, and **27% of own tax revenues of states (FY 2021)**.
- Currently, 18% of the Government Revenue is spent by the government, union and states combined, on pensions to its employees only, whereas the developed countries like USA spend around **~15% of its Government Revenue on Social Security** for *all workers* in the public and private sectors and it is **contributory**.

Pension Expenditure of All States as a Share of Revenues

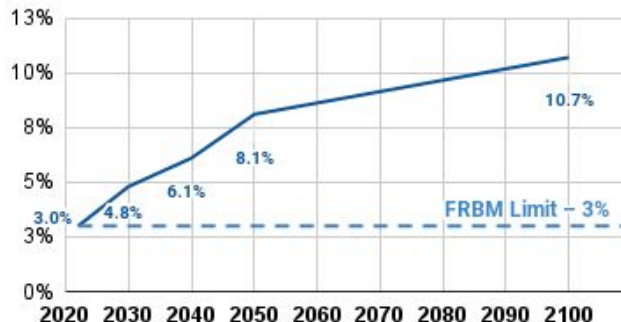


Horrendous Price with Old Pension Scheme

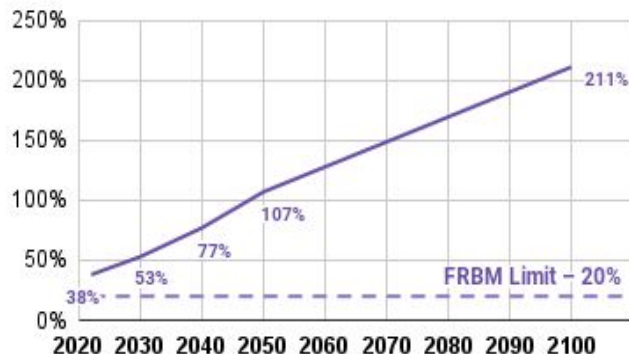
Salaries & Pensions as a Share of State's Own Revenues



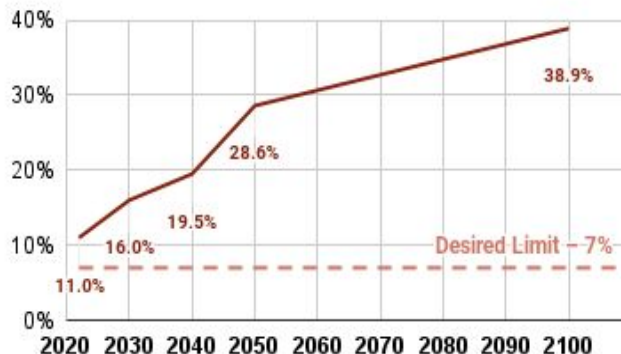
Fiscal Deficit



Debt-GSDP Ratio



Pension Burden as a % of Revenue Receipts



Andhra Pradesh's projections of key fiscal indicators upon reverting to Old Pension Scheme (OPS)

Chattisgarh, Punjab, Rajasthan, Himachal Pradesh, Jharkhand have gone back to OPS. West Bengal did not join the NPS.

Rising Debt Burden of States

Debt Burden of Select States

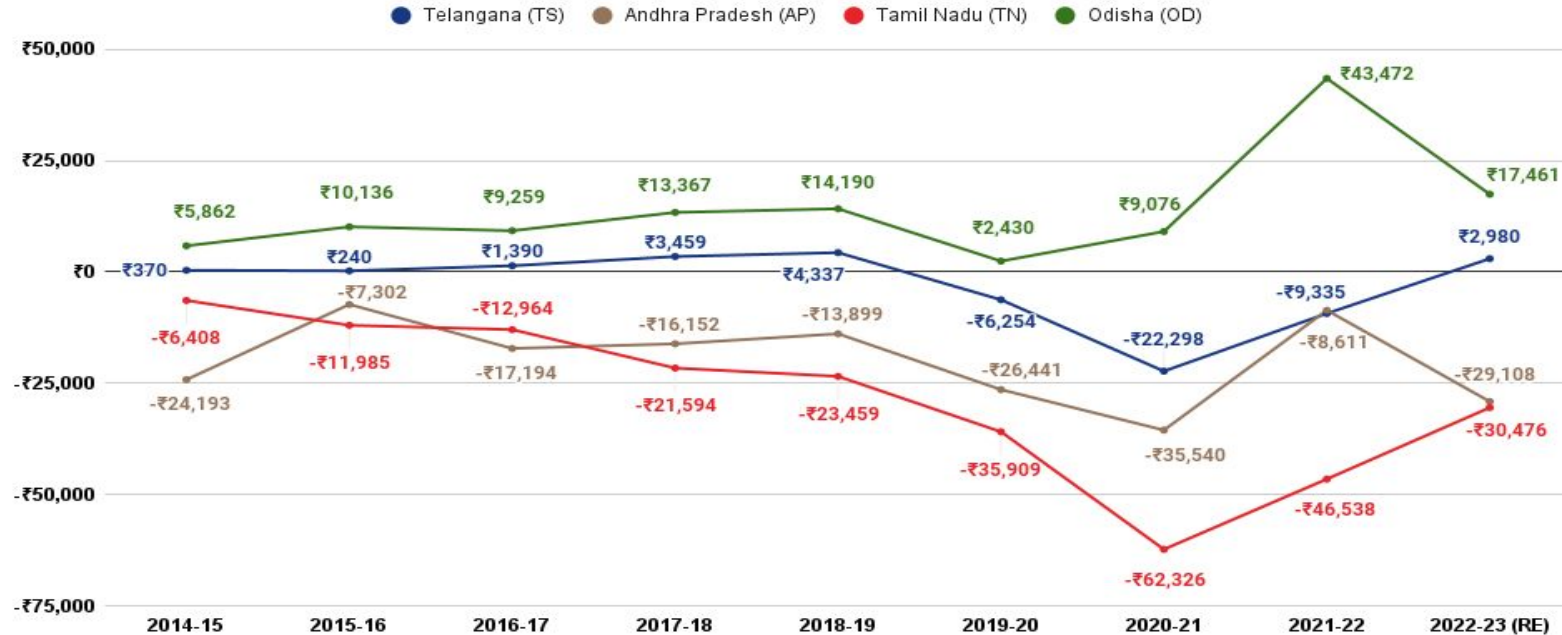
State	Outstanding Liabilities (2022) (Rs. Crores)	Government Guarantees* (Rs. Crores)	GSDP at Nominal prices (2021-22) (Rs. Crores)	Outstanding Liabilities to GSDP (exclusive of Government guarantees) (in %)	Total Liabilities to GSDP (inclusive of Government Guarantees) (in %)
Andhra Pradesh	398904	117503	1201736	33.19	42.97
Telangana	312191	135283	1148115	27.19	38.97
Tamil Nadu	659869	91818	2065436	31.95	36.39
Punjab	282865	22261	584042	48.43	52.24
Rajasthan	477177	84896	1196137	39.89	46.99
Kerala	335989	31714	901998	37.25	40.77
Uttar Pradesh	653308	153836	1863221	35.06	43.32
Madhya Pradesh	317737	34992	1169004	27.18	30.17
Odisha	167206	7068	642087	26.04	27.14
Himachal Pradesh	74686	1880	175173	42.64	43.71
Chhattisgarh**	114201	19611	400061	28.54	33.44
Jharkhand	117790	1553	343178	34.32	34.77
West Bengal***	528833	6593	1536681	34.41	34.84

GSDP: Gross State Domestic Product

- The **real debt-GDP ratio of States**, including off-budget borrowings, is of the order of **34%** by end of fiscal year 2022-23.
- There are instances of **repeated deferrals and postponements of bills** in States to the order of tens or thousand of crores, putting the actual liabilities of States at an even higher level.

From Surplus to Deficit: Impact of Populist, Unviable Projects

Revenue Balance over the Years of Select States – TS, AP, TN & OD (₹ Crore)



- Once a top-ranking state with the highest revenue surplus, **Telangana** slipped into a revenue deficit position due to the implementation of **populist projects**.
- Odisha**, a relatively less developed state, has consistently generated healthy revenue surpluses, showcasing that **balancing** political stability, electoral viability, and healthy public finances is possible.

- Sound Fiscal policies and good health of public finances are not necessarily politically costly. The governing party in Odisha has been politically stable and popular, consistently winning elections since 2000.

- **Telangana** - highest surplus resources of Rs 1,18,000 crores between 2014-15 and 2019-20 - **but** revenue deficit of Rs 22,298 crores in 2020-21
- **Andhra Pradesh** - suffered on account of loss of revenue from Hyderabad with the division of state - started with revenue deficit - **but** mounted substantially despite support of Union government
- **Tamil Nadu** - prosperous state with high degree of urbanisation - **but** fiscal profligacy in the form of ISWs and relatively low revenue mobilisation - so high revenue deficits
- **Odisha** - less developed state with low per capita income, low urbanisation - **but healthy revenue surpluses**

- Ensuring **zero Revenue Deficits** - curb borrowing for current expenditures
Realistic that all states can meet a zero revenue deficit target within 1-3 years, but the **Union may need upto 5 years on account of its structural deficit**
- **Articles 293(3)** - union's consent required for states to borrow and **Article 293(4)** - union to impose conditions for granting consent
 - States should be required to meet and **maintain zero revenue deficit targets and later revenue surplus targets under Article 293(4) as a condition** for consent to borrow.
 - In case of states shifting to OPS, establishing a **sinking fund** to provide for government pensions should be mandatory.
- **Independent, credible institution to exercise functions under Article 293(3)** given the political sensitivity of the issue.

Can be entrusted to **Finance Commission** making it a **permanent body under Article 280** or establishing a **Fiscal Council** as recommended by FRBM Review Committee headed by N K Singh

- **Discontinuation of Revenue Deficit Grants** by the Finance Commission

- UK's **Office for Budget Responsibility (OBR)** like body for independent, accurate and credible analysis, forecasts and costings of government's fiscal policies and programmes.
An equivalent body can be created under **the Comptroller and Auditor General (C&AG) under Article 150.**
- The Office of C&AG should be empowered to **seek data on public debt of the state and its agencies from public and private banks**, and it must be made **mandatory** that the said data be made available to the C&AG.
- In case of large capital expenditure, there should be a proper **cost-benefit analysis and approval of loans should be contingent upon reasonable returns or benefits from investments**, as per the conditions imposed under **Article 293(4).**

Governance For Growth

Economic Management

Fiscal Prudence & Capital Expenditure

Decentralised Development

Small Town Development

Capacity Building

Healthcare, Education & Skills

Agricultural Transformation

Liberalisation & Modernisation

Rule of Law

Contract enforcement, speedy resolution & property rights

“Never doubt that a small group of thoughtful, committed citizens can change the world. Indeed, it’s the only thing that ever has.”

– *Margaret Mead*