Reforming India's Institutions of Public Expenditure Governance*

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Revised October 2013

Abstract

The poor quality and effectiveness of much of government expenditure in India makes it important to analyze ways of improving effectiveness through institutional reform. Improvements in outcomes include better targeting of redistributive measures and more efficient spending on productive projects. Four potential areas of institutional reform are: (1) improved functioning of individual ministries and departments, at the central and state levels; (2) better coordination across individual ministries and between the center and states, through reform of the Planning Commission; (3) reassignment of expenditure responsibilities across levels of government (center to state and/or state to local); and (4) reassignment of tax authorities to provide improved incentives for expenditure governance through electoral accountability. The paper will discuss each of these four areas of potential institutional reforms, their likely impacts, and possibilities for implementing change.

* This is a revised version of a paper presented at a conference on India's State Institutions, at the Rockefeller Center, Bellagio, Italy. I am grateful to Devesh Kapur, and T.V. Somanathan for helpful discussions on an earlier version, and conference participants for additional comments. They are absolved of responsibility for shortcomings in the paper.

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1. Introduction

From the time of independence, the majority of India's political leaders have conceived of a significant role for government in promoting economic growth, as well as for fostering development more broadly. This has translated into an active role in regulating private sector economic activity, as well as direct government participation in many aspects of the economy, including production, distribution and finance, that might otherwise be performed by the private sector. The case for this degree of government control of the economy was built on a mix of conceptual and empirical foundations, including ideas of market failure (especially coordination failures but also inefficiencies and inequities created by private sector monopolies) and the apparently successful example of Soviet-style central planning. In 1947, government-led modernization of India's economy (and its society as well) was by no means an implausible path.

India's own experience and global events combined to lead to a reorientation of economic policy thinking, and, certainly from 1991, if not somewhat earlier, the government has embarked on a slow and fitful process of removing some constraints on private sector economic activity, as well as opening the economy to the rest of the world. The precise nature, timing and impact of this historical shift are still being debated. Even without definitive answers to questions about past experience, there is also a vigorous debate on the appropriate role of government in the economy going forward – here we are focusing on India, but there are similar debates across the globe.

At one level, there is now greater conceptual clarity than before about the role of government, in the sense that theoretical advances in economics and related disciplines have given us a better understanding of the working of markets, and the sources of market failure. In addition to classic arguments for government action based on the existence of public goods and externalities, there are also justifications based on the presence of asymmetries in information, and of incentives for strategic behavior. While these theoretical arguments provide a richer rationale for government intervention in the workings of the economy, they also introduce complexities that make it harder to assess the empirical experience of the past, and also to design effective future policies. On the latter front, in particular, paying attention to information and incentives raises issues of institutional design – the government is no longer a unitary, wise and benevolent ruler, but a complicated amalgam of rules, norms, individuals and motivations.[1]

[1] In fact, foregrounding the role of institutions extends to the design of market institutions (e.g., stock markets, auction markets) as well, and to the structure of private sector organizations, ranging from conventional for-profit corporations to a diversity of non-profits, cooperatives and voluntary organizations. Institutions have been given

In the Indian case, one can elucidate several facets of the current debates about economic policy. One continuing strand of argument (e.g., Bhagwati and Panagariya, 2013) is that the government needs to continue giving more space to the market in order to promote economic growth and employment generation. A different line of argument, quite widely held in India (e.g., Drèze and Sen, 2013), is that the government has retreated from its proper task of providing relief to those citizens who are deprived in essential ways – whether it is food, health care, education, livelihoods or general purchasing power. These two perspectives are not polar opposites: the real issues, often not clearly surfaced, have to do with the trade-offs that exist and that policy makers are willing to make with respect to economic growth and equality, growth and broader measures of well-being, and short-run versus medium- or long-run gains in the different dimensions of positive achievement. Disagreements about trade-offs can be positive in nature (e.g., what are the trade-offs in practice) or normative (e.g., what are the best choices along a frontier of possible combinations of growth and equality).

There is a more basic question, however, that transcends these debates about Indian economic policy making. Whatever the government does, or should do, how can it do those things better? This general question then translates into specific issues of institutional design. Of course, one cannot address institutional design of government completely independently of considerations of objectives and trade-offs. For example, how one envisages the proper role of government in providing higher education will have implications for how the education ministry or relevant department is organized, what kinds of skill sets are needed by the relevant government employees, and so on. Nevertheless, some questions of institutional design can be posed where the premises and the answers will be agreeable to a wide spectrum of opinion. For example, if there is a broad consensus that some primary health care should be directly provided by the government, though there may be differences of opinion with respect to its proper scope, there should be broad agreement that doctors who are government employees should work the hours they are paid for, in the location they are expected to serve. An institutional reform that achieves this better than the current situation (at appropriate cost and without other negative consequences) should also therefore find broad support.

Accordingly, our focus partially transcends some of the debates about the precise role of government.[2] The question we pose is even narrower than "how can the government be better at doing what it does?" Instead, we ask, "how can the government spend its money to achieve its desired results better?" This excludes many important issues of regulation – regulation does

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more attention in recent empirical attempts to explain the history of economic development and growth as well, going beyond earlier emphases on property rights, to encompass other measures of institutional quality. For a discussion of the Indian case in this context, see Singh (2004).

[2] Those questions will inevitably be in the background: in particular, our presumption is that the government has a role to play in the economy that consists of enabling markets, regulating markets and directly making up for their deficiencies, and therefore institutional reforms should be prioritized based on the "proper" role of government.

involve government expenditure, but the amounts are trivial compared to spending on salaries for large numbers of government employees, transfer payments, spending on delivery of health and education, and spending on various kinds of public infrastructure.

So far, we have spoken of "government" as a unified, somewhat abstract entity, but as was indicated earlier in this introduction, government is a complex, multi-faceted institution. To understand its working and the potential for reform, one has to unpack "government." Three important aspects of this unpacking are (1) the horizontal divisions of government across functional responsibilities (external affairs, home affairs, agriculture, industry, health, education, and so on), (2) the structures of the bureaucracy, i.e., the individuals whose careers are bound up with carrying out the functions of government, and (3) the vertical division of government across different jurisdictions (national, state and local in the case of India). In thinking about institutional reform of government, it is natural to focus on the first two of these dimensions, since the third in some ways simply acknowledges that those issues of internal organization have to be addressed at multiple levels of jurisdiction. However, one of the main arguments of this paper will be that paying close attention to this third dimension is crucial in improving the efficacy of public expenditure in India.

To understand how the government can spend its money better, we therefore consider four potential areas of institutional reform. First, we examine possibilities for the improved functioning of individual ministries and departments, at the central and state levels. The answer here is not surprising, having to do with basic improvements in information gathering, decision making, and so on, but also with some consideration of structural changes in the bureaucracy. In some ways, this is a relatively generic prescription, and the stuff of detailed discussions of public financial management.

The second area is the possibility of better coordination across individual ministries and between the center and states, through reform of the central Planning Commission. The Planning Commission, as it operates in India, is quite specific to that country, in its history and evolution, and so the treatment here is more country-specific than the first issue. Our discussion will be somewhat tentative, given the idiosyncratic nature of the institution. However, we will argue that political realities limit the coordination possibilities that the Planning Commission can achieve, but that it can, nevertheless, make a positive difference with the help of some institutional reform.

The third area for institutional reform is more significant, being structural in nature: the possible reassignment of expenditure responsibilities across levels of government. In particular, we argue for reassignment of responsibilities downward, from center to state and state to local governments. Formal expenditure responsibilities are broadly determined by the Union, State and Concurrent lists in the Indian Constitution, and for local governments by schedules introduced by the 73rd and 74th amendments that strengthened the status of the local government level. Arguably, de facto expenditure authorities do not match these constitutional assignments, being effectively much more centralized, and we discuss this issue.

Finally, we discuss and argue for a complementary reform to the decentralization of expenditure responsibilities, namely a reassignment of tax authorities that better aligns with those expenditure requirements. We argue that this will provide improved incentives for expenditure governance through electoral accountability. As noted earlier, changes in assignments across levels of government also require internal reforms at each level, but we wish to make the case that internal reforms are more likely to be successful when there is pressure that comes from better assignments of expenditure and revenue authority.

The four areas of potential institutional reforms are discussed in Sections 3 through 6 of the paper. As a prelude, Section 2 provides an evaluative overview of some of the main features of India's institutions of public expenditure management, including a discussion of different types of accountability. Ultimately, we argue, it is external accountability to citizens, however imperfect, that provides the foundational incentive mechanism for improving the governance or management of public expenditure, and this drives the nature of reforms posited in the paper. Section 7 provides a summary conclusion.

2. Institutions Governing Public Expenditure

The broad contours of India's public institutions are well known, including the constitutional framework, the structures of parliamentary democracy (with the true executive being combined with the legislative branch, and the President chiefly a symbolic post), and a relatively strong judiciary. A federal system is embodied in elected state legislatures, and, to some extent now, elected rural and urban local governments. The local level is still weak, however, while state governments have gained some autonomy and power at the expense of the center in recent years, for reasons including national party fragmentation, the rise of regional parties, and some decentralization of economic controls.

The national Indian bureaucracy is provided constitutional recognition. There are also provisions for independent bureaucracies in each state. The key component of the bureaucracy is the Indian Administrative Service (IAS), whose members are chosen by a centralized process and trained together. They are initially assigned to particular states, and may serve varying proportions of their careers at the state and national levels. The dominant post-independence economic policy approach vested the bureaucracy with considerable discretion in such matters, e.g., in granting industrial licenses. At the local level, IAS members are also vested with some judicial authority.

Turning specifically to public expenditure management, budgetary procedures for the central and state level legislatures are also detailed in the Constitution. Budgeting is the responsibility of national and state-level finance ministries. Bureaucratic support and monitoring are also provided through specialized cadres of the civil service. For example, members of the Indian Civil Accounts Service (ICAS), under the Expenditure Secretary of the central Finance Ministry, oversee and maintain central government accounts, and there are similar state level cadres. Members of the Indian Audit and Accounts Service (IAAS), under the independent Comptroller and Auditor General of India (CAGI), are responsible for auditing of central and state-level government accounts. At the center, accounting procedures are relatively strong, with reasonably good detection of certain types of malfeasance. However, corruption in various forms does exist and poor (as opposed to illegal) use of funds is not well-detected under the current system.

Over the last decade or more, the central government, with inputs from the World Bank and other agencies, has attempted to document, evaluate and improve budgetary practices. These attempts are part of a global effort to improve public financial management (PFM), and an elaborate methodology has been developed. PFM studies typically include broader considerations of fiscal management, including aggregate fiscal discipline and policy making and efficacy, in addition to budgetary and expenditure control process improvements. We provide some examples here, and return to the issues in more detail in subsequent sections. Typically, these studies are outsourced by international organizations to Indian experts.

Mathur (2001) uses the public expenditure management (PEM) framework of the Japan Bank for International Cooperation (JBIC), which identifies the stages of the PEM cycle as policy, plan/program/activity, budgeting execution, evaluation and feedback (with sub-stages or components of each of these). He gives a qualitative assessment of strengths and weaknesses at each stage, a quantitative assessment using a different, checklist approach from the World Bank (1998), and recommendations for action to support better integration of policy and budgeting, as well as better monitoring and feedback with respect to expenditures. Basic improvements such as the use of accrual accounting and more effective cash management also feature in this study.

A subsequent analysis (World Bank, 2005a) surveys the literature, and has a somewhat broader scope, engaging with issues of legislative oversight, the performance of public enterprises, controls on the voluntary sector (which receives government funds), and the quality of procurement procedures, in addition to the issues raised in Mathur (2001). This study highlights developments such the Ministry of Finance's assignment of financial advisors to individual ministries, and the push for greater transparency, including creating a "right to information." Processes of revenue administration, intergovernmental transfers and auditing mechanisms are also discussed in detail – at close to 400 pages, the report illustrates the breadth of issues encompassed within the PFM framework.

Jena (2010) provides a recent PFM report following the latest World Bank framework: this involves examining 28 categories (with multiple dimensions in some cases) spread across three broad areas: the credibility of the budget, comprehensiveness and transparency, and the budget cycle. This last area has four components: the policy basis for budgeting; predictability and control on budget execution; accounting, recording and reporting; and external scrutiny and auditing. Each of the 28 categories is assessed either quantitatively (e.g., deviations of actual from budgeted expenditure) or qualitatively (e.g., meeting norms of organizational separation, or minimum standards of reporting), and a grade is assigned, from D to A, with "pluses" used in some cases. Perhaps surprisingly, given the common impression that India's central government does a relatively good job of PFM, there are only 11 A's and B's, versus 15 C's and D's, with two categories not rated for lack of information. It is difficult to distill such a wide-ranging and detailed analysis into one or two key points, but one conclusion from the exercise is that relatively routine tasks are carried out reasonably well, while aspects of PFM that involve judgment, evaluation and effective feedback loops, especially across different components of government, are weaker.

Jena (2012), building on his World Bank report, offers a summary evaluation that lists five areas as crucial for reforms to strengthen the PFM system. These are:

- producing suitable performance measures to influence budgetary decisions
- continuing with existing efforts to expand accrual accounting
- modernizing internal audit and control
- improving the effectiveness of external audit, and
- introducing an exclusive procurement law.

This list focuses more on the (important and necessary) nuts and bolts of budget management, and while Jena discusses issues such as problems with some types of central government transfers to the states, the role of the Planning Commission, and some aspects of weakness in accountability, the main message from this approach is that incremental improvements in processes are needed in many areas of the core PFM system. On the one hand, such incremental reforms within existing institutional structures may be the most feasible. On the other hand, they may not tackle the areas where institutional reforms can have the most positive impacts.

The first item on Jena's list is, however, important for some of the subsequent discussion in this paper. Jena (2010, 2012) traces the history of performance budgeting in India, starting in the 1970s, and points out its relative ineffectiveness. He briefly discusses the introduction of outcome budgeting in the mid-2000s, outlines the process, and notes the difficulties and the potential of this approach. We take up these issues in Sections 3 and 4. Outcome budgeting seeks to get to the crux of the problem of ineffective service delivery. By documenting the results of spending, it seeks to contribute to creating an effective feedback loop from outcomes to program design and the policy basis for budgeting. One caveat comes from the work of Shah (1999, 2007), who, following another line of World Bank efforts on fiscal management,[3] emphasizes the distinction between outputs of public spending and final outcomes. For example spending on schools may lead to more school buildings, more textbooks and higher enrollments – these can all be considered outputs of public spending. The true outcome of education may, however, depend on other factors that are beyond the control of government.

[3] In this context, see also Shah (2005).

This is an appropriate point at which to discuss the issue of quality of public service delivery. Singh (2010) suggests that the poor quality of public service delivery in India can be directly observed from the poor use of inputs (e.g., absenteeism by teachers, doctors and nurses who are government employees), the direct observation of deficient outcomes (erratic electricity and water supplies), or inferred from other outcomes (e.g., large losses by public sector enterprises) or the behavior of citizens as consumers (e.g., even the poor paying for private education when free government schooling is available). Pritchett (2009) has discussed examples of corruption, absenteeism and poor quality of service in detail, and termed India a "flailing" rather than a failing state. The essence of Pritchett's view is that poor public service delivery in India is not the result of a lack of financial or human resources, but has other roots, in societal structures. A slightly different view is found in a World Bank (2008) country strategy document, which, while acknowledging absolute failures, also characterizes the problem as one of a "failure of public services to keep up with people's expectations." These and other studies make the argument for government failure on case study type evidence, which is abundant for India. On the other hand, following the approach of Afonso et al. (2005) for several other countries, Lalvani (2010) attempts to create quantitative indices of efficiency and effectiveness of public expenditure (focusing on inputs and outputs rather than outcomes, and applies it to data for India's states, constructing indices of expenditure adequacy and effectiveness.[4]

In fact, much of the discussion of PFM for India has focused on the national or central level, although the three studies (Mathur, World Bank, Jena) considered above also examine state-level performance. Problems of poor budgeting and expenditure practice are greater at the level of the states. Some states have better governance traditions than others, but all states came under fiscal stress in the 1990s. Budget practices deteriorated in this situation of intensified political competition, increased uncertainty, looser hierarchical controls, and new complexities of governance. Examples of problems in budgetary and expenditure practices include unrealistic projections, poor tracking of spending and outcomes, unclear assignment of responsibilities among different state government departments and agencies, lack of transparency, and inappropriate degrees of control – too lax in some parts of the process, too stringent in others (International Monetary Fund, 2003, Chapter 4, World Bank, 2005b, Chapter 2).[5] However, there has been a gradual effort to reverse negative trends and fix longstanding problems at the

[4] We will not discuss this analysis here, but note that it has some conceptual and technical shortcomings, unsurprising for a relatively innovative exercise. Rather than comparing public expenditure effectiveness across states, Fan, Hazell and Thorat (2000) compare different categories of public expenditure, focusing on a specific outcome, namely, reducing rural poverty. Their econometric analysis suggests that additional investments in rural roads, agricultural research and education have the largest impact on rural poverty per additional rupee spent. However, this focuses on outcomes, and does not address the issue of whether the result is tied to differences in efficiency of expenditure across categories.

[5] Three useful examples of detailed analyses of state-level public financial management and accountability are World Bank (2006, 2007, 2009).

state level as well as the center, and some states have made significant improvements in budget practices. We discuss these developments in Section 5 below.

We conclude this section with a brief discussion of accountability. That term has taken on a life of its own, and covers a variety of circumstances. We may distinguish between two fundamental types of accountability in the context of government: external and internal. External accountability refers primarily to the answerability of elected officials to citizens. The main mechanism for this accountability is through the ballot box, but the media, civil society and even avenues such as public interest legislation can serve to create collective mechanisms that push the behavior of politicians toward the interests of their constituents. In this context, the mechanism of "exit" does not provide as direct an avenue for achieving accountability – if a citizen moves jurisdictions, or switches to private providers, there is no obvious feedback mechanism to improve the behavior of politicians.

Internal accountability refers to the chains of accountability built into the institutional structures of government: these may be conventional vertical chains, or horizontal links of checks and balances. In the context of internal accountability, the links between politicians and bureaucrats are of particular importance – bureaucrats derive their legitimacy from serving elected politicians, but if there are problems with the behavior of politicians, the mechanisms of internal accountability become problematic rather than beneficial. In this context, the observation of Saxena (2005) is useful:

> "…between the expression of the will of the State (represented by politicians) and the execution of that will (through the administrators) there cannot be any long-term dichotomy. In other words, the model in which the politics will continue to be corrupt, casteist and will harbor criminals whereas civil servants will continue to be efficient, responsive to public needs and change agents cannot be sustained indefinitely. In the long-run political and administrative values have to coincide."

In other words, ultimately it is the effectiveness of external accountability that matters. This theme will be developed in Section 6, in particular.

3. Individual Ministries

Individual ministries are, of course, encompassed within the general discussion of public financial management as outlined in the previous section. We develop some of those themes with specific examples, as well as general observations. Agarwal and Somanathan (2005) provide an insightful analysis of public policy-making in India that is very relevant for the current discussion. They begin by noting that problems can arise in formulation of policy as well as implementation. They identify several key weaknesses in policy-making which are of first-order importance, and would seem to require attention before one is likely to see major benefits of the many process improvements surfaced in the World Bank-type PFM analyses.[6]

The first weakness they highlight is excessive fragmentation of decision-making, which is a consequence of dividing sectoral responsibilities (e.g., transportation) across several ministries. Unfortunately, this phenomenon is driven by the political realities of India, where numerous powerful politicians or political groups (e.g., regional factions within a party or smaller parties that are pivotal in a ruling coalition) have to be given ministerial titles with their accompanying rewards (monetary and non-monetary). Potentially, of course, there are institutions for coordinating in such cases, Cabinet meetings and the Planning Commission in particular. Why these do not work well is a subject for the next section. In any case, one probably has to accept the current degree of fragmentation across ministries as beyond any agenda of institutional reform.

The second weakness seems to be a critical issue for policy-making in India, and is not really surfaced in analyses by outsiders: Agarwal and Somanathan, on the other hand, have an insider perspective. They argue that there is over-centralization in the decision-making structures of each individual ministry. Within each ministry, the bureaucrat with Secretary rank is the Minister's "policy-adviser-in-chief," and makes or advises on decisions that can have cross-cutting impacts. However, much of these top bureaucrats' time is spent on routine administration, leaving inadequate time for policy formulation in an environment that has become increasingly complex.

A related weakness is the inadequacy of inputs from outside the government, and a lack of informed debate. A better process for obtaining and evaluating information and ideas that are pertinent to policy design would substitute to some extent for the shortage of time at the top. In other words, centralization is exacerbated by isolation. Agarwal and Somanathan make an exception in the case of the Budget formulation process, where there is a tradition of outside consultation.[7] Another example, not discussed by these authors, is the use of expert committees on areas such as various aspects of financial sector reform or tax reform.[8] In this context, the Finance Ministry probably stands out as one where these processes are used often and are better developed, whereas some other ministries do not have such strong traditions.

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[6] The focus of their analysis is on the working of central ministries, but the ideas carry over to state governments as well. This kind of analysis also provides a corrective to the view of Pritchett (2009), commenting on the elite central bureaucracy: "The brains of the Indian state can formulate excellent policies and programs in nearly every domain." Pritchett's own tentative reason for poor government functioning in India is the depth and pervasiveness of identity politics centered on caste.

[7] This positive evaluation is within the constraints imposed by the planning process and the plan-non-plan distinction in budgeting: that issue is taken up in the next section.

[8] See Singh (2012) for a discussion of the role of expert committees in influencing policy formulation and policy reforms.

A final identified weakness is also a variant of the previous two: a lack of systematic analysis and integration. On this issue, Agarwal and Somanathan suggest that specialists are not consulted enough, while the generalists (the senior IAS bureaucrats) who should be capable of the integrated analysis ultimately required are not properly trained in this skill. One is tempted to suggest that the problem lies elsewhere than the inadequate training or expertise of the top bureaucrats: we would instead argue that the weaknesses come from a lack of adequate numbers of specialists with sufficiently high status within the ranks of government, as well as the political pressures that come from many of the politicians heading the ministries.

In any case, some reforms are possible. Agarwal and Somanathan suggest that the number of Secretaries be reduced (currently there can be several in each ministry), more responsibility for implementation be pushed one or two levels below the Secretary, that policy advisory groups be created within each ministry, that the career trajectory and training of the IAS be modified, and that there be more lateral entry. In 2012, the central government took a step in the direction of reform by amending the rules for the IAS to permit earlier career evaluations than previously, with possible early retirements in the case of inadequate performance (either with respect to competence or integrity).

It is important to focus as Agarwal and Somanathan do, on the incentives and competencies of the key bureaucratic decision makers within ministries. How does the typical PFM framework relate to this focus? Much of the PFM analysis, beyond the policy-making stage, deals with tracking implementation in the sense of flows of funds. Much of this financial tracking, monitoring and evaluation are performed by specialists, rather than the generalist policy advisers of the IAS. Outcome budgeting can be thought of as providing parallel tracking tools for physical activities, as well as outputs or outcomes. Indeed, in some cases, outcome budgets mainly achieve an enumeration of what would be best classified as inputs rather than outputs, let alone outcomes. Outcome budgets, even if they do not live up to their name, therefore provide one tool to address weaknesses of information gathering and evaluation that exist in Indian public policy-making.

In this context, it is important to distinguish between the role of outcome budgets in different ministries. For example, the Ministry of Finance and the Ministry of External Affairs both produce detailed outcome budgets, but neither ministry is heavily responsible for public service delivery (except to the extent that they provide national public goods such as diplomacy and fiscal prudence).[9] At the same time, the high level objectives of each ministry are not easily aggregated up from the detailed lists of activities and achievements that constitute the outcome budget in each case. On the other hand, ministries such as Health and Family Welfare, Human Resource Development (HRD), and Rural Development have large administrative

[9] However, one important example of a traditional "public service" at the individual citizen level is the issuing and renewal of passports by the Ministry of External Affairs.

responsibilities for areas such as health, education and rural infrastructure, where large quantities of money are allocated, transferred and spent all across the country, increasingly through what are known as Centrally Sponsored Schemes (CSS). In the standard language of public finance, these are essentially categorical matching grants, but with a host of institutional features peculiar to the Indian case, which will be explored in subsequent sections of the paper. In these cases, creating a useful outcome budget is both more difficult and more valuable.[10] This point was recognized by the Deputy Chairman of the Planning Commission in public remarks made in 2009, four years after the beginning of the current outcome budgeting effort, though his take on the prospects for usefulness was more pessimistic, leaning toward giving up the exercise. To the contrary, outcome budgeting has continued and expanded.

A review of the efforts of some of the key ministries that matter for public service delivery provides a sense of where the effort currently stands. The HRD ministry, for example, produces an integrated Annual Report and, in addition, the two major departments of School Education and Literacy and of Higher Education each have a Results Framework Document (RFD) and an Outcome Budget. The outcome budgets and RFDs follow standardized templates, with detailed quantitative measures used wherever possible, grading of different possible levels of achievement, and mappings from outlays to physical outputs and outcomes. There are also summaries of the various programs, schemes and missions under which the outlays are allocated. Clearly, there are shortcomings in these documents, since there is not necessarily a high degree of confidence in numbers aggregated up from possibly thousands of field reports – this was one concern of the Deputy Chairman of the Planning Commission. In many cases, the connection between the physical outputs and outcomes that matter is weak or non-existent. This is a point made forcefully by Muralidharan (2013) in his survey of the learning outcomes in Indian schools, which are either poor, failing to improve, or not being measured, while large sums are spent on various schemes to provide "education," or at least teachers, school buildings and other potential educational inputs.

On the other hand, one can argue that outcome budgets and related documents provide a necessary first step in understanding how money is spent. They may not directly lead to better policy making, but they provide information in an integrated, accessible form that was not previously available. This information can be useful to those inside and outside government, in evaluating the effectiveness of certain kinds of spending. This is not to say that outcome budgets cannot be improved – a comparison of HRD ministry documents with concise evaluations

[10] Chakraborty et al. (2010) perform a useful exercise in estimating how much central expenditure can be ascribed to categories that are spatially dispersed, and the shares of different ministries in these categories. Excluding Finance, Defence, and Home, the ministries which spend the most are (2008-09 percentages follow each name): Rural Development (5.65), Human Resource Development (5.15), Consumer Affairs, Food and Public Distribution (4.44), Chemicals & Fertilisers (4.20), Shipping, Road Transport and Highways (2.47), Health and Family Welfare (2.41) and Agriculture (1.93).

produced by an organization such as the Accountability Initiative[11] reveals some of the tradeoffs of completeness versus comprehensibility – but they represent a new level of transparency for government.

4. Planning Commission and Coordination

Unlike many of the other institutional features we have discussed so far, such as legislative and bureaucratic structures, the central Planning Commission was not mandated in the Constitution. Instead, it was established by a resolution of the central cabinet in March 1950, within three months of the adoption of the Constitution. Membership of the Commission is determined by appointment at the Prime Minister's discretion, and can include former bureaucrats, politicians and technical specialists. Following the central model, state governments later on appointed their own planning commissions or boards. The Planning Commission began making grants to states in support of their five-year plans (which the Commission formally approved). Its activities in this realm have been justified in terms of constitutional provisions for discretionary transfers. When central ministries began making their own grants in support of CSS to be implemented by the states (also covered by the same article of the Constitution), the Planning Commission took on the task of coordinating and overseeing these funds, though with the ministries still playing a leading role in administering the schemes.

The Planning Commission makes grants and loans for implementing development plans. Before 1969, plan transfers were project-based. After that, the distribution was proposed to be made on the basis of a consensus formula decided by the National Development Council (NDC). The NDC is chaired by the Prime Minister, and its members include selected central Cabinet ministers, Chief Ministers of the states, and members of the Planning Commission, and it plays an important role in plan formulation, serving as a forum for political bargaining (as does the Commission itself, though less explicitly). In practice, discretionary transfers did not disappear, and, more recently, as central and centrally sponsored schemes have expanded, formula-based transfers have been far outstripped in aggregate amount by these project- or mission-based funds.

The role of the Planning Commission has been questioned on many fronts. The constitutionality of plan transfers has been challenged by some legal scholars. The Eleventh Finance Commission recommended a reassessment of plan transfer formulae, with this task to be brought within the scope of the Finance Commission, which is a constitutional body charged with guiding all aspects of the process of center-state transfers. This report (as well as numerous other analyses, including some of the PFM reports discussed in the previous section) noted the severe muddle with respect to Planning Commission transfers, with economically meaningless distinctions between plan and non-plan categories of expenditure. It recommended reform of the financing of

[11] The web site of this organization is http://www.accountabilityindia.in/, and it includes several studies on the accuracy of government data as well as the effectiveness of programs ("From Outlays to Outcomes"). Ministry-level outcome budgets can provide inputs into such nongovernmental studies, in addition to those studies providing independent checks on performance.

the plans so that plan revenue expenditure is financed from available revenue receipts after meeting non-plan expenditure, with borrowing used only for investments.

The last two Finance Commissions (Twelfth and Thirteenth) have echoed the recommendations of the Eleventh Finance Commission with respect to the categorization of expenditures, but there does not appear to have been much progress on that front as yet.[12] Subsequent reports bear out this assessment, having to repeat earlier recommendations. A committee set up by the Planning Commission and chaired by C. Rangarajan (Government of India, 2011a) to examine the efficient management of public expenditure called the plan-non-plan distinction in expenditure "dysfunctional and an obstacle in outcome-based budgeting." The alternative suggested in the report is a unified approach to budgeting (keeping the necessary revenue vs. capital expenditure[13] distinction), managed by the Ministry of Finance. In this new institutional framework, the Planning Commission's role would be reduced to providing technical advice, diminishing its importance as an arena for political bargaining and possible rent-seeking.[14]

Notably, the Rangarajan report, even though it recommends a downgrading one of the Planning Commission's major roles, was produced under the auspices of that body itself. On the other hand, the report stresses the Commission's potential role in providing technical assistance to individual ministries for their budgeting, and in coordinating expenditure plans across ministries. The Planning Commission is also envisaged as working with the Ministry of Finance to monitor and evaluate expenditures related to "planned" development. In some respects, the natural implication of the committee's recommendations would be to make the Planning Commission an arm of the Finance Ministry (see also footnote 14), but that is not raised as a possibility.

With respect to aspects of public expenditure management such as technical assistance, coordination and evaluation, why has there been so little improvement in the efficacy of the Planning Commission? Part of the problem may be that the Planning Commission is subject to the same structural weaknesses as individual ministries, as discussed in the previous section,

[12] The Twelfth Finance Commission also recommended a change in the Planning Commission's use of loans to the states: this change has been effectively made.

[13] Even here, there can be conceptual difficulties when investments are in people, but it seems that there is still a case for the traditional distinction based on the nature of tangible, long-lived physical capital.

[14] Singh and Srinivasan (2006) questioned the need for a Planning Commission in a market-oriented economy, and suggested an alternative system in which richer states would use market borrowing for capital projects, and poorer ones would receive grants for capital spending. Singh and Srinivasan (2013) put forward an alternative set of reforms, with the center taking full responsibility for financing, operation and maintenance of projects where it has a compelling reason for central intervention, such as spillovers across states. They suggested that the Planning Commission be reconstituted as a Fund for Public Investment (FPI) for both the center and states. Its share holders would be the state and central governments. This Fund, much like a multilateral development bank, would appraise the projects proposed for their economic and social returns as well as feasibility and soundness of proposed financing, from the center or state's own resources, borrowing from domestic and foreign sources and capital transfers from the center, if relevant. In a related approach, the Prime Minister, in 2010, announced and took steps toward a goal of transforming the Planning Commission into a strategic thinking group. We discuss that possible reform later in this section.

including over-centralization and lack of sufficient high quality inputs for policy-making.[15] But the problem is somewhat different, in that the Planning Commission has little control over implementation, governance of which lies mostly with the ministries. Hence, there is not the same problem of misallocation of organizational resources between routine implementation tasks and those requiring high-level judgment or analysis, as seems to exist in line ministries.

The real causes of the Planning Commission's limited effectiveness may lie in the political economy of the internal workings of the government. The Commission initially was a tool of a strong Prime Minister, providing discretionary control over government expenditure outside the line ministries. Over time, for a variety of reasons, the office of the Prime Minister has lost power. Instead, individual ministers who command the political support of critical factions or groups of MPs (and who are often ministers for precisely that reason) have a greater say in how funds are allocated and spent.[16] When Planning Commission transfers were made formulaic, the response over time was to expand alternative discretionary modes of transferring funds to different states or for different kinds of expenditure through the CSS. These schemes are much more under the control of individual line ministries, and the Planning Commission's supposed coordination role can only be nominal in such circumstances, although it has contributed to recurring attempts to rationalize the CSS, for example.[17]

Does this political economy argument mean that no progress is possible? One feasible avenue for improvement may lie precisely in the development of outcome budgets by individual ministries. These provide information in a reasonably standardized framework for the Planning Commission to provide a more systematic analysis of the performance of various central and centrally sponsored schemes, including the overarching "missions" that have been conceived for tackling areas such as primary education, rural health and urban infrastructure. The quantification in the

[15] This view might seem to be contradicted by the number of committees and taskforces under the aegis of the Planning Commission. The Commission's web site is comprehensive and well-organized, and lists, for example 26 categories of working groups or steering committees for the Twelfth Plan, defined mostly by sectoral focus (http://planningcommission.nic.in/aboutus/committee/index.php?about=12strindx.htm). Under one of these categories, human resource development, there are nine working groups and four steering committees listed. One of these steering committees, on Higher and Technical Education, has 33 members. The corresponding working group had 46 members. Perhaps the conclusion from these numbers is that quantity and quality of inputs are not the same thing.

[16] An interesting question is how this equation would change if the Rangarajan Committee's recommendation were implemented. Reducing the Planning Commission's role in allocation and budgeting of funds could free it up from political bargaining to provide higher quality technical inputs, but it might reduce the weight given to those inputs by central ministries. To some extent, the job of exercising political bargaining power within the government would rest more with the Finance Ministry.

[17] In particular, a report by B.K. Chaturvedi (Government of India, 2011c), a Member of the Planning Commission, offers a detailed history of the CSS, as well as recommendations such as consolidation, increased flexibility and greater evaluation and accountability. The issue of the CSS is taken up further in Section 5. A significant recommendation of the Rangarajan Committee concerns how CSS and related funds are channeled. Following Dikshit et al. (2007), a strong case is made for such central transfers to flow through state government treasuries, and from there directly and without blocking options to beneficiaries, rather than go through assorted district, block or village government agencies, or through NGOs and para-governmental societies.

individual ministry documents represents an advance on the Planning Commission's own sometimes ad hoc and qualitative analysis of how money should be spent, and its limited analysis of the impacts of spending.

Note that the recommendation being made here is different from the role of the Central Plan Scheme Monitoring System (CPSMS), which is a web-enabled management information system. The CPSMS improves tracking of financial flows, and provides a comprehensive picture of these flows across different plan or other centrally initiated schemes. This can help avoid problems such as allocating additional funds when the initial allocation lies unutilized. The CPSMS represents an important improvement in the vertical dimension of PFM, and it has the potential to force improvements in state (and eventually local) government expenditure tracking.[18] However, the CPSMS does not yield information on the physical outcomes of spending, nor is it meant to do so. Hence, it does not deal with the fundamental problem of monitoring and evaluating the results of spending.

One can also argue that an approach to expenditure management that tracks the results of spending has to be foundational to any other potential role for the Planning Commission, including strategic thinking (see footnote 14). Indeed, the current Deputy Chairman of the Planning Commission is exceptional in the latter role, but much of the rest of the organization appears to lag in complementing strategic thinking with nuts and bolts analysis of data. Of course, it is still possible that political economy considerations would work against even minor improvements in analysis and decision-making, since these improvements could reduce political discretion or rent-seeking opportunities. Our argument in this paper is not that improvement is guaranteed, but that the PFM-type process-based approach with specific incremental improvements has the best chance of getting the ball rolling with respect to positive institutional reform.

5. Expenditure Assignments

In the previous three sections, we have focused on the institutional structures of the central government that pertain to expenditure management and governance, noting only briefly that similar institutions, of varying quality, exist at the state level. A key theme has been the possibility of improving the structures and processes of expenditure management within a level of government. We now turn to considering change across different levels of government, examining expenditure in this section and revenue in the next.

The Indian Constitution, in its Seventh Schedule, assigns the powers and functions of the center and the states. The schedule specifies the exclusive powers of the center (the Union List) and the states (the State List), and those under joint jurisdiction (the Concurrent List). All residuary

[18] Further discussion of the CPSMS and recommendations for its use and extension can be found in the Rangarajan and Chaturvedi committee reports (Government of India, 2011a, 2011c).

powers are assigned to the center. Over time, through various amendments, these three lists have been altered in the direction of greater centralization, by expanding some powers in the Union List, and shifting some items from the State to the Concurrent List. The nature of the assignment of expenditure functions remains fairly typical of federal nations, and broadly fits with economists' theoretical rationale, though the breadth of the Concurrent List in some cases creates problems of lack of clear responsibility.

The State List includes health, agriculture, water (except inter-state rivers), land and local government. Education and "social and economic planning" are in the Concurrent List. The latter assignment, by virtue of its breadth, provides tremendous latitude to the center, as well as scope for conflicts of authority.[19] Nevertheless, the formal assignments of expenditure responsibility appear to give the states considerable scope with respect to public service delivery. In practice, the states' performance on this front was less than desirable. Lack of resources may have been one cause, particularly in the poorer states, but the thrust of central planning, and the mechanisms of intergovernmental transfers that sometimes were designed to fill perceived "gaps" in state resources, contributed to the problem. Essentially, state government decision makers focused on influence activities with respect to the central government, rather than making spending decisions to enhance electoral prospects. In this view of the world, voters also failed to tie electoral support to public service delivery, instead being driven by group identities and loyalties (e.g. Pritchett, 2009). A key point to make here is that the center exercised considerable influence on state expenditure priorities, both through the planning process, and through political bargaining and control, so that real and formal expenditure authority have diverged, to the detriment of efficiency of expenditure.

The initial decade of economic liberalization also saw a strengthening of regional political power, and one can make the case that the central government responded to this challenge to its control by expanding the scope of its categorical transfers such as the large new CSS (e.g., Sarva Shiksha Abhiyan (SSA), National Rural Health Mission (NRHM) and Jawaharlal Nehru National Urban Renewal Mission (JNNURM)). Other possible reasons for the central government's shift could be the global demonstration effect of the Millennium Development Goals, and growing worries that liberalization was undercutting the political and fiscal ability of the states to direct adequate expenditure toward economic and human development. In any case, the new millennium has seen the rise of large central government schemes that provide funds to the states for implementation in areas such as education and health, but constrain the states in the process.[20]

[19] Education was, in fact, on the State List until 1971, when it was moved to the Concurrent List by a constitutional amendment.

[20] For example, the NRHM creates separate new bureaucracies in each state, bypassing the consolidated fund of the state, as well as much of the state government bureaucracy (although senior bureaucrats and ministers end up exercising control in any case).

We have noted attempts to rationalize the CSS, through consolidation and redesign, and through improving information systems for flows of funds, but the problem is deeper,[21] and may require a more fundamental solution. In the last section, we argued that there is scope for the Planning Commission to do a better job of monitoring, evaluating and perhaps coordinating across states and schemes. A more fundamental reform would be to make categorical (block or matching) grants for areas such as health or education, or even just to provide the states with more untied funds (e.g., through the Finance Commission) and allow them to choose how to spend the money. The incentives for state government decision-makers would come from meeting the expectations of their constituents. This line of reasoning is based on the assumption that external, electoral accountability works as outlined in Section 2. How true has this been in India?

Some theoretical models of the democratic political process (Downs, 1957) predict politicians' efficient responsiveness to voters' preferences, driven by their own preferences for getting re-elected. However, the existence of interest groups can lead to lobbying or other political pressure and therefore to biased outcomes. Politics in India at all levels seems to have been characterized by such "rent-seeking," evidenced in subsidies, overstaffing of government, and distortion of expenditure plans. It has also been argued that rent-seeking in India increased over time.[22] On the other hand, state level expenditure policies have been influenced by intra-state competition for political power (Rao, 1979, 1981; Dutta, 2000), as one would expect if electoral accountability is operative. Furthermore, Khemani (2001) compares national and state elections, and finds evidence that voters reward (punish) governments for good (poor) economic performance more at the state than the national level.[23] At the same time, the central government tries to influence state-level policy choices, and indirectly, voters, through funds transfers to states (Rao and Singh, 2002; Arulampalam, Dasgupta, Dhillon and Dutta, 2009).

One can view the current situation as one in which the center, with a coalition headed by a quasi-national political party, competes with regional parties for votes. Delivery of public services through CSS allows the national government to claim more credit for delivering public services as well as for making transfers through subsidies. Given this structure, we have argued in the previous three sections that there are specific micro improvements that can be made in

[21] The World Bank (2008) Country Strategy document states, "Accountability for service delivery is recognized as weak, as a result of entrenched bureaucracies, systemic corruption, and an incomplete process of decentralization. Moreover the public financial management system has not kept pace with the rapid growth, and is therefore not able to provide relevant and in-time information for decision making. These issues are particularly acute in Centrally Sponsored Schemes (CSSs), which are designed and funded by the central government but implemented by the states and lower tiers of government."

[22] For example, Chhibber (1995) explains the deepening of rent-seeking and the persistence of laws that made it possible in terms of intensifying needs of political competition. Powers of patronage for electoral support became more important in the 1970s and 1980s, swamping possible concerns about the inefficiency. Also, Rao and Singh (2005) and Kapur and Mehta (2006) have argued that large payments were directed by the center in the late 1990s to the states of origin (Andhra Pradesh and Punjab) of regional parties that were key central coalition partners.

[23] This result is consistent with survey evidence that voters look mainly to state governments for provision of many public goods (Chhibber, Shastri and Sisson, 2004).

organizational processes and structures. Here we suggest that a more effective institutional reform, albeit a more difficult one, would be to provide states with clearer expenditure authority. This would, of course, increase the need for internal reforms at the state level, but supporting those reforms is precisely the kind of public good that the center should be providing to the states. Electoral accountability will operate more effectively in such a situation.[24]

This argument for clear decentralization of expenditure authority does not stop at the level of the states, but extends to the local level. As it is, the district is already effectively the pivot point for implementation of many types of government expenditure, having been a crucial administrative unit at least since the Mughal period. The IAS structure also works to make administering a district a key step in the career path.[25]

Local governments in India were given formal constitutional status through the passage of the 73rd and 74th amendments in 1993, which assigned new expenditure responsibilities to the local level and mandated regular local elections. Guidelines for assignments of local subjects were added to the Constitution, in the Eleventh and Twelfth Schedules. Precise assignments were made through individual states' legislations, and there was considerable variation among the states in the extent to which the functions in the two new constitutional schedules were transferred (Rao and Singh, 2003; Chaudhuri, 2003), particularly for rural governments. In many cases, states chose to hold back in devolving the full list of functions from the Eleventh Schedule.[26] A significant problem with the new local expenditure responsibilities has been the overlapping of the "local lists" with the State List of the Constitution. Combined with the lack of effective decentralization of funds and personnel, this gives the states the ability to overawe local governments completely, if they wish.

Despite these severe limitations, the local government "experiment" in India provides new evidence on electoral accountability. At the local level, the measurement of local public good delivery can potentially be more precise, through geographically concentrated survey data. Regular direct local elections have the potential to increase the accountability of local

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[24] The argument is not complete, since the revenue side also has to be considered, and we do that in the next section.

[25] The linkage between senior IAS officials in Delhi and their junior colleagues in the districts is a parallel channel of communication and influence, though formal authority is meant to flow from the center through the federal structures of state legislatures and cabinets, not purely through bureaucracies. Of course, there are senior IAS officers in every state capital as well, and they also serve as links in this chain. There is a complicated institutional process whereby bureaucrats and politicians engage with each other: this includes the location and nature of assignments, and the frequency and types of transfers (Iyer and Mani, 2012). However, district level development bodies are typically controlled by IAS officials or state level politicians, and this works against effective local spending authority. In this context, the Thirteenth Finance Commission stated, "Ideally, development authorities should be dissolved and their functions taken over by the local bodies in whose jurisdiction they operate." (Finance Commission, 2009, p. 182, Para. 10.168)

[26] They also capped village level authority to directly approve expenditures, often at very low levels. In general, even states which devolved significant responsibilities to local governments subsequent to the amendments retained control over the requisite funds, as well as over the bureaucrats or functionaries who would be responsible for implementation.

government by providing more direct and refined incentives to please constituents. The counter-argument is that interest groups or powerful individuals will instead have more influence at the local level.[27]

Interestingly, as long ago as 1965, Andre Béteille countered the pessimistic view of elite domination in local government, observing in his study of a rural area of Tamil Nadu, "Adult franchise and Panchayati Raj have introduced new processes into village society" (p. 221), and "political and legislative changes have altered the bargaining positions of the old economic classes" (p. 223). He argued that local elections increased the power of those who were worse off but were in greater numbers, rather than perpetuating or increasing domination by the traditional rural elite. In another early example, the Shiv Sena (often better known for other aspects of its ideology) built some of its success as a political organization on its attention to ward and municipal constituencies in Mumbai. It achieved electoral rewards by being responsive to those near the bottom of the economic ladder (Naipaul, 1975).

There is significant evidence that local electoral participation is beginning to influence outcomes, often positively. For example, Chaudhuri (2005) found that decentralized resource allocation in Kerala improved *perceived* delivery of roads, housing and child development services, with the decentralization involving devolution of budgetary authority to elected rural local governments.[28] Initial social conditions such as education and caste, as well as the precise structure of political institutions[29] do matter for outcomes, but these may be unavoidable and acceptable limits on the efficacy of the political process. While we cannot precisely compare outcomes of state and local electoral accountability, it appears that the experience of decentralization to the local level in India has had many positive outcomes, and has not been subject to extremes of local capture.

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[27] Concerns about elite domination of elected rural local bodies have existed since independence and heavily influenced India's federal design. Pre-reform qualitative studies of local government found examples of interest group capture, but also positive impacts of local democratic processes. For example, Dash (1988, p. 223) gave examples of the Puri Municipal Council in Orissa providing reductions in, or exemptions from *octroi* taxes to specific commercial products, benefiting local interest groups. Other case studies note the reluctance of local governments to impose taxes, being responsive to their constituents in this respect (e.g., Aziz, 1998). Bardhan and Mookherjee (2000) provided an post-reform analysis of "local capture," while Banerjee and Somanathan (2001, 2007) found that local heterogeneity distorted the pattern of public service delivery. Kochar, Singh and Singh (2009) provide an analysis of institutional features of rural spending, to explain some of these results in more depth. See Keefer and Khemani (2003, 2004) for an overview of some of this literature.

[28] Other examples include Besley, Pande and Rao (2006a, b) and Besley, Pande, Rahman and Rao (2006) for southern India, and Bardhan and Mookherjee (2006a,b) for West Bengal in eastern India. Local government may not be the only avenue for political voice. Jha, Rao and Woolcock (2007) found that informal governance structures arose within Delhi slums, and in turn provided more general access to public services through their leaders' links to elected local politicians. Other studies of southern India (Chaudhuri and Heller, 2003; Besley, Pande and Rao, 2006b) suggest that participation in village assemblies (gram sabhas) is driven by constituents' self-interest, but amenable to being changed through policy interventions. Thus, participation in this new avenue of direct democracy has also been encouraging, despite initial concerns about its efficacy.

[29] For example, for positive impacts of seat reservations at the local level, see Chattopadhyay and Duflo (2004), Dongre (2010) and Deininger et al., 2011).

The positive results on local electoral responsiveness are emerging *even though* the institutional structures are generally far from supportive. Besides lacking independent revenue authority, local governments are still subject to control and interference from state-level bureaucrats and politicians over their entire domain of expenditure authority. Furthermore, local governments are often restricted in key areas such as land use, where state governments retain control. A final problem has been low levels of human and organizational capital in local government, typically summarized as "lack of institutional capacity." This lack has been somewhat of a self-fulfilling expectation of higher-level decision-makers, since local governments were denied the resources and authority to make meaningful decisions.[30] It is well understood that building local capacity in areas such as budgetary management is critical (Finance Commission, 2004, Chapter 8), but there have been problems in getting the states to pursue this objective effectively. For example, grants made by the Eleventh Finance Commission to improve the databases and accounts of local bodies (urban and rural) remained 70 percent unutilized when the next commission examined the situation almost five years later (Finance Commission, 2004, paragraph 8.43).

We end this section by briefly noting the efforts in institutional capacity building, tying these back to the discussion of the previous sections. A synthesis report on PFM (augmented by the new condition of Accountability, so PFMA) for urban local bodies by a consulting firm, submitted to the World Bank (Infrastructure Professionals Enterprise, 2006), provided an important summary of the situation at the time. The report described and analyzed weaknesses in legislative frameworks, planning and budgeting, budget execution, accounting procedures, cash and fund flow management, procurement, internal control and audit, asset and liability management, reporting, external audit, and external oversight. In other words, every possible dimension of the effective organization of these bodies needed attention, though there was naturally considerable variation across different local governments, by region and by scale.[31]

The magnitude of the task is enormous, and recent documents of the Planning Commission and the JNNURM indicate only slow progress in capacity building, with efforts still being made to professionalize urban management and provide the requisite skill training. The JNNURM has started to produce score cards similar to those in outcome budgets, identifying whether specific

[30] One might also argue that the use of information technology and standardization of production allow for greater centralization, by expanding the span of control. However, the case for decentralization is not simply based on technical efficiency considerations, but on how well incentives work. The argument is that internal, hierarchical accountability for public service delivery is difficult to achieve, and that external, electoral accountability has more potential to improve efficiency. Hence, elected local officials have to clearly bear the responsibility for good or bad performance. They can still outsource some functions, or get technical assistance from those with greater expertise.
[31] All of these issues apply to rural local bodies, and are briefly discussed in the report of the Thirteenth Finance Commission (Finance Commission, 2009, Chapter 10). One weak link in this chain is the low status and poor quality of work of many of the State Finance Commissions, which is another dimension of lack of institutional capacity.

cities have adopted double-entry accrual accounting, for example, but the data is presented for only 12 states, suggesting that progress is quite incomplete.[32]

6. Tax Authority

To achieve effective accountability, decentralization of expenditure responsibility must be matched by some degree of decentralization of revenue or tax authority. The reasons are twofold – first, an over dependence on intergovernmental transfers has the potential to soften budget constraints; and second, reliance on transfers weakens the connection for constituents between benefits and costs (called the Wicksellian connection by Breton, 1996) and makes lines of accountability more difficult to establish. However, just as on the expenditure side, decentralization does not guarantee efficiency: there can be interest group capture, inefficient tax competition, and problems of government credibility that can make revenue-raising politically difficult. We address these issues after laying out the current situation and recommendations.

The initial constitutional assignment of tax powers in India was based on a principle of separation, with tax categories being exclusively assigned either to the center or to the states. Most broad-based taxes were assigned to the center, including taxes on income and wealth from non-agricultural sources, corporation tax, taxes on production (excluding those on alcoholic liquors) and customs duty. These were often taxes where the revenue potential was greater, as a result of relatively lower collection costs, and higher elasticities with respect to growth. The center was also assigned all residual tax powers.

Initially, the central government followed principles that emphasized extreme progressivity and narrow targeting, resulting in a very inefficient tax structure, and tax administration that was highly susceptible to corruption. Economic reform has led to a substantial rationalization of the central government tax structure, in terms of lowering marginal rates, simplification of the rate structure, and some degree of base broadening. In the realm of tax administration, also, some progress has been made, through the use of information technology.

At the subnational level, a long list of taxes was constitutionally assigned to the states, but only the tax on the sale of goods has turned out to be significant for state revenues. This is largely a result of political economy factors (e.g., rural landed interests were initially quite powerful in government at the state level) that have eroded or precluded the use of taxes on agricultural land or incomes (and also of user charges for public irrigation and electricity) by state governments. In addition, the separation of income tax powers between the center and states based on source (agriculture vs. non-agriculture) created avenues for evasion, since the states chose not to tax agricultural income.

[32] This assessment is based on material on the JNNURM web site, and is subject to change over time, of course. Examples of conceptual exercises with respect to capacity building efforts for urban local governance are in Government of India (2011b, 2013).

The greatest inefficiencies arose in indirect taxes. Even though in a legal sense taxes on production (central manufacturing excises) and sale (state sales taxes) were separate, they taxed the same base, causing overlapping and cascading, and leaving the states less room to effectively choose indirect tax rates. Also, the states were allowed to levy taxes on the sale and purchase of goods (entry 54 in the State List) but not services. This also provided avenues for tax evasion, and delayed the design and implementation of a comprehensive value added tax (VAT). These issues have been a major subject of recent policy and institutional reform initiatives, with the VAT having been successfully introduced, and now being transitioned into a relatively comprehensive Goods and Services Tax (GST).

Through the combination of tax assignments and choices by the states, their revenues are well short of their expenditure responsibilities, and the difference is made up by constitutionally mandated tax sharing, guided by the Finance Commission, but also other channels discussed in previous sections. Several of these transfer channels involve responding to states' projected revenue gaps. These features encourage unrealistic budgeting to try and enhance transfers, and make clear budgeting and proper tracking of spending and outcomes difficult.

For local governments, the constitutional amendments provided no explicit guidelines for revenue authority. The language of the amendments simply leaves such assignment up to the states, which are supposed to decide which taxes local bodies may levy themselves, and which state-collected taxes are to be assigned to local governments.[33] Thus, tax assignments remain unclear, nor do states provide assistance or guidance to local bodies in implementing tax collection. Rural local governments in particular do not have adequate sources of revenue assigned to them, although for both rural and urban governments, the problem is also one of inadequate revenue effort. Even so, revenue authority may be the dimension of decentralization where local governments are most constrained. The State Finance Commissions have generally failed to do an effective job of making transfers to local governments, reflecting the states' political reluctance and budget constraints.

[33] Even before the constitutional changes, local governments had a number of taxes assigned to them by individual states. Rural local governments had as many as 27 different taxes (20 exclusive, 7 concurrent with the state government) available to them (Datta, 1992), but with great variation across states. Exclusive taxes included terminal taxes and octroi; property and building taxes; oil engine, food, timber, fishery and produce taxes; and profession and labor taxes. Concurrent taxes included those on commercial crops and on land. For the lowest rural government level in some states, land revenue was a significant proportion of revenue, though absolute amounts were small in all cases: no rural local tax was a significant source of revenue. Twenty different taxes were available to urban governments, nine exclusively to them and 11 concurrent with state governments. In contrast to rural governments, several of these were significant revenue sources, particularly octroi and property taxes, but also entertainment taxes in some cities.

Turning to non-tax revenue (from user charges and fees),[34] this was on average less than tax revenue for rural and urban governments, though the ranking was reversed in many states (Finance Commission, 2004, Annexures 8.8 and 8.9). Poor delivery often creates a situation where the imposition of user charges is politically difficult, because the benefits are not clear to the payers: a low level equilibrium persists (Rao and Singh, 2003). In many cases, unclear or overlapping assignments of expenditure responsibility compound problems of accountability and implementation of fees.

At both the state and local levels, therefore, revenue authority falls short of what would allow each level to independently meet its expenditure responsibilities. To some extent, this is a natural outcome of the different driving forces for assigning revenue authority and expenditure responsibility. Most significantly, mobility across jurisdictions increases as the size of the jurisdictional unit decreases, and a tax base that is mobile may shrink dramatically in response to a tax, making it harder for smaller jurisdictions to raise revenue from taxes. If this factor implies that more taxes should be collected by the center, there will be a tendency for there to be a mismatch between revenues and expenditures for subnational jurisdictions, to the extent that subnational governments are relatively better able to respond to diversity of preferences.[35] This is certainly true in India, and is dealt with through large intergovernmental transfers, including tax sharing but also the other channels discussed in earlier sections. The argument in this paper is that large transfers create problems for expenditure efficiency, and that this argues for decentralizing revenue authority along with expenditure responsibilities.[36]

[34] The most common fees are user charges for water and lighting. These are typically collected at the lowest rural level and, in the absence of monitoring ability, are flat fees. On the other hand, charges for sanitation, or for public events such as fairs and festivals, are rarely assigned or employed. *Panchayats* (village level councils) are usually not empowered to levy user charges on health and education (with some states being exceptions), even though aspects of these functions are assigned to them. User charges in urban areas are often extremely low, not just for goods consumed by the poor, but also services such as land development (Rao and Singh, 2003).

[35] The problem of tax competition can be avoided to some extent by coordination of taxes among subnational jurisdictions. For example, different states might agree to charge the same minimum sales tax rate or income tax rate. The center can also impose this coordination of minimum rates, to reduce cheating.

[36] Singh and Srinivasan (2013) analyze issues of incentives with respect to intergovernmental transfers. In addition to arguing for redesigning the formulaic part of the intergovernmental transfer system to directly improve marginal incentives, they also suggest that reducing the magnitude of transfers can decrease the scope for political influence effects that distort subnational behavior, as well as directly improving subnational political incentives – constituents of subnational jurisdictions can more clearly identify the Wicksellian connection between their costs and benefits in voting on taxation when transfer revenues do not dominate lower level government budgets. Since there is no reason for centralizing expenditure decisions more than the status quo, reducing transfers requires further decentralization of tax authority. This can be done through allowing subnational jurisdictions to piggyback on some of the same tax bases that are used for center-state tax sharing. For example, allowing states and local governments to impose income tax surcharges would not only improve their marginal retention, but it could reduce the need for tax sharing. Piggybacking, combined with a removal of the distinction between nonagricultural and agricultural income, would represent a change in tax assignments that could increase efficiency as well as reduce the states' fiscal problems. Paralleling the suggestions for center-state tax coordination, small piggybacking taxes can also be introduced at the local level at the point of last sale to replace octroi, giving local governments a chance to benefit from the new GST infrastructure.

The last dimension of revenue institutions, after statutory assignment and imposition, is collection. Collection of taxes and user charges is relatively poor at all levels of government. Even the mechanisms for collection of charges between governments or government-owned enterprises function poorly, although India has reasonably well-defined institutions and organizational structures for collection. Of course, corruption is a major problem at all levels, so that illegal payments substitute for tax or fee collection. Designing administrative systems to control corruption is not easy, but can be done, following certain conceptual guidelines (Das-Gupta and Mookherjee, 1998). In many cases, the design of tax systems is poor, hindering collection and encouraging corruption, and here progress has been made in areas such as the national income tax and state sales taxes. However, particularly at the state and local levels, design problems remain. Sometimes rates or fees are trivially low, making collection inefficient. In other cases, tax rates are prohibitively high, encouraging corruption. Assessment of tax liabilities is often done poorly, especially for cases such as the property tax (World Bank, 2004). Exemptions of various kinds narrow tax bases, reduce fairness, decrease allocative efficiency, and also encourage evasion.

Poorly designed tax systems and fee schedules make collection more difficult, contributing to poor collection rates. For some taxes, such as the urban property tax in many cities, collection rates have been abysmally low, but problems have also existed for national taxes such as the personal income tax. Poor collection rates at the local level are also a reflection of poor accountability, both in delivery of public services that are meant to be funded from these taxes and fees, and in the collection agencies and their political superiors. Poor revenue collection is therefore another aspect of the low level political equilibrium analyzed by Rao and Singh (2003).[37] Formal institutions such as the bureaucracy and public enterprises function below their potential in this kind of equilibrium.

A final point to emphasize is with respect to the political economy of the three tiers of government in India. Center-state relations have long been viewed as contentious, with the central government seeking to impose political and economic control on the states, for reasons ranging from fears of disintegration to individual egos and insecurities. Economic liberalization in the 1990s coincided with the beginning of local government reform, but also problems of fiscal management at the state level. In a sense, this was the least auspicious time for trying to push expenditure and revenue authority down to the local level, in order to improve the delivery of local public goods and services. The states in some cases even viewed local government strengthening as driven by a desire of the center to do an end run around them. From this

[37] Their model of government-citizen decision-making is adapted from Inman (1985), in analyzing tax limitations imposed by voters in some states in the U.S. The relevance in this context is the observation for Indian local governments that their decision-makers are reluctant to impose higher taxes, or to collect existing taxes because they fear voters' displeasure – indeed, one hears the argument that taxation should be determined at a distance from the taxed. At the same time, as has been the main concern of this paper, the level of local public services is perceived as too low. The model displays this type of equilibrium. Importantly, it also shows that increasing efficiency, even slightly, may lead to a very different equilibrium, with higher levels of provision and higher welfare.

perspective, the structure of center-state fiscal relations continues to be a barrier to local government reform. The politically feasible way to improve local government functioning may therefore be to increase the revenue authority of the states, giving them the fiscal room to support urban governments in particular, where infrastructure needs and growth will create the greatest pressures.

7. Conclusions

India's government works very well in some ways (functioning democracy, stability, responsiveness, and so on) but is maddeningly inept in others, especially in improving provision of basic public services, ranging from health and education to water and electricity supplies. Lant Pritchett's term of a "flailing" state for India uses a bodily metaphor: "*a nation-state in which the head, that is the elite institutions at the national (and in some states) level remain sound and functional but … this head is no longer reliably connected via nerves and sinews to its own limbs*. In many parts of India in many sectors, the everyday actions of the field level agents of the state—policemen, engineers, teachers, health workers—are increasingly beyond the control of the administration at the national or state level." It may be debatable whether the deterioration is in absolute terms, or relative to expectations and aspirations, but the question is what can be done to change this situation.

Pritchett's solution to the problem that so many have identified, and which he has so picturesquely named, is unclear. He suggests that India's "administrative modernism" is out of step with the country's politics and society. He argues that political competition focuses on loyalty to identity groups, rather than provision of effective public services. He suggests that India will eventually muddle through with incremental reforms and learning by doing. This paper has offered some different perspectives on the problem and the possible solutions.

Ultimately, as Pritchett and others have recognized, a major issue is that of weak accountability of government employees. Accountability can be internal, within an organization (for example, to one's boss), or external, such as to citizens as voters. There are a variety of ways in which accountability can be improved. Agarwal and Somanathan (2005), themselves senior bureaucrats, suggested some structural changes for decision-making within central ministries, including letting more policy implementation be managed below the top level, providing better career incentives for performance by elite bureaucrats, and broadening the input of expertise into policy-making.

The suggested changes can, in fact, be thought of as embodying two fundamental principles, those of decentralization and competition. Decentralization allows for better matching of skills and tasks, at least when training is appropriately provided. Competition provides incentives, sometimes pecuniary, but sometimes non-pecuniary, for better effort. The interesting idea here is that relatively small structural changes at the very top may have significant impacts – the decentralization envisaged is modest, just pushing some decisions one or two levels down the hierarchy. The competition envisaged is also modest – slightly more in the way of performance expectations and appraisals, plus potential and actual competition from outsiders to the bureaucracy.

Such micro reforms can, of course be copied at the level of each state government, and would need to be. A second set of reforms, which are much more macro in nature, apply the principles of decentralization and competition at a different scale. This paper has argued that India's so-called flailing state is very much a result of over-centralization with respect to the different tiers of government. It has argued that more expenditure authority needs to be pushed down to the level of state governments, and from there to local governments, particularly city and town governments. Currently, the states appear to have considerable responsibilities for expenditure, and there is a view that they have failed to meet these responsibilities, necessitating more central government control through transfers with strings attached. Here we have developed a case that state governments instead need to be given more autonomy, and that more revenue authority needs to be delegated to state governments, who must then delegate further to local governments. Decentralization is essential for creating effective external accountability, which in turn can drive internal accountability.

Of course, in decentralizing there are issues of inequity, of corruption, and of capacity. However, each of these can be addressed directly. None of these problems is solely associated with decentralization, and none of them has to be a necessary difficulty of decentralization. The initial evidence from India's massive local government reform supports the idea that accountability and effectiveness can increase with decentralization, even as mechanisms are needed to deal with the adverse consequences mentioned. And this has happened without giving local governments even a semblance of appropriate revenue authority.

The two suggestions for government reform presented here – decentralization and competition within top-level government organizations, and across tiers of government – illustrate the problem with Pritchett's metaphor. There is not just one brain that controls nerves, sinews and limbs. Government is made of individuals with skills that can be better utilized, and that can be improved. Democratic governments ultimately serve at the pleasure of citizens, and government workers need to make that connection more explicitly. A focus on these possibilities can make government work better more rapidly than the pessimists might believe.

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