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India's Interventionist State

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India's Interventionist State

Reduce Its Scope and Increase its capability

By Ajay Chhibber [1]

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Abstract: *This paper lays out a two-part strategy to improve the effectiveness of the state in India reduce the scope of the state and then improve its capability. It argues that the state tries to do too many things and ends up doing many of them badly. It must reduce its scope and change the way it does things – reduce their complexity. It must also strengthen the capabilities of the state institutions – especially those dealing with administrative functions and rule of law. The state must also build up the capability of local administration and increase its financing. It must also get out of the business of business by privatizing state -owned enterprises.*

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"Institutions, not armies, determine the destinies of nations" Napoleon Bonaparte

Among the many things COVID-19 exposed, is not just how weak is India's health system but more broadly how insufficient is India's state capacity to manage and coordinate and to deliver responses to such shocks. India has seen, reportedly,[2] lower incidence rates and death rates per capita compared to most western countries, but within Asia it remains amongst the most severely affected country. But these weaknesses were evident in its inability to deliver basic public services like health and education well before the pandemic hit.

A reform of the state to reduce its scope and increase its effectiveness at all levels is badly needed to reset India for the 21st century. It was a reform India needed even before the pandemic, but its urgency has now been brought to the forefront – not only to deal with future emergencies, but also if India is to emerge as an economic power in the 21st century and be a happier country with social justice and a healthy democracy.

This paper tries to lay out the broad contours of that reform, what it would entail and how to prioritize in such an ambitious undertaking.

I. What Kind of State does India have?

There is a saying on the front of the Vidhan Sabha of Karnataka in the city of Mysore "Government Work is God's work". This was meant to be a positive motivator– but now usually elicits a laugh – as the government is seen as overbearing and omnipotent in a not so positive manner and corruption-ridden. Sarkari Raj permeates all aspects of life in India.

India's state is more welfarist than developmental. But it does not even do welfare very well. That is why the term "welfarist" – that the intent is welfare but not the outcome is more appropriate. India also aspires to be a developmental state but spends so little on basics like education, health, infrastructure that it can hardly be called one.

The size of the government, even adding in sub-national governments, is not too large[3] but its scope is very wide. As a result, it ends up trying to do too much and end up doing things badly. Some have called it the "flailing" state – suggesting that the head and its limbs are not well coordinated.[4] It has a penchant for grand schemes and

[2] India's official numbers on incidence and deaths are probably a substantial under-count

[3] Kapur (2020) says it's too small – but he looks at tax receipts not at total receipts and when we add large fiscal deficits the total government spend is not too low by India's level of GDP.

[4] Pritchett, Lant. 2009. Is India a Flailing State? Detours on the Four Lane Highway to Modernization. HKS Faculty Research Working Paper Series RWP09-013, John F. Kennedy School of Government, Harvard University.

plans – whose execution is weak. Some even argue that India has developed despite the state and that India grows at night when the government sleeps. [5]

India's constitution was amended to add the word "socialistic". That again showed no clarity on intent – neither socialist nor capitalist – a muddled hybrid. Since the 1991 liberalisation India has become over time more capitalist but its capitalists remain highly dependent on the state. The Modi government which came to power in 2014 said "the business of government is not business". But getting the government out of business has not yet seen much success and the state remains omnipotent – perhaps even more so.

Because India is a democracy it cannot be an overly predatory state like in kleptocracies such as Congo [6] The poor are the vote banks and are doled out larger and larger promises of programs and subsidies – which are then poorly distributed – subject to huge leakages. The voters keep government from becoming too predatory by throwing out government ever so often. It is a form of populism exercised every time there is an election. The electoral cycle doles out more and more hand-outs, what people need are steady hand-ups to help them stand on their own feet through better education, health, electricity, roads and decent jobs.

Mehta and Walton (2014)[7] pose these dilemmas of the Indian state by presenting three positive attributes of the Indian state – its stated objectives and its outcomes as three negative realities. They argue that the Indian state wants to be seen as a provider of services and protector of the disadvantaged ; but also as a social welfare state built on the rights of citizens and as a handmaiden of capitalist development to make India an economically great nation in the world and that different parts of the political system and the bureaucracy espouse these objectives. But the reality is quite different from those laudable objectives. The state has become more a mechanism of distributing privileges to individuals and groups, more populist and captured by capitalist interest groups increasing inequalities and damaging the environment.[8]

This constant and continuous struggle between these aspects of the state have played out but as we shall we see in this chapter the negative outcomes are winning out in various ways and unless a major reset is undertaken will hold back India in the 21st century. This nexus between India's capitalists and the state – and the growing illiberalism of the state – towards dissent, towards minorities and the destruction of independent institutions is document also in a recent book Kaur (2020) – and is not unique to India.

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[5] India Grows at Night: A Liberal Case for a Strong State Hardcover – December 12, 2012 by Gurcharan Das.

[6] Evans, Peter B. "Predatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State." *Sociological Forum*, vol. 4, no. 4, 1989, pp. 561–587.

[7] ESID Working Paper No. 36 Ideas, interests and the politics of development change in India: capitalism, inclusion and the state: Pratap Bhanu Mehta and Michael Walton July 2014

[8] See also Bardhan (1996) for a review of the role of the state.

II. Some History: How Did We Get here?

The Arthashastra laid out the principles of good governance and state administration by Chanakya (Kautilya) as early 300 BC – but were then forgotten for centuries after the Gupta Empire crumbled around 600 AD. In amazing detail, the principles of public administration were laid out and explained – from taxation, tax administration, judicial administration, activities of various departments, foreign policy, to dealing with epidemics, famines and catastrophes like fires and floods. With such attention to the conduct of the state it is not surprising that Indian flourished during the Mauryan empire.

Another golden period was the rule of Akbar the Great during the Mughal empire around 1600 when taxation was tempered, wars were contained and trade and commerce flourished – but all this soon disappeared as in fighting and wars exacted huge pressures towards greater taxation and by the time of Aurangzeb's rule was over around 1700, the empire was already in decline.

Pre-independence most Indians were used to a colonial style government that provided rudimentary security but not much else. [9]Even at times of extreme catastrophe – such as the 1918 Spanish flu pandemic, or during massive famines in 1944 the government did very little to help people[10]. Whatever help came, it came largely as a by-product of the colonial interest. The railway system was not designed to develop India but to carry products needed by England to the ports and for military logistics. The plunder of India by the British was well documented early on by eminent scholars like Dadabhai Naoroji and one of the best accounts recently is by Tharoor (2016).

As a result, between 1900 and 1950 India's GDP did not grow at all and at independence almost 80 percent of the population were in extreme poverty. As Dr Manmohan Singh[11] summarized it well, "*There is no doubt that our grievances against the British Empire had a sound basis. As the painstaking statistical work of the Cambridge historian Angus Maddison has shown, India's share of world income collapsed from 22.6% in 1700, almost equal to Europe's share of 23.3% at that time, to as low as 3.8% in 1952. Indeed, at the beginning of the 20th century, "the brightest jewel in the British Crown" was the poorest country in the world in terms of per capita income."*

With independence India swung from a minimalist extractive colonial state to the other extreme. Enamored by the industrial success of the USSR, Prime Minister Nehru espoused a state-led development model where the "commanding heights of the Indian economy "would be in state hands. In 1956 with the Industrial Policy Resolution

[9] Kapur (2020) shows that British India spent even less than other colonial administrations. Perhaps that was good as it meant less taxation and had it spent more it would probably have not been to help India's development but to meet colonial interests.

[10] In fact, as brought out in Tharoor (2018) under Churchill's orders grain was moved from India to southern Europe for troops fighting there while millions starved

[11] "Of Oxford, economics, empire, and freedom". *The Hindu*. Chennai. 2 October 2005. Retrieved 2010-12-06.

India restricted key sectors of the economy to the state, nationalized some companies which were considered strategic like air lines and shipbuilding. Subsequently India nationalised large parts of its financial system, as well as some sectors such as coal and steel.

Figure1: Degrees of State Intervention

<table>
<tr><th></th><th colspan="3">Addressing Market Failures</th><th>Improving Equity</th></tr>
<tr><td>Minimal Functions</td><td colspan="3">Providing Pure Public Goods:
Defense
Law and Order
Property Rights
Macroeconomic Management
Public Health</td><td>Protecting the Poor:
Antipoverty Programs
Disaster Relief</td></tr>
<tr><td>Intermediate Functions</td><td>Addressing Externalities:
Basic Education
Environmental Protection</td><td>Regulating Monopoly:
Utility Regulation
Antitrust Policy</td><td>Overcoming Imperfect Information:
Insurance (health, life, pensions)
Financial Regulation
Consumer Protection</td><td>Providing Social Insurance:
Redistributive Pensions
Family Allowances
Unemployment Insurance</td></tr>
<tr><td>Activist Functions</td><td colspan="3">Coordinating Private Activity:
Fostering Markets
Cluster Initiatives
State-Owned Enterprises and Banks</td><td>Redistribution:
Asset Redistribution</td></tr>
</table>

Source: Adapted from World Development Report 1997, World Bank

Figure 1 adapted from the 1997 World Development Report shows degrees of state intervention. Based on this India covered pretty much all the possibilities of state intervention – except perhaps for asset distribution – although nationalization could be considered a form of asset distribution. But India did not do serious land reform as was done in many East Asian countries. [12]The key goals of the Industrial Policy Resolution of 1956 were - i to build infrastructure and promote industrialization, ii. To promote employment and balanced regional development, iii. To create a self-reliant economy

[12] See also Kelkar and Shah (2019) for numerous examples of where the Indian state intervenes far beyond justified reasons for intervention such as addressing market failure, provision of public goods and asymmetric information.

through import substitution and promote exports, iv. To generate surpluses for development, v. To prevent concentration of economic power. During this period, public sector investment reached over 50 % of total investment. Many new public sector companies were established and private companies in sectors such as coal, airlines, banking and insurance were nationalized.

Industrial licensing was introduced - prescribing what the public and the private sector could produce.[13] India was not the only country in the developing world that went down this path after WWII. Most post -colonial countries went down this path across Africa and Asia but so did countries like China and others in Latin America. Import substitution and state led planned development became the model across much of the developing world. In India this involved not only setting up state -owned enterprises but also efforts to control and plan private sector development. An entire apparatus - often referred to as the "license-raj" was established to make decisions on the number and types of licenses.

The license-raj combined with inefficient public enterprises nurtured inefficiency and corruption, producing a bevy of intermediaries, whose main function was to grab these licenses and sell them off to the highest bidder. Prof Raj Krishna called the license-raj, "Socialist allocation in the first round followed by market allocation in the second round". In some cases, large private business houses would grab the license to expand production but delay its execution in order to benefit from the shortages, or just keep the license unutilized to stave off a competitor from entry into the industry. One of the original objectives of the policy to establish PSE's was to help industrialize the economy and build infrastructure: especially as was then thought the private sector was unwilling to enter.

Soon after independence the sense was that the private sector was too weak to be able to handle risks especially in capital intensive sectors. But unlike Japan, Korea and Taiwan which relied on a strategy of helping the private sector grow and reduce their risks, India followed the approach of setting up public sector companies. Such thinking was not just Nehruvian socialism but strongly supported by the industrial class of the day. [14]

But this approach proved disastrous and India's GDP growth remained low averaging only 3.5 % between 1950 and 1980, in the first 3 decades after independence with per capita GDP growing at only 1.3% on average.[15] It was famously called the "Hindu growth rate" suggesting that Hindu fatalism was responsible for this slow growth, but as we saw later when with better policies India grew faster, Hinduism

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[13] See Mohan and Aggarwal (1990) for a detailed description and its history of India's license-raj regime.
[14] Ajay Chhibber (2019) in an article published in a book on the Bombay Plan edited by Sanjaya Baru and Meghnad Desai "shows that "…the parenthood of India's shift to State Planning is hard pin on Prime Minister Nehru alone. Even the top industrialists of that time, JRD Tata and GD Birla, were pushing for State control and planning as co-authors of the Bombay Plan."
[15] This was of course faster than growth in the period 1900-1950, but well below what other developing countries in East Asia and Latin America were able to achieve especially after 1965.

had nothing to do with it. India's poverty rose during this period and India fell behind many countries on social and economic indicators. Some internal liberalization was pursued in the 1980's, but it was insufficient to address the growing problems in the economy. It eventually took a balance of payments crisis in 1991 to force the political establishment to accept the need for reform.

After pursuing state-led capitalism for four decades after Independence, triggered by a major economic and financial crisis, India introduced a new industrial policy in the 1990s. Given the perception that state-led capitalism had failed there was a significant change in thinking after the 1991 liberalization. The private sector could enter many restricted areas especially in mining, power generation and in telecommunications and airlines. The state had expanded its role in certain priority areas like electricity. But subsequently state control on the economy was reduced. The Electricity Act 2003 was enacted which completely de-licensed power generation and also permitted captive power plants. It also facilitated private sector participation in transmission sector and provide open access to grid sector. Various policy measures facilitated increased private sector participation in key infrastructure sectors such as, telecommunication, roads and ports. Foreign equity participation up to 100 per cent was allowed in construction and maintenance of roads and bridges

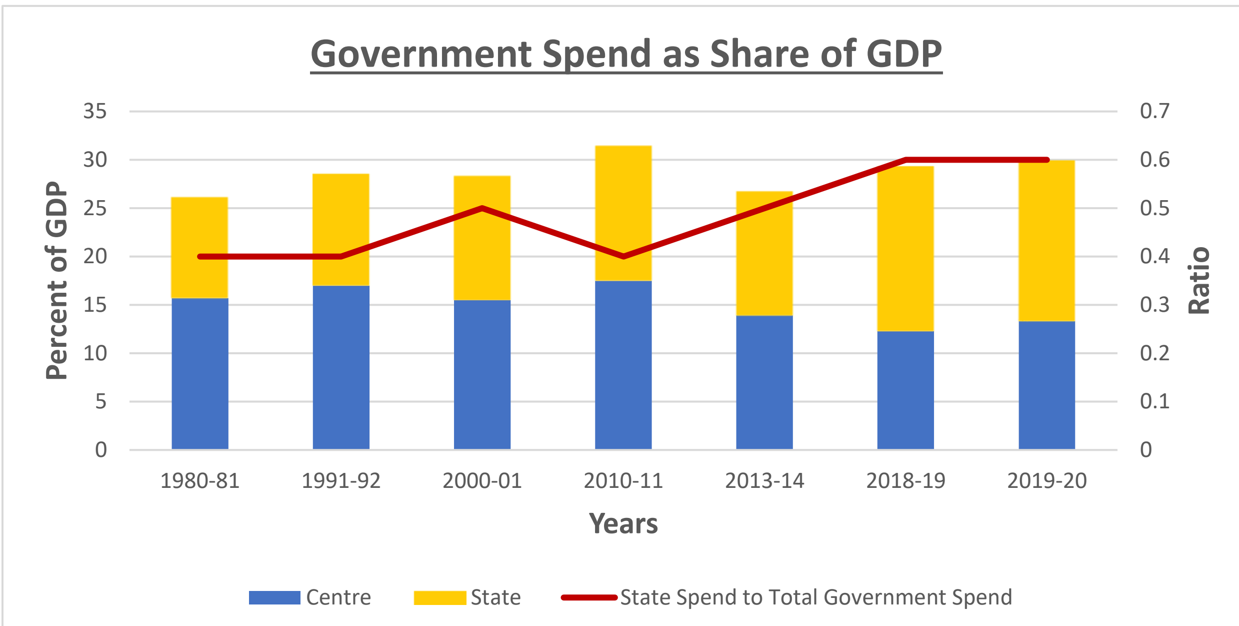
III. The Broad Strategy for State Reform

What does reform of government entail? The size of India's government is not outlandishly large - but its scope is very wide and as a result its capabilities are declining over time. Despite the 1991 reforms, which rid us of the license raj, the government still remains involved in too many things and its new regulatory structure has reverted to a pseudo license raj that it thought it rid itself of in the 1990s. And now judicial activism triggered by brazen corruption (scams) creates its own uncertainty. As they say, in India, unlike in East Asia, even the corruption is unpredictable.

The size as measured by government expenditure in fact increased – between 1980-81 to 1991-92 and has since remained in the range of 26-31% of GDP – averaging around 28%. What has changed is the composition – more money is now spent by state governments since the acceptance of the recommendation of the 14th Finance Commission (Figure 2). The GST was another major reform – heralded as a major– the recent imbroglio over GST – has shown how quickly the central government can take back what they promised. As GST revenues fell sharply in 2020 due to the pandemic the central government reneged on its promise to increase state GST revenue share by 14% every year and has now provided states the option to borrow on their behalf the shortfall in revenue. This has soured center-state relations and put the entire spirit of "cooperative federalism" in jeopardy. This has also meant that further reform of GST – to bring in petrol, real estate and liquor into the GST is now unlikely. [16]

But while government spend remains at around 28% of GDP overall revenues have only been in the range 21% of GDP – so that the combined deficit of state and central government has been around 7% of GDP. Financing this deficit has meant huge financial repression – as India has run a current account deficit of only around 2% of GDP this has meant that around 5% of combined government deficit was financed by domestic savings. Such large financing needs has meant substantial financial repression – which has distorted India's financial system. The GST promised an increase in revenues by 2-3 % of GDP, but with a botched start and major design issues whose resolution is now in jeopardy that promise will not be realized for some time to come.

Figure 2: Government Expenditure by Centre and States in India



Source: Handbook of Statistics on the Indian Economy: Reserve Bank of India, various issues

Some argue that the Indian state is too small. Kapur (2020) makes that case adjusting taxpayers and tax revenue as a share of GDP. But he makes an odd adjustment for democracy to make the case that India is below the cross-country regression. There is no compelling reason why democracies need to collect higher taxes. Many socialist non-democracies who provide more government services to their citizens must also raise more taxes. But he also misses out India's huge non-tax revenues. India also runs large fiscal deficits both at the centre and in the states so a better comparison would be to compare India's total government spend as a share of GDP.

[16] And as Kelkar and Shah (2019) point out it would have been better to have started with a single rate GST with additional revenue collected in the form of luxury or sin taxes and introduce complexity once the implementation was well established.

Here as Figures 3 and 4 show India spends as much as a share of GDP as many countries at higher GDP levels.

Figure 3: India Revenue Comparison with OECD and select Emerging Economies

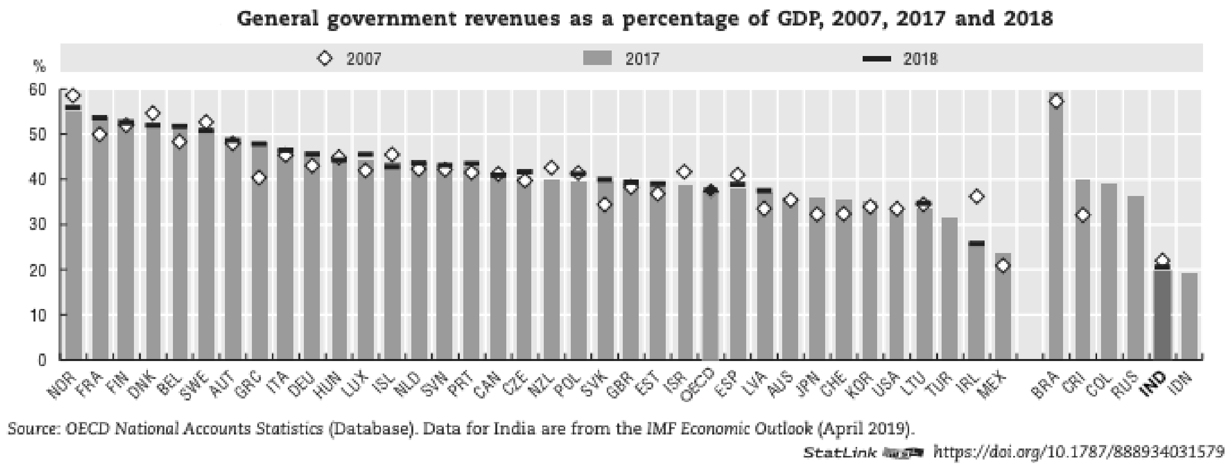


Figure 4: India Expenditure Comparison with OECD and select Emerging Economies

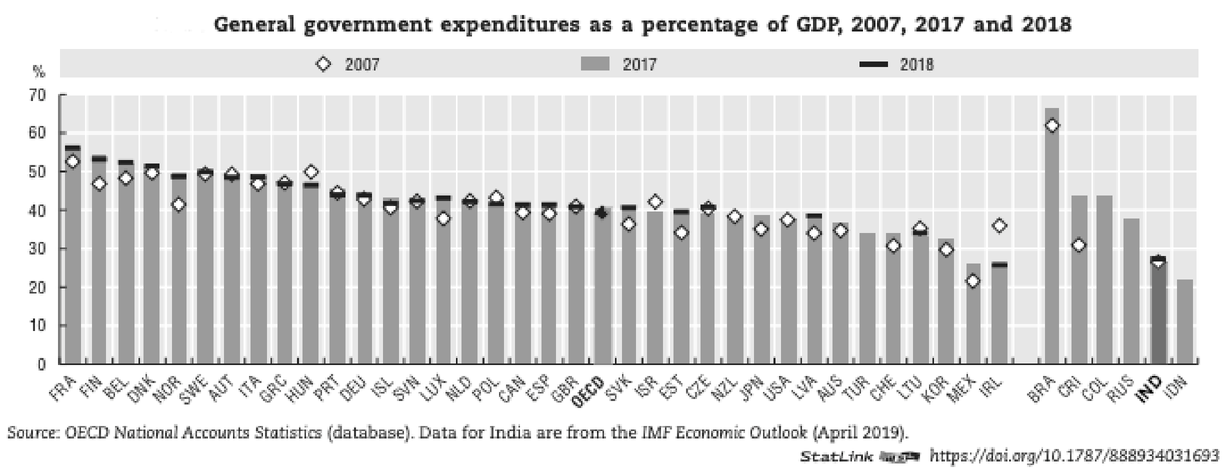


Figure 5 adapted from the World Development Report 1997 and Fukuyama (2004) demonstrates how state effectiveness is determined by its scope of intervention and capability[17]. For any specific level of capability, greater state intervention is beneficial up to a point – but if the scope gets too interventionist for any given level of capability – the state's effectiveness declines. Effectiveness can be improved by reducing scope and increasing capability. [18]This – two-part strategy for improving the effectiveness of the state was first laid out for large parts of the developing world in WDR 1997.

[17] I prefer the term capability to capacity – capability means capacity plus the ability to use that capacity.
[18] See Akram and Rath (2020) for evidence of state size and effectiveness.

India was hugely interventionist in 1990. For the sake of comparison, we show that broadly the degree of intervention of the Indian state is more than in Korea, but their capabilities are much higher. China's state is more interventionist but also more capable. New Zealand carried out huge state reforms in the 1980's and became much less interventionist but also far more capable (Figure 4). For India, the 1991 reforms meant that by 2020 the degree of state intervention declined to some extent, but the capability of the state had also declined – due to corruption, lack of administrative reforms and reduced competence To improve India's state effectiveness, it must further reduce its degree of intervention and build up the capability of the state. Such a process will take a at least a decade up to 2030.

Figure 5: State Reform: Reduce Scope, Improve Capability, Increase Effectiveness

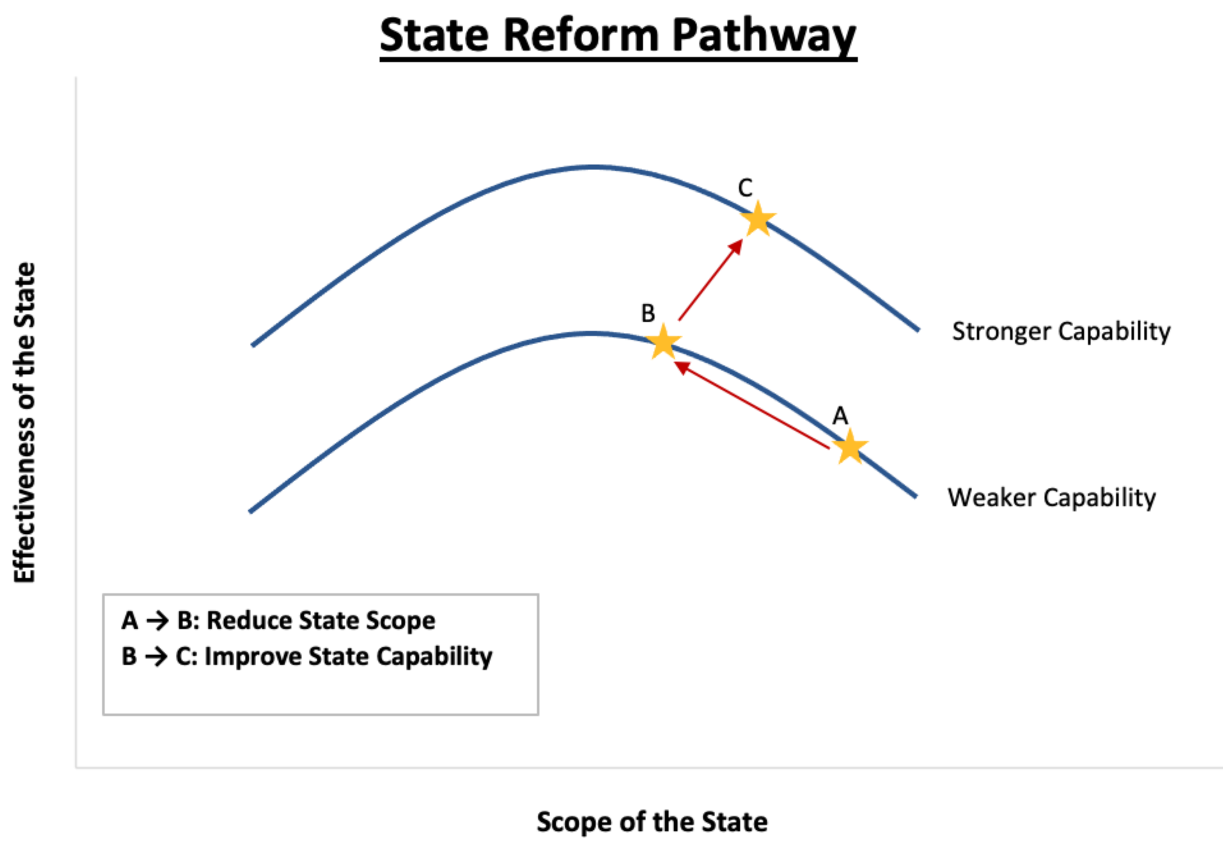
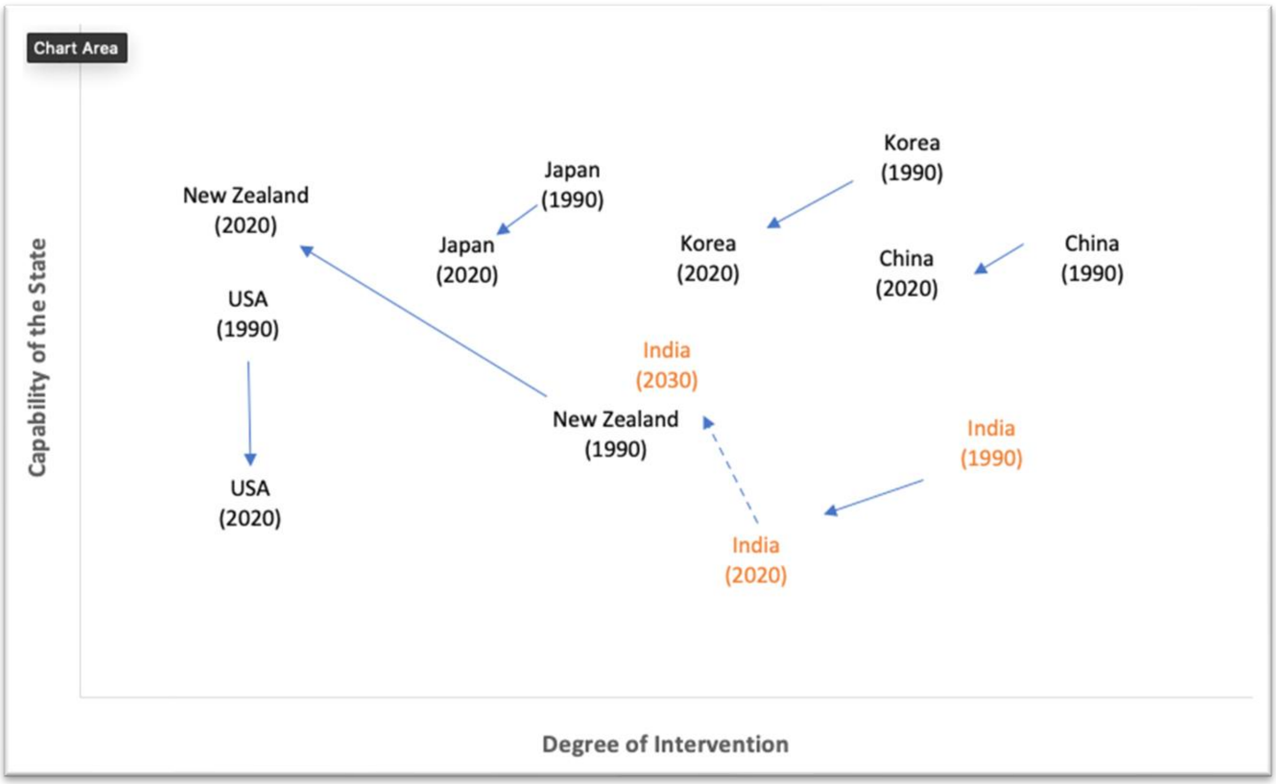


Figure 6: Direction of State Capability and Scope in India and Selected Countries



Source: Adapted from Fukuyama (2004)

India underwent a phase of liberalization after the 1991 reforms but some 25 years later the legacy of the public sector and government control remains large at the central and state level. Controls have shifted from licensing to regulatory bodies and a large public banking system remains allowing the business-politician nexus enormous power, patronage and opportunity to shift down -side risks to the taxpayer and derive huge profits on the upside.

India is ready for a second set of reforms to unshackle India from state controls reduce the footprint of the state so that the government's slogan of "maximum governance; minimal government" can be realized. India has a public sector balance sheet with a large portfolio of public sector companies whose total assets exceed \$500 billion (18% of GDP). It must, over the next ten years, convert this balance sheet of capital in PSE's into a balance sheet of public infrastructure which can deliver services and crowd-in private investment for sustained long term growth and poverty eradication. We take this issue up in Section IV.

But while reducing the scope of government is one phase of the reform, improving state capacity to perform vital functions must also be a key part of that reform. In many East Asian countries administrative reforms have been given as much attention as economic reforms. There is no point in formulating great policies and policies, if you cannot implement them. China began its economic reforms in 1980 under Deng Xiaoping, which allowed a market system to develop and the economy to start growing rapidly. Some 15 years later Premier Zhu Rongji carried out a sweeping reform of the bureaucracy and public administration to ensure that a more effective and smarter government emerged to meet China's new challenges. This helped China maintain the momentum to sustained growth for another two decades.

India started its liberalization in 1991 with then Finance Minister Manmohan Singh as the principal architect of the reforms. This helped boost growth for two decades or so. But India missed the bus on administrative reforms when he was Prime Minister. Had India followed the Chinese pace it should have carried out such reforms in 2005-06[19], the period of the UPA-I government, but coalition realities probably held it back from doing so. India certainly had another opportunity to do so again when UPA-II came back to power but did not take up the challenge. Perhaps it was distracted by the global crisis and perhaps administrative reforms are not politically easy for a democratically elected government, as it means giving up your own power. The bureaucracy finds hundreds of ways to stall such reforms – a big political push is needed, and their time frame would span at least a decade – too long for the electoral cycle.

India is becoming a welfare state before becoming a developed state. The compulsions of its democratic system have forced it to address the problems of poverty with subsidies rather than more long-term sustainable solutions. As a result, India now spends almost 4 per cent of GDP on subsidies (almost as much as it spends on public education and health) - but also delivers them in a very ineffective manner with high leakages. Again, the contrast with China is striking which has addressed poverty by creating jobs and providing basic services - health, education, sanitation and not through subsidies.

Even those emerging market economies that use subsidies have shifted away from product-based subsidies (food, fuel, fertilizer, etc.) to more people-based subsidies (cash transfers) to reduce costs and provide the poor more flexibility in their decision making. India must move in this direction, reduce its subsidy bill and release more resources for health, education, water and sanitation.

IV. Dealing with the State-Owned Enterprises – Bharat's Other Ratnas[20]

We all know about "Bharat Ratna" India's highest civilian award. Famous individuals like many of our independence fighters and more recent awardees like the great cricketer Sachin Tendulakar and the famous singer Lata Mangeshkar have received the Bharat Ratna. They are the venerated "Whose' Who" of India.

[19] An administrative reforms commission (the second one after 1956) was established under Veerappa Moily in 2005 and it submitted a comprehensive report with over 1600 recommendations but very little was done.

[20] This section draws heavily on Chhibber (2018), Chhibber and Gupta (2017)

But there is surprisingly little debate on India's other Ratnas — the more than 230 public sector undertakings that were once the commanding heights of India's socialistic economy and still account for about 20 per cent of the GDP and 15 per cent of stock market capitalization through 50 listed firms? Prime Minister Modi made a pledge to the US investors almost two years ago, which he repeated to German investors recently, that "the government has no business to do business".

India calls its state-owned enterprises public sector undertakings (PSU's). Despite all the rhetoric, of privatization and reform India still has over 230 Central PSUs, of which seven are Maharatnas, 17 are Navratnas and more than 70 are Miniratnas — the crown jewels of India's socialist legacy. There are also over 1,000 PSUs in state and municipal hands. It is time to clean up this costly legacy. But how to do this and what approach to take towards them is not so straightforward given the vast network of vested interests that are keen on their perpetuation. How did we create such a giant albatross is described in Chapter …? Here we examine what reforms have been undertaken so far and what India needs to do for a reset to the 21st century.

The Declining Role of PSU's in the Indian Economy

Since the 1991 liberalization the role of PSUs has begun to decline, largely because the private sector has expanded rapidly. PSU share in employment in the organized labor force and its share of value added in GDP is now around 5 percent-down from 10% in 1990. But they still retain substantial assets: over 20% of GDP. Their share in manufacturing and mining has declined but remains significant.

About half of them are in manufacturing and mining and the rest are in service S sector – transport, telecommunications, financial and technical services. Service sector PSU's are just over 100 while, non-service is around 130. There are over 1000 state level public sector enterprises (SLPE's), but they do not follow any classification system and are not all covered in a uniform manner across states. The combined assets of all PSU's was around 35% of GDP has declined to just over 20% of GDP [21] Over the same period the sales to GDP ratio declined from 20% of GDP in 1990 to about 14% of GDP : a much smaller decline indicating that the sales to asset ratio (also sometimes referred to as the turnover ratio) increased from 0.5 in 1990 to around 0.8 . Value added created by PSU's as a share of GDP and the ratio of PSU employment to total organized employment in the economy declined from around 8% of GDP in 1990 to under 5% of GDP. Post the 1991 liberalization although the number of PSU's has remained the same, their share in the economy measured by value added, employment and sales has declined, as the private sector has expanded faster. This is a pattern we see in several other countries with state capitalism such as in Brazil and China, where the share of state enterprises has also been declining.

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There have been very significant changes in the value added from PSU's in different sectors of the economy. PSU value-added share in mining has declined from 80% in 1990 to less than 50% by 2003-04 and under 20% today. The share of PSUs in the service sector has remained low. In the manufacturing sector it declined from 20% in 1990 to under 10% in 2004-5 but has surprisingly risen again in the last three years, mainly due to the oil and petroleum PSU's, and those dealing with by products such as chemicals and fertilizers.[22]

Combined, PSU's make profits, but about 30% of them are serial loss makers[23] and the return on capital – except for the largest PSU's -is below that of comparable private firms. The losses alone would amount to around 10% of India's public infrastructure investment showing the opportunity cost of persisting with these enterprises in the state sector. Labor productivity in PSU's has grown at 2% per annum as against 5.2 % for the economy.[24]

The PSU's can be classified into 3 tiers: loss makers, profit makers and those that fluctuate between profit and loss and could potentially be turned around either through better performance in state hands or through disinvestment. PSUUs have gone through various types of restructuring and for various reasons. In some the purpose of the restructuring is to get the company ready for disinvestment (share sale) and listing in the stock market. In others, it is to stem the losses and in some it has been to try and turn loss makers into profitable companies. The restructuring story is very firm specific and cannot be summarized into any neat category.

In addition to government equity some PSU's relied on soft loans from the government. These soft loans are in addition to their borrowing from the financial sector and international agencies. The soft loans have been criticized as they remove a hard budget constraint and allow inefficiency to persist and work against the objective of greater commercialization in the functioning of PSU's.

Surprisingly such soft loans continued to rise even after the 1991 liberalization[25]. Some of these loans were paid back but in many cases were delinquent and were written off and some turned into equity. The government was keeping a lifeline to loss makers through these soft loans, while at the same time trying to get them to improve sending very conflicting signals.

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[22] The PSU's which have shown biggest improvements in value added in the last three years are: Bharat Electronics Ltd, Bharat Petroleum Corporation Ltd, Chennai Petroleum Corporation Ltd, Hindustan Petroleum Corporation Ltd, Indian Oil Corporation Ltd, Numaligarh Refinery Ltd, Rashtriya Chemicals & Fertilizers Ltd, Steel Authority of India Ltd

[23] These figures do not include the contribution of the state level PSU's for which a centralized data base does not exist. Their contribution varies widely. In 2015-16, for example, in Assam sales to GDP was just over 2% of state GDP whereas in Punjab it was around 13% of state GDP.

[24] This does not include the SLPE's, but given their much poorer performance, lack of any established skills development and training programs their growth in labor productivity is likely to be even lower.

[25] See Chhibber and Gupta (2018) for a fuller discussion on soft loans to PSU's.

The larger PSU's appear to be doing even better than private companies of similar size, based on their reported data. For example, the return-on-assets and return-on-capital in the largest 7 PSUs - Maharatna's appears to be better than firms in the private sector and in FDI-based companies of similar size, though the value of assets, especially land, needs careful scrutiny.[26] Independent audits are needed to assess their performance. But in the case of the next category of PSU's -the 17 Navratna's, the performance of the private firms of similar size is much better, except for the better performance of the Navratna's over their private sector comparators during the period of high growth from 2003-4 to around 2008-9. It is also interesting that the returns on both assets and on capital for the Navratnas went up during the period of rapid growth and has declined quite sharply since the global economic crisis.

PSU's in the service sectors, such as Air India, MTNL and BSNL, and those providing a range of other types of services both financial and nonfinancial have done poorly relative to those in mining and manufacturing. This is also not surprising, given the lack of service orientation in PSUs. Not only is the performance of PSU's in the service sectors worse but their presence could have also adversely affected the performance of private sector firms in those sectors. This is because the government introduces regulation and preferred policies to favor PSU's get a better deal than the private competition in that sector. Mukherjee (2015) stated that in service sectors with erstwhile public monopolies, the vested interest of the government and PSUs adversely affect the performance of the entire sector.[27]

PSU's have also under-performed on various productivity indicators used to measure firm performance. Profit before interest, taxes per employee (PBITE) and Net sales per employee (NSE) have increased five-fold and value-added per employee (VAE) has increased four-fold respectively between 1990 and 2019 .But labor productivity in PSU's – measured by Value-added per employee increased considerably slower at 2% per annum, than average labor productivity growth of

[26] The main issue is whether land owned by these PSU's is entered at book value or market value. In the latter case the picture on their financial performance could look different.

[27] This is probably a bigger issue in the airline sector than in the telecommunication sector. The presence of PSUs in the telecom sector has not had a negative effect on the industry because of a more effective regulatory environment, has not hindered private sector companies. TRAI the telecommunication regulator has had its share of criticism, but it has not been accused of helping PSU's against the private sector[27]. But in aviation, the Director General of Civil Aviation DGCA has not worked as effectively in creating a level playing field and has favored Air-India. It has deliberately or unconsciously affected the performance of private sector airlines. But service sector private companies have also performed poorly for a variety of other reasons.

around 5.2 % for the economy as a whole (including low productivity sector such as agriculture) over the same period.

A major objective in setting up PSU's was to increase employment and this objective was pursued vigorously. Between 1970 and 1990 employment in PSU's almost doubled from 1.1 million in 1970 to almost 2 million in 1990 (around 10% of the organized labor force). The objective was not only to create more jobs but also to improve the skills base of the labor force. This was to be done by a focus on skills development, training and HRD. At the same time PSU's were also told to give special preference to Scheduled Class (SC) and Scheduled Tribes (ST).

In summary there was, and probably still exists considerable over-employment in the PSU's. Their total employment which had reached a peak of 2 million employees in the central PSU's is now only 1.25 million employees for about the same number of firms. This would suggest that under the guise of job creation over-employment of around 60% existed in the PSU's. Some of this has now been corrected and the remaining work force is given better training and skills development. But despite these efforts at improving the skills of PSU employees the growth in labor productivity in PSU's is much below than that of the economy.

Efforts to Reform and Privatize PSU's since 1991

While privatization of PSU's was not part of the liberalization package of the 1991 reforms, efforts to try and improve their performance was. It was too big and messy an issue to tackle during a crisis and in any case the first stage reforms were primarily designed to liberalize trade and markets. But some change was envisaged even in the way the state managed its enterprises Greater delegation of decision making, more commercialization for profitable PSUs and, restructuring of loss-making firms through the Bureau of Industrial Financing and Restructuring were included. Other elements of the liberalization involved: i) Free entry to private sector firms in industries reserved exclusively for PSUs; ii) Disinvestment of a small part of the government's shareholding (while still holding majority stocks) and listing PSUs on the stock exchanges. The most significant of industries affected by the former policy were telecommunications, petroleum (from extraction to refining and marketing), electricity generation and distribution, several basic goods industries like steel, aluminum, mining, and air transportation. And for the latter, ensuring that the listed PSUs follow the stock exchanges' listing requirements necessitated disclosure and governance regulations, appointment of independent directors, independent remuneration and audit committees. Withholding or withdrawing budgetary support to loss-making('sick') PSUs. Subsequently, sick PSUs were denied permission to revise wages and salaries. Loss making PSU's were to be encouraged to lay off workers to seek commercial viability, failing which, they were to be closed.

But between 1992 and 1998, privatization was not pursued aggressively as there was no strong pressure brought on India externally or internally to do that. The IMF did not insist on this as part of its financial conditionality and strong labor unions ensured that the political costs of privatization would be high. Strong political and vested interests and deep-seated bureaucratic preference for PSU's where jobs could be had made sure there was no strong internal constituency for privatization. The Board of Industrial Financing and Restructuring (BIFR) was created to track performance of PSU's and advise them- especially the sick ones- on investment and restructuring. Three categories of PSU's were formed and named; Maharatna's, Navratna's, 3 4 and Mini Ratna's, and performance contract (MOU's) were signed with them to create incentives for better performance.

The NDA government under PM Vajpayee that came to power in 1999, was the first one that followed an aggressive privatization policy but faced political and bureaucratic hurdles. A separate Ministry of Disinvestment was created in 1999[28] -and the objective of disinvestment under it was not just to raise revenue but also improve efficiency. Over 30 companies were either fully privatized or 50 per cent of their stock divested, including one of India's most successful privatization initiatives - the sale of Maruti to Suzuki was completed during this period. Arun Shourie the then Minister for Disinvestment described it well when he stated, "these are not the crown jewels (Ratnas) of India's economy but bleeding ulcers". Under him, privatization which in India is euphemistically called "strategic disinvestment" was pursued with determination but opposition was faced especially from labor unions who had extracted many concessions from the government. But opposition came even from within the NDA government and the bureaucracy as the control over PSU's meant jobs, patronage, and the ability to make money through PSU contracts.

The UPA 1 government which came to power in 2004, dependent on the communists, did not try to privatize PSUs - although, a few were shut down. Prime Minister Manmohan Singh explained his constraints quite clearly, "We are a coalition government, and that limits our options in some ways. Privatization happens to be one such area." It instead encouraged restructuring of state-owned firms by creating the Board for Reconstruction of Public Sector Enterprises (BRSPE) to advise the Government on the strategies, measures and schemes related to strengthening, modernizing, reviving, and restructuring of public sector enterprises. A National Investment Fund was also created to collect disinvestment receipts, with the idea that it would be strategically deployed rather than used as part of budget receipts. Following fiscal pressures after the 2008-2009 crisis, the criterion was gradually relaxed until the fund, for all practical purposes, became part of the budget.

UPA 2 from 2009-2014 pursued aggressive disinvestment (share sales) – not privatization. Its main objective was to raise revenue for the budget: not with any intent to improve performance although that may have turned out to be its unintended

[28] Earlier it was a department of the finance ministry. The subsequent UPA government's once again abolished the ministry and the NDA government under Modi has pushed privatization but has not created a separate ministry to carry it out , presumably because there was so much opposition to that ministry when it was created by PM Vajpayee and headed by Arun Shourie.

outcome, as firms were prepared for listing in the stock market. With the arrival of the NDA government again in 2014 there was an expectation that the disinvestment pursued quite aggressively by NDA1 between 1999 and 2004 would be taken up again and while not much has happened in the first term so far there are signals that more effort will be made in the second term. The government has announced a list of PSUs for closure and for privatization including Air India, but it remains to be seen how much progress will be made on this front. With COVID-19 the plans for privatization have in any case had to be delayed – but are expected to resume in post-COVID as government needs revenue and there are powerful corporate interests wanting to buy these assets.

What does the evidence on PSU (State Owned Enterprises) performance tell us?

There are a vast number of studies PSU's (state enterprises) around the world. Many of them show that privatization improves labor productivity and even profitability of PSU's but not necessarily overall efficiency and productivity. A comprehensive survey of this literature (Megginson and Netter, 2001) concluded that divested (fully and partially privatized) firms almost always become more profitable and more efficient. An OECD survey soon thereafter also came to the same conclusion. Subsequent surveys (Muhlenkamp, 2013) have questioned these findings and shown that the previous survey suffered from flaws. It questions whether privatization leads to greater efficiency and argue that public and private sector firms perform the same when subject to competition and better regulation. Some have argued that many of the studies suffer from methodological flaws as the gains from privatization maybe due to selection bias – as better performing PSU's maybe privatized first.

The most recent survey by UNDP's Global Centre for Public Service Excellence (GSCPE, 2017), shows that privatization is likely to lead to positive results in markets with greater competition and better regulation. This is more likely in developed countries but not so in middle income and developing economies, where the results of privatization are more mixed. Factors affecting PSU performance can be economy wide variables - GDP growth rate, sector or industry specific variables including concentration of firms, size of the firm, export orientation, capital intensity to name some of the most important ones. In addition, the share of private equity (degree of privatization) and performance contracts[29] can also potentially affect firm performance by encouraging commercialization, reducing political interference and giving the PSU management clearer performance goals and targets and pay and other incentives for improved performance.

There is some empirical evidence that performance contracts can improve PSU performance (Shirley and Xu, 1998). There are many studies that try and discuss the performance of PSU's in the Indian context. But very few of these use rigorous techniques and are therefore largely descriptive (Arun and Nixson, 2000; Mathur, 2010;

[29] In India we call performance contract between government and a PSU Memorandum of Understanding (MOU)

Nagaraj, 2005 and Trivedi, 1990). When we look at the more rigorous one's we get some interesting findings.

In a recent paper, (Jain, 2016) uses technical efficiency of the firm as the performance variable, instead of financial rates of return. She applies a stochastic frontier analysis technique to generate technical efficiency by industry and by firm and then examines the impact of disinvestment and the ideology of the state government in which the enterprise is located as well as whether the state government belongs to a political party that is different from the central government. The results indicate that disinvestment - even partial disinvestment - has a strong positive effect on firm performance. The political ideology of the state government as well as whether the state government and the central government belong to different parties has a significant effect on performance. Her results are however dependent on the credibility of the method used to calculate technical efficiency, which is derived as a residual in the stochastic frontier analysis and is therefore dependent on how well specified the model is itself.

(Gupta, 2006) showed that disinvestment (even the sale of minority shares) had a positive effect on PSU financial performance, ostensibly because new owners injected greater commercial drive, which helped improve profitability. Gupta (2011) focused on the evaluation of performance of the PSU's based on data of 213 manufacturing and non-financial service sector firms from CMIE (Centre of Monitoring the Indian Economy) for the period 1988- 2009. This paper supported the fact that the sale of both partial and majority equity stake accompanied by the transfer of management control from government to private owners has economically significant positive impact on performance of PSUs. The paper also considered the impact of the disinvestment on the compensation of employees and employment and shows that the improvement in profitability following privatization is not accompanied by a decline in worker compensation and employment, after controlling for observable and unobservable characteristics of the firms such as firm size, industry Herfindahl index and year dummies to control for contemporaneous macroeconomic shocks. The paper did not look at all at the role of performance contracts (MOU's) and focused entirely on the role of disinvestment. It was also using data from the period largely before the new improved MOU's were introduced.

But this result has been challenged by recent studies as it did not factor in the effect of performance contracts - MOU's. Gunasekar and Sarkar (2014) show that when PSU's with and without MOUs are considered, much of the financial performance improvement using Return on Assets (ROC) - attributed to privatization is due to the performance effect of MOU's. The positive effect of privatization disappears once the MOU performance effect is considered. So, a policy of selling a minority stake (up to 49 per cent) as a disinvestment measure is unlikely to have any positive effect on financial performance. In their first paper (Chhibber and Gupta, 2018) had analyzed the financial performance of India's 235 PSU's using firm level data over the period 1990-2015 from the Public Enterprise Survey (time series panel data set). The paper investigated factors that explain the financial performance - return on capital (ROC) and return on assets (ROA) of these PSU's. The results did show a positive effect of MOU's on their return on capital (ROC), but not on return to assets (ROA) as was shown in the Gunasekar and Sarkar paper.

However, this result, holds only for the non-service sector (manufacturing, mining) but not for service sector firms. In the case of service sector firms, divestment (share sales) had a positive impact on performance, making them ideal candidates for more aggressive privatization. The results also show that larger PSU's -Maharatna's appear to perform better on financial indicators than smaller PSU's and even better than private firms of similar size. GDP growth has as expected a positive effect on PSU performance and soft loans have a negative effect as they reduce the pressure on firm performance. Export orientation and capital intensity have no clear effect on PSU performance.

In a subsequent paper (Chhibber and Gupta 2019) the focus is on explaining the factors affecting the efficiency and productivity of India's PSUs using various measures of productivity, instead of financial indicators. In this paper, value added per employee is used as a measure of labour productivity and value added per capital and value added per asset to measure productive use of capital and assets. [30]The results show that MOU - performance contracts - have no positive and sometimes negative effect on performance. The results provide very clear support for share sales (divestment) and privatization (strategic divestment) as opposed to performance contracts (MOUs) to improve the performance of PSU's. They also indicate that MOU's are not producing the results for which it was designed. There is also the possibility that PSU's only agree to benchmarks which are easily achievable and are gaming the MOU system. They have a cozy relationship with their sectoral ministry and can use that relationship to ensure high MOU ratings even when their productivity parameters are low or even declining.

Performance of CPSU's After Strategic Disinvestment (Outright Privatization)

In addition to partial share sales (divestment) India also had a unique experiment with full privatization (strategic disinvestment) during the period of the NDA 1 government from 1999 to 2004.What does the evidence on the performance of PSUs that underwent strategic disinvestment tell us? Some 30 entities were strategically disinvested during that period. Of these, 23 several were hotels, sold largely for their land and assets. Some PSUs were sold to other PSUs, and therefore did not really pass into private hands. Twelve companies were fully privatized between 1999 and 2004 under the NDA1 government-where over 50 per cent of their shares and management control passed into private hands- ceding management control to the private sector.

[30] The model used ensures correction for self-selection by estimating the results with and without MOU's and with and without disinvestment creating six different samples of firms. The results are therefore done separately for firms without MOU or disinvestment, with disinvestment only, with MOU only and with firms that have both MOU and disinvestment.

The performance of these 12 PSUs- Bharat Aluminum, CMC, Hindustan Teleprinters, Hindustan Zinc, HTL, ICI India, Indian Petrochemicals, Jessop and Co, Lagan Jute Mills, Maruti Udyog, Modern Food Industries, Paradeep Phosphates and Videsh Sanchar Nigam shows considerable improvements after strategic disinvestment. The weighted return on capital (ROC)tripled on average from around 5 per cent in 1999-2004 to 15.1 per cent in 2010-2015 and went even higher in the high growth phase 2004-2009 to average around 25%. The ROA for these firms also stays high - higher than those of the Navratnas that remained in public hands. It also jumps up in the high growth phase and remains over 15% in the period 2010-2015 - of course it was also high in the period 1999-2004.

The experience of privatization undertaken by the NDA 1 government from 1999 to 2004 has turned out to be quite positive. The results provide very clear support for share sales (divestment) and privatization (strategic divestment) as opposed to performance contracts (MOUs) to improve the performance of PSU's.[31]

Getting Government Out of the Business of Business

India needs a 10-year plan for reform of the PSU's instead of the piece-meal annual announcements of closure, privatization, divestiture followed so far. For now, it should keep the Maharatna's in the public sector but try to make them world class companies. For the others with few exceptions the ten-year plan should include their sale or closure. The plan could have two phases of 5 years each; with Phase 1 focused on PSU's that require closure and those in mining, manufacturing, and services where outright sales do not require other sectoral reforms. Phase 2 could be reserved for PSU's where other reforms are needed to provide alternates to citizens for services currently provided by PSU's.

The Maharatnas in state hands-whose total assets are around Rs 10 trillion ($133 billion), about one-third of total PSU assets of about Rs 30 trillion ($500 billion). In any case, the Maharatnas-BHEL, Coal India, GAIL, Indian Oil, NTPC, ONGC and SAIL-are collectively doing better than private companies of similar size. Their return on capital and return on assets have been higher than those of comparable private firms by 4% and 2%, respectively. However, even in this category the situation has seen a reversal of trends in the last three years; the private sector has shown a surprising improvement in return on capital and return on assets while the Maharatnas are showing a continuous decline in performance. Therefore, among the Maharatnas, SAIL, BHEL and Indian Oil need serious restructuring and better leadership to make them world-class companies.

The remaining two-thirds of state assets are in the 17 Navratnas,73 Miniratnas and 120 odd companies that are not given a Ratna status. The performance of the 17 Navratnas is consistently worse than that of comparable private companies, with return

[31] It is of course possible that there was a selection bias in that better performing PSU's were selected for strategic disinvestment (privatization).

on capital roughly 2% lower. Many of the companies in this group could be privatized in Phase 1-especially Bharat Electronics, MTNL, NMDC and Oil India.

The category of Miniratna is formed by 73 companies, and these are the ones that are most ripe for strategic disinvestment in Phase 1. A plan to sell most of these companies should be developed, with those in manufacturing and the services sector high on the list for immediate sale as these are the worst performers. There will be many arguments made against selling these companies to the private sector, but there seems to be no reason to run these as public companies except to provide employment to a small number of people and to be able to provide managerial positions to party members once any new government comes into power. A far more serious issue is that of tainted contracts and procurement, where lucrative deals are handed out to cronies.

It is often argued that PSU's should be prepared for privatization through restructuring prior to the sale. But it is not evident that such restructurings are helpful or get higher valuations. The buyer may or may not value any of these restructurings and may have very different ideas of how to improve the company. So operational restructuring is often not advisable. On the other hand, financial restructuring may be needed for many PSU's as they often have a web of complicated financial relationships or like Air India are saddled with large debt.

But even for those that appear at first blush to be indispensable India needs a long-term plan to look for alternative ways to serve national and consumer interest. For example, it will be argued that the Food Corporation of India (FCI) is needed for India's food policy objectives. But if India reforms its food policy and allows private traders to play a much bigger role in the purchase, storage and sale of food (along the lines of the Shanta Kumar Committee Report, 2016) the FCI could be run as a small non-profit agency. Poor consumers could be provided cash transfers instead of the elaborate system of fair price shops. Mexico provides a good example of how it got rid of a costly state-owned enterprise CONASUPO over a ten-year period and replaced it with a well-run cash transfer system called PROCAMPO.

However, such huge changes in the entire food marketing chain will take time and cannot be done overnight. But without a clear plan on where India needs to be 10 years from now it is hard to make any change at all. The same logic applies to India's numerous fertilizer PSU's. Farmers (especially small farmers) should be paid a cash subsidy to help them purchase fertilizers and other inputs. But the private sector should gradually take over the production and distribution of fertilizers and get the numerous fertilizer PSU's out of the system altogether. Again Mexico (through its PROGRESSA program) and later Turkey were able to make this transformation with huge savings to the budget. [32]

[32] At the state level more than half the SLPEs should be shut down. In fact, over 300 of the registered companies are "non-working" and should be wound down immediately. There is no reason to keep them open; other than the state does not know what to do with employees who are part of the payroll of these

There is a case to keep some of the power and oil companies in public hands at least in the first phase. For example, the Power Grid Corporation[33] could remain in government hands until complete unbundling has occurred in the power sector after which it too could go into private hands. Some of the oil companies could also for now remain in government control until fuel prices are liberalized and brought under the GST. There was a case earlier for defense-related PSU's on security grounds- such as Hindustan Aeronautics Limited (HAL). That case may yet exist but with the government opening the defense sector to private investment and consciously encouraging the private sector to enter this excluded area the case for defense sector PSU's becomes weaker. It may in any case help bring in foreign partners into these companies to upgrade their technology and make them more cost conscious. But even in the security area the case for PSU's is now much weaker and even these could be under plans for privatization in Phase 2.

How and to whom these companies are sold does matter. Russian-style or Latin America style privatization-where most of state assets were sold to "oligarchs"- must be avoided.[34] Transparent processes, competitive bidding and ensuring that some of the funds are set aside for worker compensation are vital for strategic disinvestment to succeed. Strategic sales are considered the optimal way to get the best returns from privatization, but this need not be so. In democratic countries with reasonably developed capital markets, open market sales (share sales) could be designed to widen ownership and create a greater public stake for the sales. India now has many large well-functioning private companies with professional management and are not family owned. Employees could also be provided shares – employee stock option plans (ESOPs) in the privately managed companies so that they are not so resistant to the sale and share in the upside post-privatization.

For companies that are already listed the concern that such large block sales will lower their share price can be countered by call-auctions and pre-announced share sales in smaller chunks over time. FII's could be allowed to purchase shares so that there would be no need to list these companies in international stock exchanges. They could be listed in the National Stock Exchange or the Mumbai Stock Exchange – which are now experienced enough to handle such sales- but with FII access the market for these shares would be wider. The opposition to such an approach will come from trade unions, vested interests and even consumers afraid of higher prices. But considering the

companies. But despite repeated admonitions by the CAG these have not been closed. But even among the “functioning PSU's” there are many loss-making companies that have outlived their usefulness and are candidates for closure. A centralized account should be created to know the full financial picture of all remaining SLPE's just as has been done for the CPSU’s. A dividend policy should be enforced so that profit making SLPE's provide a return to the taxpayer. Privatization should be pushed for those in the mining and manufacturing sector and much greater commercialization for the service PSU's in water, electricity distribution and in transport.

[33] Partial share sales in it have improved its performance.

[34] There is a strong risk that in India’s “Billionaire Raj” privatization will allow large corporate interests to grab these assets.

long-term benefits to the economy and better services and products to the consumer, this approach is worth exploring.

Without such a bold approach we will perhaps see some temporary improvements in some PSU's but the underlying incentives for better performance will not have changed and future politicians will have the opportunity to misuse them, again. The PPP program needs a major overhaul along the lines of the Kelkar committee recommendations. Banks are not the best place to seek long term finance for PPP projects and efforts must be made to develop non-bank financial sources: the bond market, insurance and pension funds going directly to finance such projects. And the banking sector itself needs a dose of privatization.

In order to avoid the charge that the government is selling the family silver to so to speak pay the grocer's bill – the proceeds from the privatization and sales of assets of closed firms should not go back into the budget but instead should be put into the National Infrastructure Investment Fund and used to pay worker compensation so that the people can visibly identify how the proceeds are being utilized. Such an approach also follows the best practices of the IMF's fiscal rules which have inexplicably been eroded in India and even the IMF has acquiesced in this relaxation of the fiscal rules for India.

It is time to make the slogan "The Business of Government is not Business" a reality. Just kicking the can down the road again and again will not work. A litmus test would be the sale of Air-India.

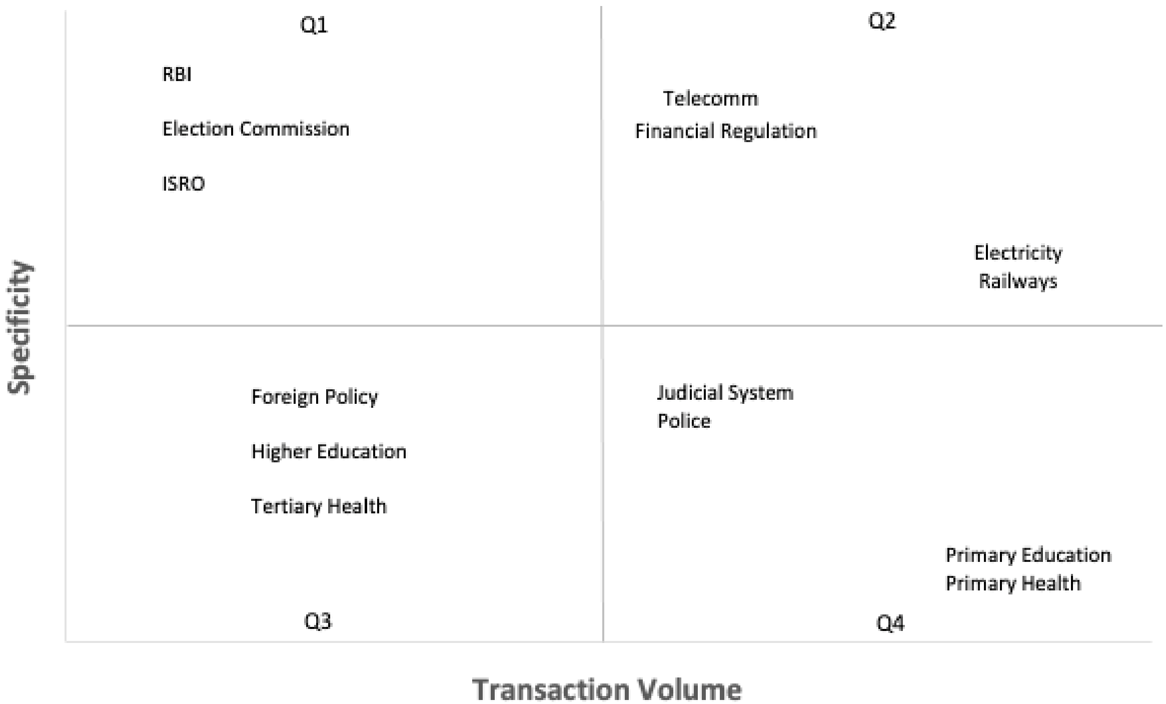
V. Re-strengthening the State to Deliver

"…. reforming an existing order is one of the most dangerous and difficult things…Those who benefited from the old order will resist change very fiercely. By contrast, those who can benefit from the new order will be less fierce in their support, because the new order is unfamiliar, and they are not certain it will live up to its promises" **Nicolo Machiavelli**

A major puzzle in India the government appears to do a few things well but its ability to provide basic services across the board remains very weak. India has a competent central bank – the RBI, has an Election Commission that can run elections as well if not better than any other democratic country, has a space agency ISRO that can launch satellites cheaper than anyone else. But India seems unable to deliver basic education, provide primary health care and water and sanitation. In this India is not unique in the developing world, but some have solved this problem. Many East Asian countries like Taiwan, China, Korea and now Vietnam were able to do this through well monitored competent bureaucracies. Some like Bangladesh have managed – despite incompetent and corrupt bureaucracy, by allowing NGO's to deliver these services.

Arturo Israel[35] provides a useful way of thinking through this problem by a dual classification of service delivery – specificity (or discretion)[36] and transaction volume.

Figure 7: Classifying Government Activities by Specificity and Transaction Volume



Source: Adapted from Israel (1987)

Figure 7 provides an illustration for India using Israel's classification. Government functions are classified into 4 quadrants – based on the specificity of the tasks they perform and transactions volume. The RBI[37], ISRO and the Election Commission perform very specific tasks with considerable discretion, - they have high specificity and low volume of transactions. At the opposite end are services that have large volume of transactions – but lack specificity – in the sense that it is difficult to measure performance and/or ascribe it to a specific input. Low scores in the school system could

[35] Institutional Development: Incentives to Performance (World Bank) 1987 by Arturo Israel

[36] Woolcock and Pritchett (2017) changed the Israel terminology from specificity to discretion. But here we stick to the Israel terminology and use specificity. Kelkar and Shah (2019) add two other elements to this terminology- stake and secrecy. These maybe relevant as well in some circumstances but broadly the two elements identified by Israel suffice.

[37] The RBI has a specific task – setting its interest rates – which is now done through the MPC. Whether it does this well is a matter of judgement but it's very specific. Less specific is its regulation of the banking system – where how to judge its performance is not that easy. What yardstick to use – India has not had a full-blown banking crisis but rising NPA's and scams have indicated a growing problem in the banking system.

be due to poor administration, bad teaching, lack of educational supplies or even poor nutrition for the children. The same applies in even greater measure to health, where poor health outcomes could be due to a variety of factors and the most important ones, such as water and sanitation, mother's education may not even be in the health sector. The same problem also afflicts the police and the judiciary – where transaction volume is sufficiently large and specificity also low – although perhaps not as much as in health.

The volume of transactions is less in higher education or tertiary education in Quadrant 3, but they also suffer from lower specificity – except for some elite institutions. Railways, electricity providers, telecommunications providers are in Quadrant 2 where they have high specificity – measures of performance but have high transactions volume. Such services are best commercialized or provided by the private sector, as far as possible. In electricity, for example generation and distribution could be in private hands with transmission in a semi-public agency. Rail lines could be in the public sector but wagons, catering etc. could all be in private hands.

Agencies in Quadrant 1 perform better whereas those in Quadrant IV are the most difficult to deliver as they lack specificity (are hard to measure performance and ascribe it to a factor) and have high transactions volume. So central banking, or rocketry, or running an election are very specific tasks and when run by agencies that are given considerable discretion in their decision making can be run very effectively. School teaching or primary health care are high volume transactions with little specificity. The education and health outcomes are dependent on many things of which the effectiveness of the teacher or the primary health care worker are only one part and often not the most important part. You have lack of specificity (discretion) and large volume making accountability very difficult. Higher education has more specificity – so India can run a few IIT's and IIM's reasonably well – but even here a mass of higher education institutions – can exist basically providing degrees but no skills.

It also explains why government's are keen to deliver things like toilets, water, gas cylinders, bank accounts – where they can show the beneficiary immediate results but do not show the same interest in delivering the more difficult services like health and education which may have much better long-term development outcomes. This new welfarism[38] helps win elections but not development.

Aircraft maintenance, airports, ports, highway maintenance, commercial banking have some specificity and larger volumes of transactions than a central bank, or an election commission, but if interfered with by political masters can also deteriorate quickly. Courts have specificity but even larger transactions than these agencies and enormous opportunity for corruption as the Indian system shows. Transparency through IT is one solution where discretion in decision making is not needed. So, payment of taxes, electricity and water utility, registration of property etc.

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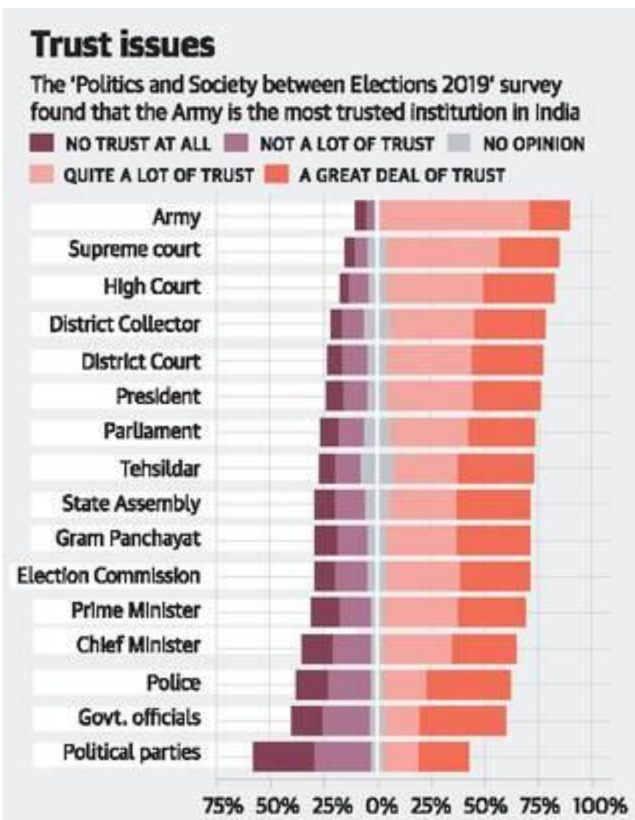
[38] See Anand, Dimble and Subramanian (2021) for a discussion on this new welfarism. But this type of welfarism has prevailed in India in the past as well. In many states local leaders have distributed such welfarism to win elections. What may be new is that India's central government has now made it more widespread and national.

can be digitized with huge improvement in service – and post pandemic this shift will increase hugely.

What this means is that services like basic health and education – must be localized, with some overall guidelines and regulations. Local governments do this well in some states like Kerala , but there is a risk that in some states such as Bihar and UP local elites will control the hiring of teachers and primary health workers and turn these into jobs for their friends and family and their supporters. NGO's could be another option as in Bangladesh and NGO's like Pratham are already highlighting the problems in India's education system. Local property taxation to fund these services will also provide greater ownership and control over the provision of these services – which lack specificity and have a high volume of transactions. Corporatization, or private provision of a range of services with appropriate regulation is another option. Telecommunications and transport are already moving in this direction. Much of India's electricity sector could also be privatized.

Figure 8: Trust in State Institutions India 2019



Source Politics and Society Between Elections 2019 CSDS (Lokniti)

Reform of the state is not an easy process – especially in a democratic set-up with a five-year electoral cycle. It's a long-term project and may need decades of reform. Resistance builds up very quickly from those who will lose out and as Machiavelli says it very accurately – the support from the beneficiaries is scattered and weak. Many countries carried out such reforms after war and conflict when state administrations were re-built. It is important therefore to start with some priorities and take on something achievable – but does require strong leadership and mobilization of citizen support.

One way to prioritize state reform is to assess how citizens view the state and its various branches. A poll carried out just before the 2019 elections by CSDS, Lokniti and Azim Premji University[39] showed that the army and the courts remain the most trusted as well as the District Collector, the official responsible for state administration at the district level, and much higher than the Chief Minister of each state(province) and even the Prime Minister(Figure 8). The high trust in the judiciary is surprising given the high level of judicial corruption and the huge backlog of cases – whereby justice is denied for so long. The police, government officials in general (other than the district collector) get low marks on trust and the least trusted are political parties.

Broadly, among the three branches of government the judiciary gets the highest marks, the legislative bodies are second and the administrative branch of government is the least trusted. Political parties are in the complete doghouse as per this survey and the new laws that allow donors to buy electoral bonds without divulging their identity allows electoral funding to be used to buy favors legally without any scrutiny from the election commission. Based on this an administrative reform of government would be a good place to start, given how difficult it will be to do election funding reform.

India's Boutique Government – Small in Size but Hugely Expensive

The size of the civil service is by itself not large, but its composition needs a huge restructuring - too many clerical and administrative staff and too few technocratic experts, teachers, and health workers. Kapur (2020) argues that the size of the state is small because it has too few judges, police officers, teachers, doctors etc. That is probably true – as the share of general government employment to total employment was around 1% - the lowest in Asia in the 1990's (Schiavo-Campo, Tommaso and Mukherjee (1998) and has not changed much since then. In most Asian countries its above 2%, and in Malaysia and Srilanka over 3%.[40] On the other hand, the small size comes with a very heavy cost. In India the average wage of a general government employee to GDP per capita is around 7 – amongst the highest in the world , whereas in most of Asia that ratio lies between 1 (Vietnam , China) and 2.5 (Indonesia, Sri Lanka, Philippines). Even Korea, Thaland and Malaysia have a ratio of general government wage to per capita GDP of around 3-4. With a ratio of 7 India is in the category of some former -French ruled African countries like Senegal. In much of the Arab world and Turkey that ratio is around 2-3. These ratios need updating, but they probably have not changed much and if anything, have probably worsened – in that government salaries especially after the last pay commission have gone even higher

[39] POLITICS and SOCIETY between ELECTIONS 2019 Survey Report by CSDS, Lokniti and Azim Premji University.

[40] See Salvatore Schiavo-Campo Giulio de Tommaso Amitabha Mukherjee 1998.

and government employment as share of total employment has gone even lower – despite large increases in employment in railways and police. India runs a boutique government – small relative to its needs but very expensive relative to its income.

At the apex of this bureaucracy sits a mandarin-like elite administrative service who are competent and smart but who are shuffled around like a deck of cards at a bridge game and therefore have no time to develop the in-depth expertise needed to remain abreast of global developments in those fields. They lack the technical edge required to lead India's government policy in their sectors to retain our competitive edge and they often suffer from excessive political interference in their functioning. A more professional, performance-based civil service with promotions based on regular testing rather than a time-bound lifelong sinecure is needed to maintain a meritocratic culture. There is much to learn from the civil service systems of East Asian countries such as Japan, Korea, Singapore, and Taiwan[41]. Much greater specialization is also needed at the top of the bureaucracy – instead of the generalist model India adopted from its colonial administrative system. [42]

Another factor that has contributed to huge inefficiencies in the civil services is the compression ratio- the ratio of average salaries in the highest to lowest bracket. India's wage compression ratio declined considerably. This has come about by keeping salaries of the top low and increasing rapidly salaries at the lower end of the bureaucracy. The 7th Pay Commission defined the compression ratio as the ratio of the entry level employee at Grade A to C at 3.12 and for the ratio of the highest paid at Grade a to Grade c at 3.74. The upper end of the civil service has seen its real wages fall well below that of the private sector, whereas at the lower end salaries (including benefits) can be more secure and are even higher than in the private sector.[43] This has meant that the pay and as a result the quality of the inductees at the higher end – with discretionary decision-making authority has declined, whereas those at the lower end – that make up more than 90% of the government labor force end up paid a much higher wage than the private sector and what the labour market delivers. India spends too much on its government as it pays too high a salary at many lower levels of government and ends up having too few government teachers, health workers, policemen and judges.

[41] See Hyung-Ki Kim (1995) "The Japanese Civil Service and Economic Development: Lessons for Policy Makers from Other Countries" in Hyung-Ki Kim, M. Muramatsu, T.J. Pempel and K Yamamura The Japanese Civil Service and Economic Development Catalysts of Change Clarendon Press, Oxford.

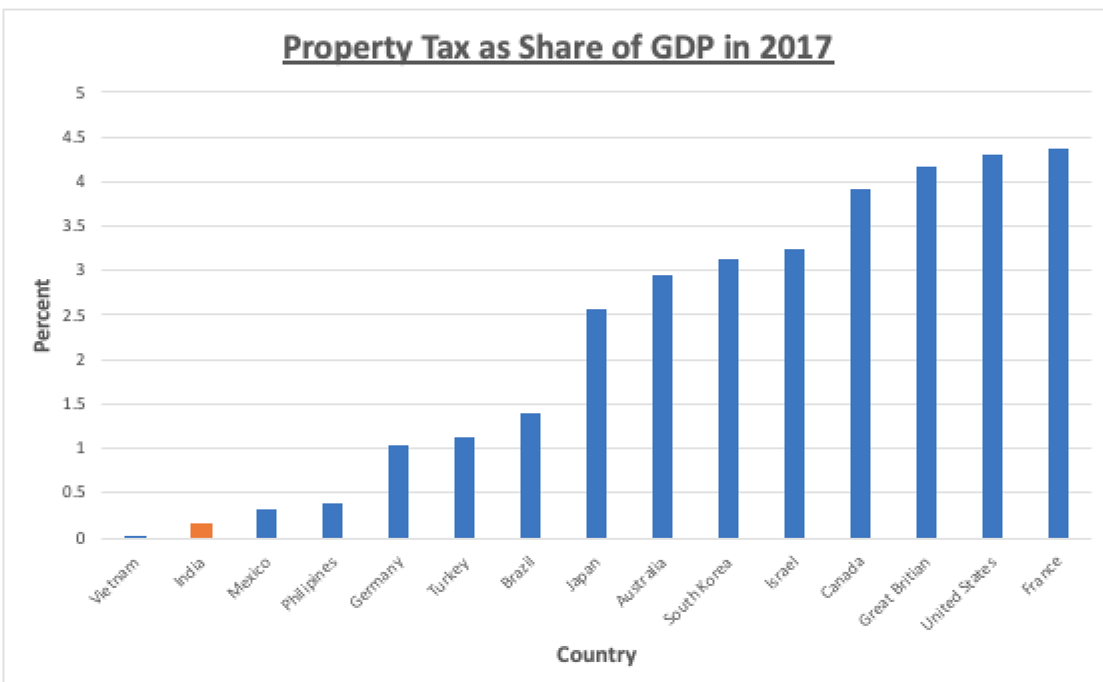
[42]Kapur (2020) makes the case that India's civil administration is not based on patronage because there are so many vacancies. Many of those exist because of lack of funds. The main issue is lack of motivation and stagnation as there is no performance- based evaluation system. People are promoted based on years of service, except at the very end.

[43] See Sonalde Desai (2015) in the Hindu October 2015 an unjustified pay-hike Desai shows that at every level of education public sector wage in India are higher than in the private sector. She writes "The CPC found that compensation to Group C and D employees in government was higher than that in the private sector; for Group B it was similar and only for Group A was it lower. Group A employees form less than 5 per cent of the total Central government workforce; Group C and D are about 90 per cent."

However, that just means India's public spend which is quite large is spent badly. It does not mean India should increase government spending but re-orient its spending better. Almost 50% of total governmental expenditure is non-developmental – with large chunks going to defense, pensions, and interest payments. India also spends too much at central and state levels and very little (3%) at the local administration level. The same amount spent at the local level would allow it to hire many more teachers or nurses and compounders as local wages are much lower than those determined at state capitals or at the centre in New Delhi.

The new bureaucratic elite are the regulatory bodies - often headed by retired senior government officials, not by technically competent experts as is the case in most other parts of the world. We need a blueprint of a modern regulatory structure which can then be developed over the next five years in a systematic manner – more transparent, less complex and headed by professionals with knowledge domain – not career bureaucrats. We need a system that will minimize regulatory capture[44] but that does not choke private investment and allocates resources in a transparent and efficient manner. This should also allow private investment in many sectors where it is currently restricted, including in natural resources and defense production, and help avoid coordination problems which have led to a situation in which India, with the second largest reserves in the world, now imports record levels of coal.

Figure 9: India's Property Tax Amongst Lowest in the World



Source: Author calculations based on OECD and World Bank data bases

[44] The Telecomm regulator TRAI started well but is now perceived as being captured by one large promoter. The RBI is now considering allowing corporates to own banks.

A regulatory review is needed to assess the effectiveness of regulations. One principle that must be kept in mind that more complex regulations can create more effective outcomes – but they also require much greater capacity to manage, implement and monitor those regulations. If that capacity does not exist a simpler regulatory structure should be considered. A big deficiency in India is that regulations are hard to monitor – corruption abounds and often the left hand of government does not know what the right hand is doing. Civil society can play a big role in highlighting failures in administering regulations and should be seen by regulatory bodies as an all not an enemy – especially in natural resource management. In the financial sector, RBI and SEBI are considered competent but disentangling the roles and responsibilities of different regulators should also be investigated and a clean-up of the nested relationships between the RBI and government must be a priority as well.

VI. More devolution to Sub-National Government

A review is also needed of the roles and responsibilities of the central, state and local government. The proliferation of national flagship schemes has blurred the role and responsibilities of the Centre and the states and diminished accountability. The idea that the Centre will design national schemes which will then be implemented in a proscribed manner by state governments and districts with huge variability in their capacity and governance quality is itself absurd. The 14th Finance Commission shifted larger share of resources to the state level – but much remains to be done to shift more resources to the local level (Figure 9). As Kapur (2020) has shown India's share of local government spend and hiring is much lower than in most developed countries but also much lower than in authoritarian centrally dominant countries like China where delegation and devolution is very substantial making government far more effective. One argument that is often made is that India does not even collect enough revenues for the needs of the centre and the states – so there is limited scope for shifting more resources to the local level. But this argument is spurious. A rise in property taxes – which remain amongst the lowest in the world - is the most obvious way to provide more resources at the local level without eating into state and central government revenues. It remains a surprise why this most obvious way to raise resources for municipal and civic infrastructure and help build "smart" cities has not been utilized, so far.

One big issue that India will face growing forward is the changing composition of population by states. The southern states population growth rates are much lower than those in the North. Several North-east states and even West Bengal have lowered their fertility rates hugely. Their quite legitimate gripe is that, if resources are decided largely by population they are being penalized for faster development and better education and health services which have pushed their population growth down. This will become an even bigger battle by 2026 – when the decision will have to be made on the distribution of parliamentary seats which currently are based on the 1971 census.

Some creative options can be considered to reduce this tension between the states with fast versus slow growing population. One option is to give credit to states which have reduced population growth rates. This would encourage efforts to control population in those states where the fertility rate remains very high. The 15th Finance

Commission has given a 12.5% share to demographic performance so as to reward states that have provided priorities to development priorities which have helped demography.

A second would be to give credit to states which have seen greater in-migration. The common misperception is that intra state migration is large, but interstate migration is quite low. But as the 2016-17 Economic Survey pointed out, interstate migration is hugely underestimated and during the decade 2001-2011 could have been as high as 60 million and by 2019 when the pandemic struck was as high as 200 million. Creative ways to give credit to states with in-migration between 1971 and 2011 could be considered. This would also encourage states receiving migrants to provide them better services, which they are now usually denied and discourage discrimination against migrants.

A second worry is that devolution may have gone too far. The 15th Finance Commission was asked to examine *"the impact on the finances of the Union government of substantially enhanced devolution to the states following the recommendation of the 14th Finance Commission coupled with the continuing imperative of the national development program - including New India 2022"*. Does this suggest that the government is having second thoughts on the fiscal devolution it accepted earlier? Other countries such as Brazil and Indonesia did claw back big-bang decentralization to some extent.

But in India's such an approach will be counterproductive as the 2014 devolution did not lead to any change in the total amount of funds to the states, just the way they were delivered. Whereas earlier they were tied up in central flagship schemes they were now to be provided in an unfettered form to the states to decide how best to spend them. In fact, India needs even greater devolution going forward and remains in form a highly centralized country. And as the latest GST imbroglio shows is quite willing to go back on promises made to the states. In the end the 15th Finance Commission has kept the share more or less the same. Its reduced from 42% to 41% because Jammu and Kashmir and Ladakh have become Union Territories not states and will be largely funded from the central pool.

A third concern is regarding the request to the commission to examine "*control or lack of it in incurring expenditure on populist measures.*" Given the growing concerns over rising state deficits - especially in Bihar and Punjab - the concerns over excessive state spending are well taken. But it is again very subjective as there is no clear definition of "populist" programs. Who decides what is "populist" or realistic? And what of the populist programs in the union budget? Telling states how to spend their money did not work well earlier and will not work well now. In the spirit of "cooperative federalism" state governments must be allowed to make their own choices and face the electorate in their own performance. Any restrictions added on would deliver an additional blow to "cooperative federalism" that GST initially generated, but has been set-back, perhaps irreparably, by the 2020 GST imbroglio.

Other Considerations: Smaller States and More Time Zones to Improve Governance and Productivity

One issue that has not generated enough focus is the optimal size of states (provinces) in India. Some are too large to be governed well. The break-up of states, politically tortuous as it has been, has led to improved economic development. The creation of Haryana and Himachal Pradesh in the 1960's led to very rapid progress in both states. These had been neglected parts of a much larger Punjab state – but took off after their creation. Similarly, Uttaranchal has done well after being hived off from UP as has Jharkhand after its split from Bihar and Chhattisgarh from MP. The latest is the split of Telangana from Andhra Pradesh.

Obvious candidates for further split are UP with a population of 230 million Bihar with a population of 120 million and Maharashtra. With a projected population of 1.5 billion and assuming an optimal state size of 30 million India should eventually become 50 states. By this logic even MP (even after the creation of Chhattisgarh), West Bengal, Tamil Nadu and Rajasthan are candidates for split-ups.

The current government is pushing for faster development of India's Eastern states. Among other factors – one issue that has not got enough attention is the diminution of productivity in the North-East from being forced into an India wide time zone.[45] Gujnani ((2019) has shown significant effects of sleep timings on years of schooling as well. With productive hours considerably affected – especially in winter months – a natural productivity boost would come from the creation of two time zone for the country. Most people suggest the timeline be drawn between the N_E of India and the rest of the country – but this might have political implications. One obvious natural longitudinal line would be with Orissa, Bihar, West Bengal and the North-Eastern states in one time zone and the rest of the country in another natural time zone.

VII. Dealing with the Cancer of Corruption

> "*Just as it is impossible to know when a swimming fish is drinking water, so it is impossible to find out when a government servant is stealing money*"
> — **Kautilya**

Corruption in India is now an accepted way of life. It's a deadweight loss. India's corruption score on the Transparency International Index has improved a bit over the last 6 years but remains high. The massive scams that India witnessed in the last phase of the UPA government are no longer splashed all over the papers. But a new Netflix series "Bad Boy Billionaires" shows how deep the rot is in India's corruption -ridden society.

[45] Tea Estates in the North-East have shifted their clocks by and hour to increase daylight savings.

India and China both rank 80th in 2019 rankings of the Transparency International along with Ghana and Benin and slightly better than Indonesia, Philippines, Thailand and Vietnam. But as the joke goes in East Asia you pay a bribe and your work gets done. In India even that is not always the case and often bribes are paid to stop your competitor – and nothing gets done. Even bribery in India is inefficient. But whatever it is bribery is a huge curse on the economy and a massive tax on common people- especially the poor.

How does one address it? Corruption is a symptom of a dysfunctional interface between the government and society. But the moment also provides us an opportunity to initiate wider reforms to tackle corruption.

First, we must consider the issue of how much discretionary power the government should have and where it should be placed. As James Madison, a founding fathers of the American Constitution wrote in the Federalist, 'In framing a government to be administered by men over men, the great difficulty lies in this; you must first enable the government to control the governed; and in the next place oblige it to control itself.' In India, the discretionary power of the executive has, over time, become too great. Laws and rules, contradicting each other, and accumulated over the years are open to interpretation by officials.

Second, corruption can be reduced through greater competition or contestability. If the services that people need are provided in a contestable way, corruption will decline. This has been proved in the case of telecommunications. Twenty years ago, every household in India wanted a telephone and people paid bribes to get ahead in the queue for connections. With the arrival of mobiles, no one bothered about fixed-line connections, but corruption moved to a higher level to procure 2G spectrum licenses. India got it right with 3G licenses, which shows that more competition and careful design can reduce corruption. The opportunity for corruption exists wherever there are excessive controls and public monopolies. Easing access to these services will reduce corruption.

Third, greater transparency is needed wherever major financial resources are involved. 'Follow the money' is a good guide to look for places to prioritize. Procurement, licensing and other major public transactions are all areas in need of greater public scrutiny and transparency. The procurement and mining laws, where public funds and assets are involved, need major upgrading to bring them to global standards. The Citizen Right to Information Act has been a significant milestone. But its use is not easy and public officials find many ways to withhold information. E-services are an effective step forward and wherever introduced have helped citizens meet their basic services in a transparent manner.

Fourth, we need incentives against corruption. Singapore had one of the most corrupt customs services in the world. It realized that to be a trade and service centre for the region, it would have to root out corruption. It now pays its civil servants the equivalent of private sector wages. Public sector wages have risen over the years in India as well and while not equivalent to private sector levels, they are nevertheless competitive. But the public sector requires more merit-based hiring to dispense with the system of paying bribes to get stable jobs in public sector undertakings

Fifth, election financing is a major reason cited for political corruption. The US faced the same problem around 150 years ago. Meaningful election financing reform could be enacted in the USA only in the 1970s. Two areas to start election financing reforms would be raising funds for electioneering and containing alleged vote-buying schemes. India has unfortunately moved in the opposite direction by introducing an opaque system of electoral bonds – whereby donations to political parties can be made without disclosure and without scrutiny by the Election Commission. It is no wonder – political parties – are the least trusted institution in the country.

Sixth, India needs a serious judicial reform to ease the backlog of cases. We also need more predictability in outcomes, both in the judiciary and in the administration. The judiciary remains small and arcane in its procedures – and judicial activism has amplified but is very selective and one might even say capricious, often at the cost of further delays in the cases piled up at the doors of the courts. Digitization of the court system, records hiring more judges and modernizing the system by increasing systems of arbitration and commercial courts will also help reduce delays. As the saying goes "justice delayed is justice denied" and India is denying justice on a gigantic scale and are then open to massive corruption in the judicial system.

India signed the UN Convention Against Corruption that sets global standards on tackling corruption this year. But it still has a long way to go to meet global best practices. The passionate response to corruption in every citizen survey has sent a strong message to the government that citizens demand serious and urgent action. Such reforms aren't easy as they will be opposed by narrow interests that have much to gain from the status quo.

If Kautilya in the Arthshastra could lay down the methods of dealing with corruption, surely modern India, with ambitions of becoming a global power, can take on the scourge of corruption. All developed countries had to tackle corruption systematically at some point. India now has a historic opportunity to do the same.

VIII. Fixing Welfare: Going from Product to People based Subsidies

India spends close to four per cent of its GDP on an alphabet soup of welfare schemes and subsidies - it has become a welfare state before becoming a developed state. Despite its significant costs, India's welfare system is neither comprehensive nor very effective - subject to huge leakages and corruption, and not well knit into a coordinated whole.

Subsidies on the 3 Fs - food, fuel and fertiliser - cost 2.5 per cent of GDP, greater than the sum assigned to all development schemes. In the 1960s and 1970s, when India had mass poverty, subsidizing products, such as food or fuel, made some sense; but today, when poverty has declined, product-based subsidies mainly benefit the nonpoor and distort markets. We need to move away from product- to portable people-based subsidies - especially as India will witness 300 million migrants over the next 15 years. Cash transfers have proven to be the best delivery option to reduce costs all over the world, through better targeting without diluting benefits. An NCAER study found that in 2005 The PDS costs Rs 3-4 to deliver Rs 1 of subsidy. There are two parts to this cost – the cost coming from problems at the fair price shops – where leakages in fair price shops (outright corruption) and mis-targeting errors were abundant. due to an outdated ration card system based on household surveys carried out in 1993-94. A subsequent evaluation carried out by NCAER (2016) showed some improvements – especially as the ration cards were updated and Type I (exclusion errors) were reduced.

But the bigger problem lies in the operations of the Food Corporation of India, which procures, stores and moves grain from surplus to deficit states and does all this very badly. Fixing the FCI maybe one solution but doing away with it altogether must also be an option. The one-nation one ration card is what is proposed – but leave migrants even more at the mercy of corrupt fair-price shop officials. Better to have cash transfer schemes for them and everyone as well.

One bold solution would be to shift not only to cash transfers on the consumer side but also on the producer side, as in Mexico and in Turkey. [46]The PM-Kisan scheme is a start and could be expanded if all other producer and input subsidies were done away with. This would allow the government to collapse fertilizer and all other input subsidies into a cash subsidy, allow the private movement of grain from surplus to deficit states, with the government buying small quantities needed for its strategic reserve. Public stocks would decline from the current level of 80 million tonnes to around 20 million tonnes, with huge fiscal savings. The entire food market would shift out of government hands into private hands. Several emerging economies such as Mexico and Turkey have made such a switch with savings of around 60 per cent. For those concerned about such a sudden shift, transition arrangements could be made with the shift to cash transfers occurring first in urban areas and even by keeping ration shops only for BPL households for a while.

India cannot afford to rely only on Western-style welfare. It runs one of the world's largest "workfare" (cash-for-work) programmes, the rural employment guarantee scheme - but with mixed success and implementation problems. Part of the problem is that there are at least 18 other uncoordinated schemes that deal with rural and land development. The MGNREGA scheme itself has seven stated objectives - so it's difficult to measure success, especially as none of these seven has any clear yardstick for success. Even the basic objective of 100 days of employment is not based on any assessment of needs. Some states may need 50 days, and others may need as much as 150.

Ironically, more developed states, with better administration, have used these schemes more than the more needy backward states, widening further the gap between them and the opposite of what one would expect for a scheme designed to

[46] This could be considered a quasi-UBI system, a means-tested income transfer not a universal UBI.

help the genuinely needy. The assets created have not been durable and their creation is not consciously linked to any district- or block-level development plan. In 2013-14, it cost Rs 175 to deliver Rs 132 of wages, of which about Rs 90 got to beneficiaries (using a leakage rate of 30 per cent)[47]. But if no real assets are created, it's better to shift to a simple cash transfer to help the beneficiaries and save money.

Since last year MGNREGA work has been allowed on private small farms of backward communities, which has helped improve land productivity and its employment potential by enabling the shift from traditional cereals to more lucrative cash crops, vegetables and fruit. But these remain a very small part of the total scheme so far. MGNREGA work has been allowed for building toilets - but that diffused its core objectives even further and has now fortunately been stopped.

India needs workfare to complement welfare, but it should be refocused on fewer objectives that will increase community resilience to drought and climate change such as land improvement, water management and reforestation. It should also have a sunset clause so that once the assets are built, MGNREGA support can be phased out in an area.

The health-related schemes also need significant review and rationalization. Of India's Millennium Development Goals for 2015, it is furthest behind in maternal and infant mortality (and neo-natal mortality). Despite so many schemes, "out of pocket" expenses on health, at 60 per cent, are the highest in the world. But in health, cash transfers are not the best answer, as shown by the poor experience with Janani Suraksha Yojana. Better results are being achieved by the recently introduced Janani Shishu Suraksha Karyakram (JSSK), which is a cashless scheme designed to provide a combined package for the mother and child from seven months of pregnancy to one month after pregnancy. It has helped reduce the maternal mortality rate as well as the neo-natal mortality rate. The Ayushman Bharat scheme is a start with 1 crore beneficiaries in its first- but it should not be an alternative to a functioning health system without which over 100 crores are left at the mercy of unregulated private providers.

IX. Conclusion

To conclude, India does not need a smaller government or for that matter a much larger one, but a more focused, smarter and more accountable government with much clearer roles and responsibilities. A two-pronged strategy of reducing its scope [48](not size) and improving state capability is the way forward. Countries' that have grasped this nettle have gone through the "middle income trap". China is on its way - but many others have floundered. Will India grasp the nettle in the coming year and revive its long-term prospects is a hope all of us must ensure. At 8-9 per cent GDP growth India can not only eliminate poverty but become an industrial country in three

[47] Based on author's calculations using data on accounts of MGNREGA.
[48] Meaning the number of things, it gets involved in.

decades. At 4-5 per cent growth India is unfortunately stuck in the middle-income trap for another 50 years.

The coronavirus has exposed the inefficiencies in government more sharply. India's inability to manage the pandemic was inevitable given the weak health system – with one of the lowest public health spending as a share of GDP in the world. But other inadequacies were also exposed including a very weak and badly run social safety net and lack of coordination between the center and the states, very inadequate funding for local government which at the front-line of the fight against the pandemic. Trust in public institutions was surprisingly relatively high in India but may now have declined as more and more people lost lives and livelihoods.

This paper has shown a two-pronged strategy for improving the effectiveness of government, reduce its scope and improve its capability. Let it do a fewer set of things and do them well – keep the regulatory system simple and transparent and avoid doing what the private sector and civil society do better. India must also decentralize and devolve much more – but also build up greater capability in local government. If India is to reset for the 21st century, our future and those of our children lies in reforming government now for rapid, sustained long-term growth and a happier society. No quick fixes will work. Only then can we say that "Government Work is God's Work."

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