

Ethics & Values in Public Governance

ISB, Hyderabad
01st March, 2023

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

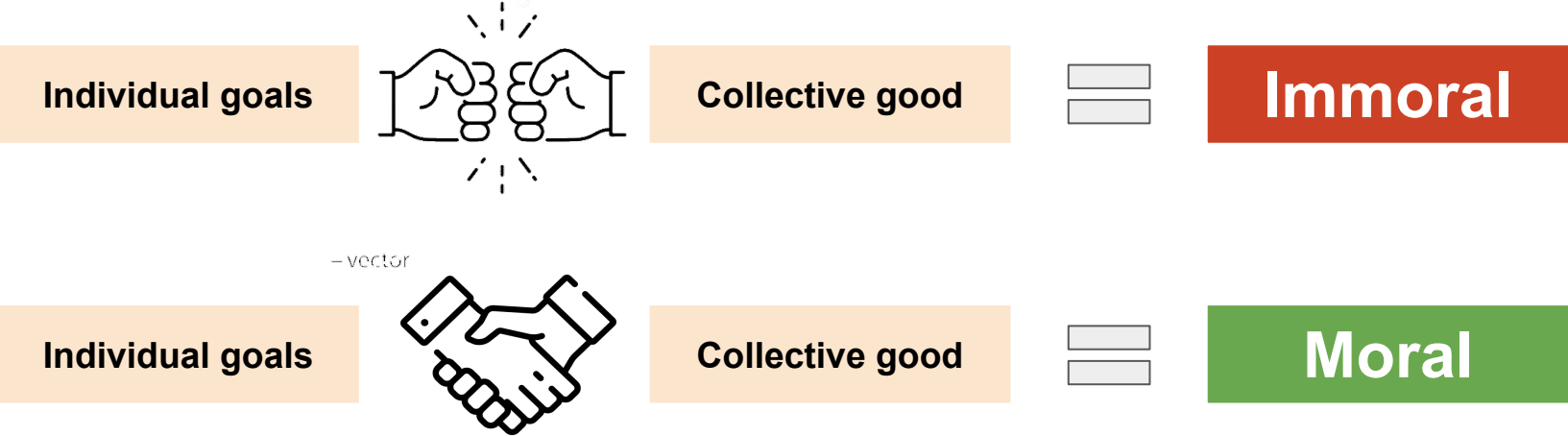
– *William Gladstone*

- Do we lack morals and values?
- Are we *even* capable of democratic governance?
- What is the roadblock – values or institutions?

What is Morality?

- That which **reconciles** individual goals with public good

Central Principle of Morality



Calculus of Risk and Reward

WHEN GOOD BEHAVIOUR IS NOT REWARDED
AND **BAD BEHAVIOUR IS REWARDED**



WHEN **GOOD BEHAVIOUR IS REWARDED**
AND BAD BEHAVIOUR IS PUNISHED

Institutions that Determine the Calculus of Risk and Reward

Religion	<ul style="list-style-type: none">● Most Indians are God-fearing
Society	<ul style="list-style-type: none">● Strong family bonds● Fear of social sanctions / loss of face● Sense of Dharma beyond faith● Acceptance of multiple faiths / belief systems● Contentment● Sense of community
State	<ul style="list-style-type: none">● The real challenge is failings of the Indian state● With increasing urbanisation and lives becoming more impersonal, the state assumes greater importance

Regulating Human Behaviour: A Virtuous Cycle



- Changing **incentives alter behaviour** that results in **better outcomes**
- Better outcomes create an **ethical society** that further strengthens the **institutions**
- Institutions that **reward good behaviour** and **punish bad behaviour**

Institutions and Incentives Shape Outcomes

Where institutions and incentives are in place, corruption has declined

- Railway Reservation – Technology and Transparency
- Telephone services – Competition and Choice
- Spectrum allocation – Competition and Transparency through competitive bidding
- Passport – Technology; Transparency; Predictability

Indian society: Flaws and Correctives

Dr. Carolyn Elliott summed up the societal flaws as **absence of a sense of equality, trust and common fate.**

Equality	<ul style="list-style-type: none">● Suffer from moral neutrality to inequity by birth● Can be corrected by movements within civil society, and political institutions
Trust	<ul style="list-style-type: none">● Better-off sections of society instinctively reject the capacity of all citizens for self-governance● Trust that binds family, caste group must be extended in all social interactions across diverse groups
Sense of common fate	<ul style="list-style-type: none">● Vital to bind people to create an orderly society● Citizens should recognize that rights and duties coexist; one's rights are translated as duties of others, and vice versa

Journey So Far: Significant Successes

A Functioning Democracy – Four Conditions by Myron Weiner



Successes of Indian Democracy

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

Still a lot of angst..

Unfinished Tasks

**Third tier of
governance**

Rule of Law

Healthcare

**Agriculture
sector
reforms**

Urbanisation

**Civil service
reforms**

Education

**Service
delivery**

**Electoral
reforms**

**Political
reforms**

**Sound
public
finance**

Infrastructure

Comparison of Various Development Indicators Among 50 Large Economies											
Rank	GDP Per Capita (PPP, 2019)	Life Expectancy (2019)	IMR (2019)	MMR (2017)	Out-of-Pocket-Expenditure on Healthcare (2018)	EYS (Expected Years of Schooling, 2019)	MYS (Mean Years of Schooling, 2020)	HDI (Human Development Index, 2020)	Power Consumption (Kwh Per capita, 2019)	Employment in Agriculture (% of total employment, 2019)	LFPR (Labor Force Participation Rate - female, 2018)
1	Switzerland	Hong Kong	Hong Kong	Hong Kong	South Africa	Australia	Germany	Norway	Norway	Singapore	Sweden
2	Ireland	Japan	Japan	Italy	France	Belgium	Canada	Ireland	Canada	Argentina	Switzerland
3	Norway	Switzerland	Finland	Norway	Netherlands	Sweden	Switzerland	Switzerland	Sweden	Hong Kong	Vietnam
4	Singapore	Spain	Norway	Poland	United States	Finland	United States	Hong Kong	UAE	Belgium	New Zealand
5	United States	Singapore	Sweden	Czech Republic	Thailand	Denmark	United Kingdom	Germany	United States	Israel	Netherlands
6	Denmark	Italy	Singapore	Finland	Ireland	New Zealand	Israel	Sweden	Finland	United Kingdom	Finland
7	Australia	South Korea	Czech Republic	Israel	Germany	Ireland	Norway	Australia	Taiwan	Germany	Denmark
8	Netherlands	Sweden	Spain	UAE	UAE	Netherlands	Finland	Netherlands	Saudi Arabia	United States	Norway
9	Sweden	Australia	Italy	Denmark	Japan	Norway	Japan	Denmark	South Korea	UAE	Canada
10	Austria	Norway	South Korea	Spain	New Zealand	Argentina	New Zealand	Finland	Australia	Canada	Germany
11	Finland	Israel	Belgium	Sweden	Denmark	Spain	Australia	Singapore	New Zealand	Sweden	Peru
12	Hong Kong	France	Austria	Austria	Sweden	United Kingdom	Czechia	United Kingdom	Singapore	Norway	Australia
13	Germany	Ireland	Ireland	Belgium	Czech Republic	Germany	Ireland	Belgium	France	Netherlands	United Kingdom
14	Belgium	Canada	Israel	Ireland	Norway	Hong Kong	Denmark	New Zealand	Switzerland	Denmark	Portugal
15	Canada	Netherlands	Australia	Japan	Saudi Arabia	Czechia	Austria	Canada	Israel	Saudi Arabia	Japan
16	Israel	Austria	Portugal	Netherlands	Canada	Turkey	Poland	United States	Austria	France	Austria
17	UAE	Finland	Germany	Switzerland	Colombia	Taiwan	Sweden	Austria	Czechia	Australia	Czech Republic
18	New Zealand	Belgium	Denmark	Australia	United Kingdom	South Korea	Netherlands	Israel	Japan	Switzerland	Singapore
19	United Kingdom	New Zealand	Netherlands	Germany	Turkey	Portugal	Hong Kong	Japan	Belgium	Czech Republic	Israel
20	Japan	United Kingdom	Switzerland	United Kingdom	Australia	Singapore	South Korea	South Korea	Netherlands	Japan	Spain
21	France	Denmark	United Kingdom	France	Austria	Chile	Russia	Spain	Russia	Austria	Russia
22	Italy	Germany	France	Portugal	Finland	Switzerland	Belgium	France	Germany	Finland	China
23	South Korea	Taiwan	Poland	Singapore	Belgium	United States	UAE	Czech Republic	Ireland	Italy	France
24	Spain	Portugal	Taiwan	New Zealand	Romania	Poland	Taiwan	Italy	Spain	Spain	United States
25	Taiwan	Chile	New Zealand	Canada	Poland	Canada	Singapore	UAE	China	Ireland	Ireland
26	Czech Republic	Czech Republic	Canada	Taiwan	Israel	Israel	France	Ireland	Portugal	Taiwan	Thailand

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27	Portugal	United States	Russia	South Korea	Spain	Austria	Romania	Portugal	Malaysia	South Korea	Hong Kong
28	Saudi Arabia	UAE	United States	Chile	Italy	Italy	Argentina	Saudi Arabia	Denmark	South Africa	Belgium
29	Poland	Poland	Saudi Arabia	Russia	Brazil	Saudi Arabia	Chile	Chile	Hong Kong	Portugal	Poland
30	Chile	Turkey	Romania	Saudi Arabia	Argentina	France	Italy	Argentina	Italy	Russia	Brazil
31	Romania	Colombia	Chile	Turkey	Switzerland	Brazil	Malaysia	Romania	United Kingdom	New Zealand	Colombia
32	Russia	Thailand	UAE	Uruguay	Peru	Japan	Spain	Russia	Poland	Chile	South Korea
33	Malaysia	China	China	Romania	Portugal	Russia	Saudi Arabia	Turkey	Chile	Brazil	Argentina
34	China	Argentina	Malaysia	China	Singapore	Peru	South Africa	Malaysia	South Africa	Poland	Romania
35	Mexico	Peru	Thailand	Malaysia	Hong Kong	Thailand	Peru	Mexico	Turkey	Malaysia	Chile
36	Argentina	Malaysia	Argentina	Mexico	South Korea	Mexico	Philippines	Peru	Argentina	Mexico	Italy
37	Turkey	Brazil	Turkey	Egypt	Chile	Colombia	Portugal	Thailand	Romania	Colombia	Indonesia
38	Brazil	Romania	Peru	Thailand	Indonesia	UAE	Mexico	Colombia	Brazil	Turkey	Malaysia
39	Thailand	Vietnam	Colombia	Argentina	Malaysia	Romania	Colombia	Brazil	Vietnam	Egypt	South Africa
40	Peru	Mexico	Mexico	Vietnam	Taiwan	China	Viet Nam	China	Thailand	Romania	UAE
41	Colombia	Saudi Arabia	Brazil	Brazil	China	South Africa	Indonesia	Indonesia	Mexico	Philippines	Taiwan
42	South Africa	Russia	Vietnam	Colombia	Russia	Malaysia	China	Philippines	Egypt	China	Nigeria
43	Indonesia	Bangladesh	Egypt	Peru	Mexico	Indonesia	Turkey	South Africa	Peru	Peru	Philippines
44	Philippines	Egypt	Indonesia	South Africa	Vietnam	Egypt	Brazil	Egypt	Colombia	Indonesia	Mexico
45	Egypt	Indonesia	Philippines	Philippines	Philippines	Philippines	Thailand	Vietnam	Indonesia	Thailand	Bangladesh
46	Vietnam	Philippines	Bangladesh	Pakistan	Pakistan	Vietnam	Egypt	India	India	Nigeria	Turkey
47	Nigeria	India	South Africa	India	Egypt	India	Nigeria	Bangladesh	Philippines	Pakistan	Saudi Arabia
48	India	Pakistan	India	Bangladesh	India	Bangladesh	India	Pakistan	Pakistan	Vietnam	Pakistan
49	Bangladesh	South Africa	Pakistan	Indonesia	Bangladesh	Nigeria	Bangladesh	Nigeria	Bangladesh	Bangladesh	India
50	Pakistan	Nigeria	Nigeria	Nigeria	Nigeria	Pakistan	Pakistan	*Taiwan	Nigeria	India	Egypt
*Taiwan is not included in UNDP's HDI rankings											

Moving beyond false dichotomies: A case in point

Ubiquitous Corruption – Value System or Perverse Incentive?

- Corruption - most visible symptom of **dysfunctional governance**

Extortory Corruption	Collusive corruption
Citizens subjected to extortion for myriad services; a cruel choice - comply with bribe and get work done or resist the demand and suffer delays and harassment	Both bribe-taker and bribe-giver act in collusion and undermine public interest; example - awarding of contract, transfer of officials, recruitment in public service, interference in crime investigation
Citizens become victims of extortory corruption; racked by guilt and an oppressive feeling of moral compromise	Competition is eroded, public resources swindled, injustice done, and monopolies are created.
Citizen's charter with penalties for non-delivery of services; digitalisation; transparency, and empowerment of local communities	Needs to be treated on a higher footing and impose rigorous punishments

Concerted efforts to build **institutions and practices** to ensure prompt delivery of services is needed.

Crisis of Governance

- Inefficient state apparatus
- Unresponsive bureaucracy
- Failure of Rule of Law
 - Crime investigation
 - Contract enforcement
 - Ineffective and unresponsive judicial system
- All pervasive corruption
- Criminalization of politics
- Money and muscle power in elections

Distortions of State Power

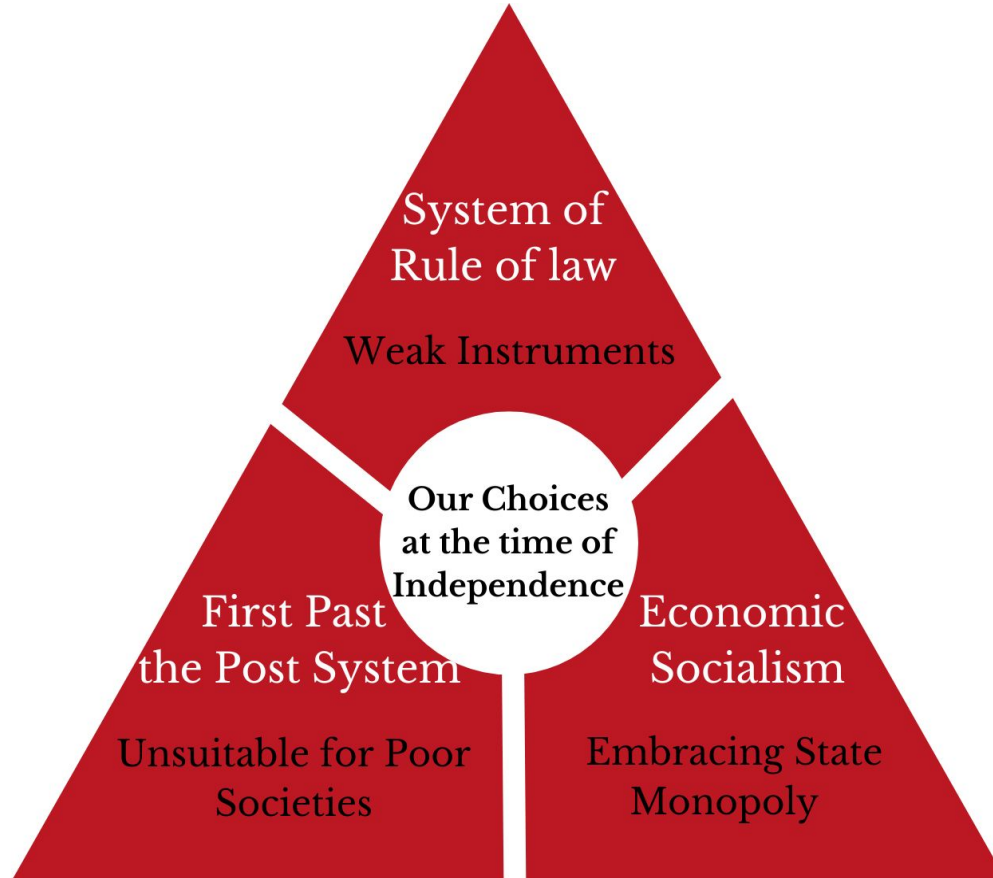
- Positive Power restricted
Negative Power unchecked
- State organs are dysfunctional
- A system of alibis
Victims of a vicious cycle
- Change of players
No change in the rules of the game
- Political process ought to be the solution
But has become the problem itself

How did we get to this point ?

The initial conditions....



How did we get to this point?



The Vicious Cycle

Inexhaustible demand for illegitimate funds

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

Most expenditure incurred for vote buying

Poor service delivery and vote delinked from consequence

Rise of political fiefdoms

Entry barriers as money, caste and local clout become critical

Vote delinked from public good

Centralised polity drives voter to maximise short-term gain

Taxes delinked from services

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

Political survival and honesty incompatible

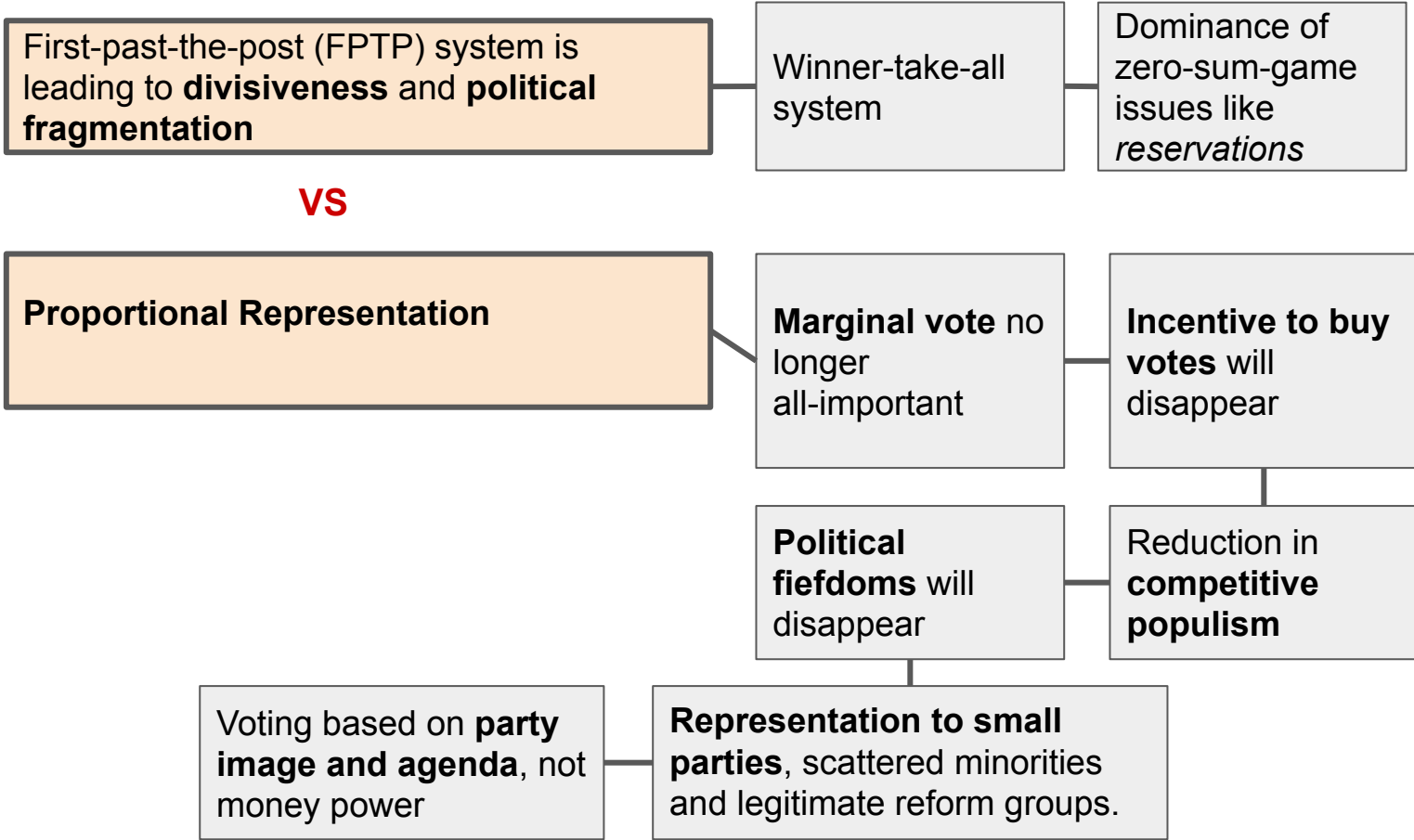
Dependence on legislator support for survival makes corruption and misgovernance endemic

Social divisions are exacerbated

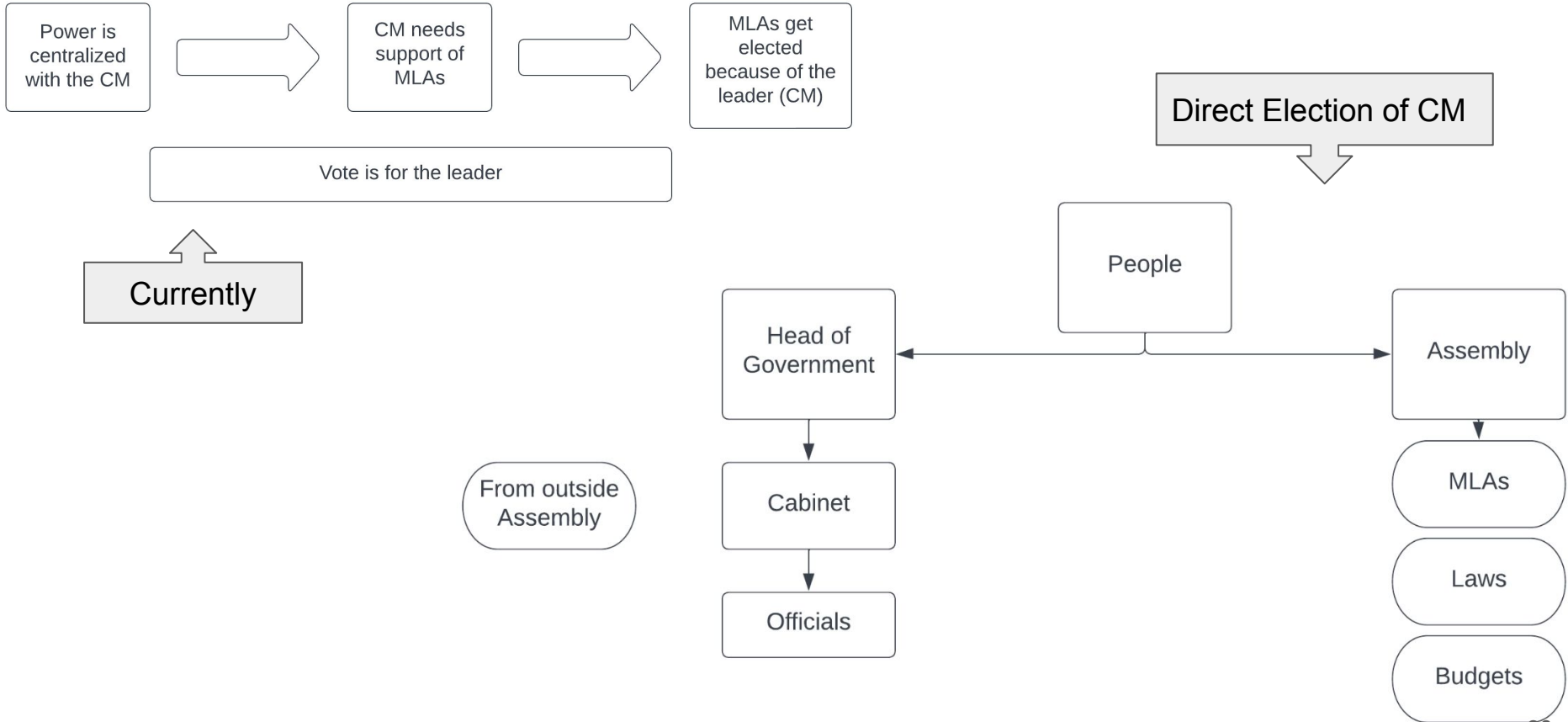
Vote bank politics – marginalisation and ghettoisation based on primordial loyalties

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

Altering Incentives – Proportional Representation

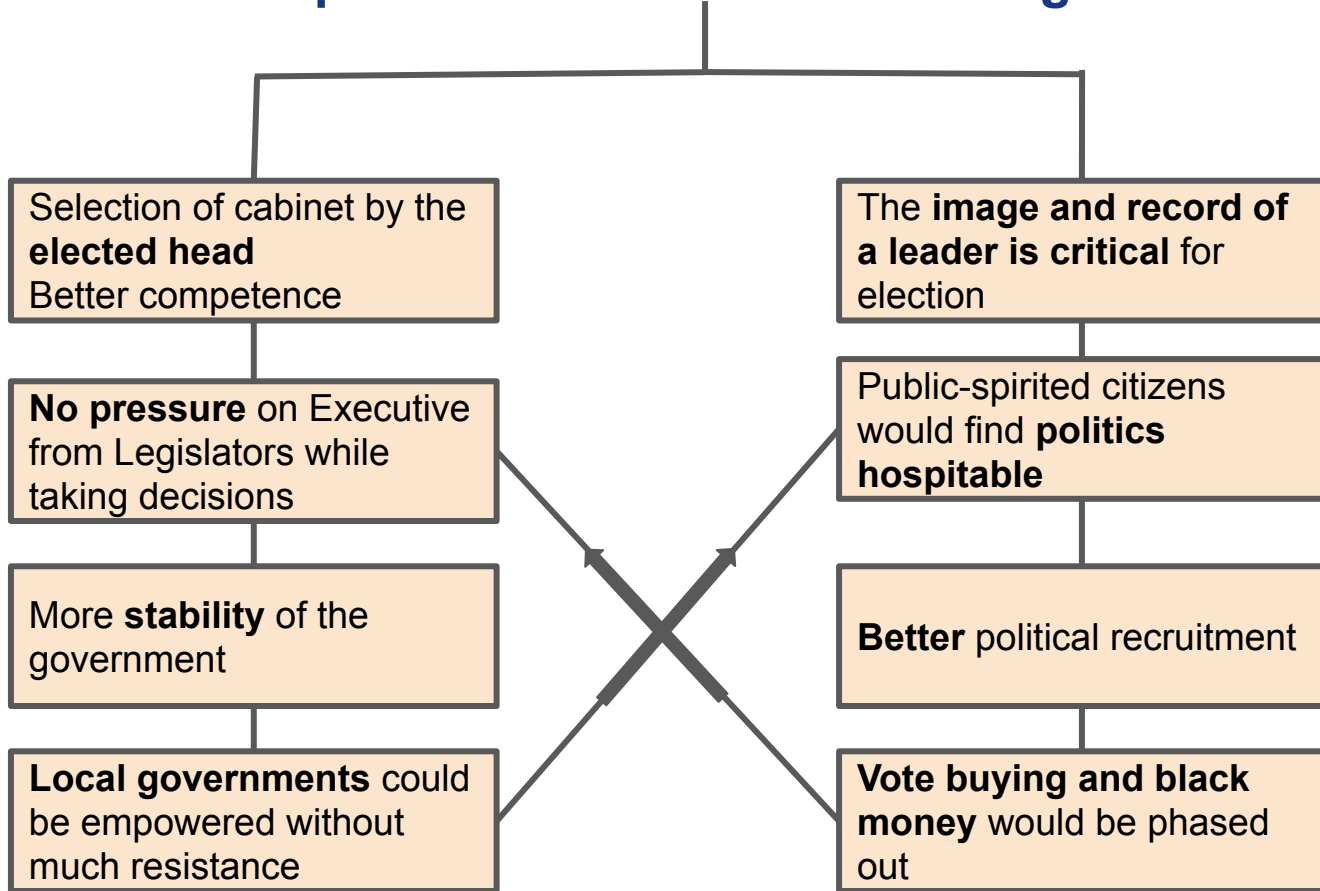


Altering Incentives – Separation of Powers

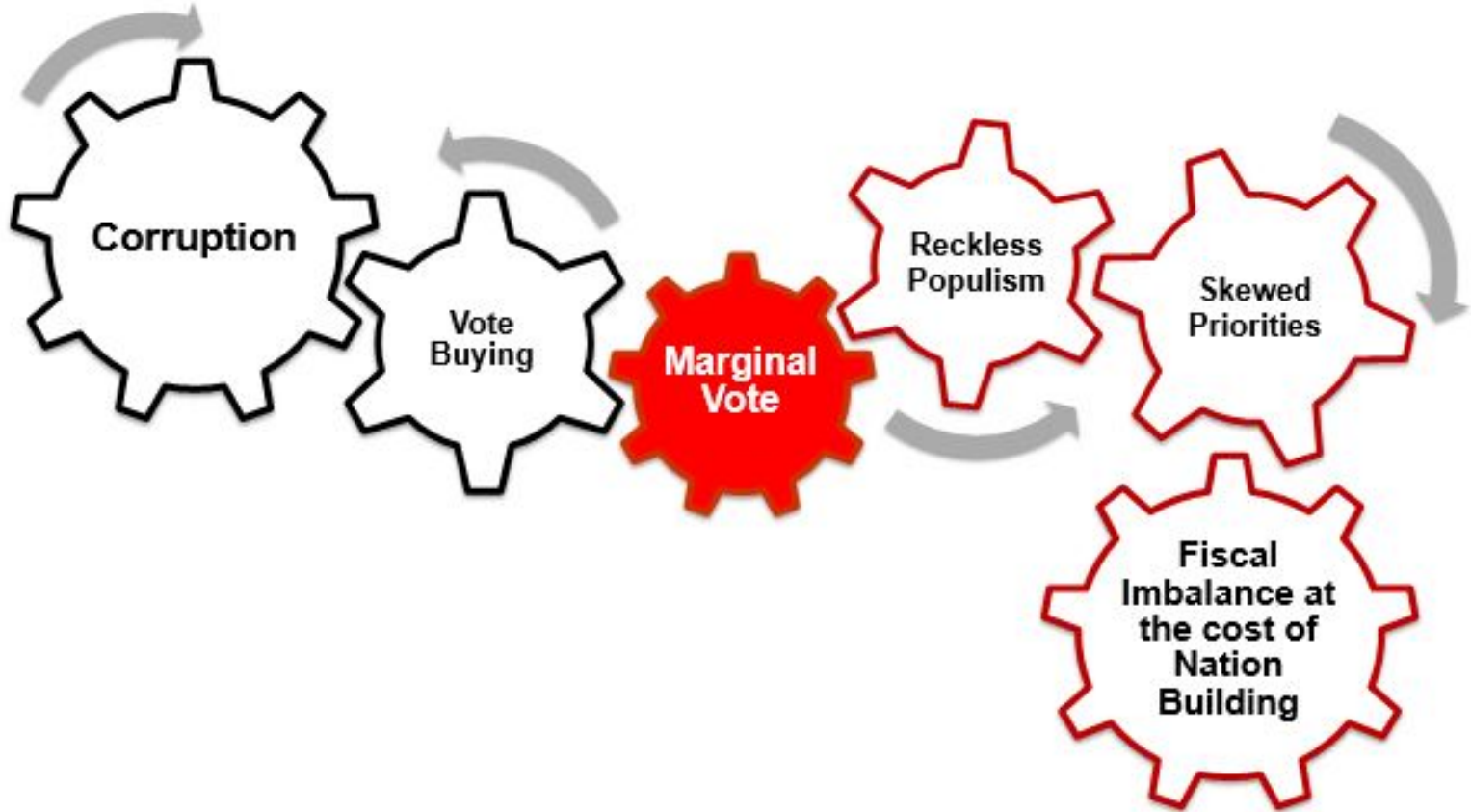


Altering Incentives – Separation of Powers

Separation of Executive and Legislature



Consequences of Marginal Vote in the Current System



Emerging Fault Lines in Electoral Politics

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

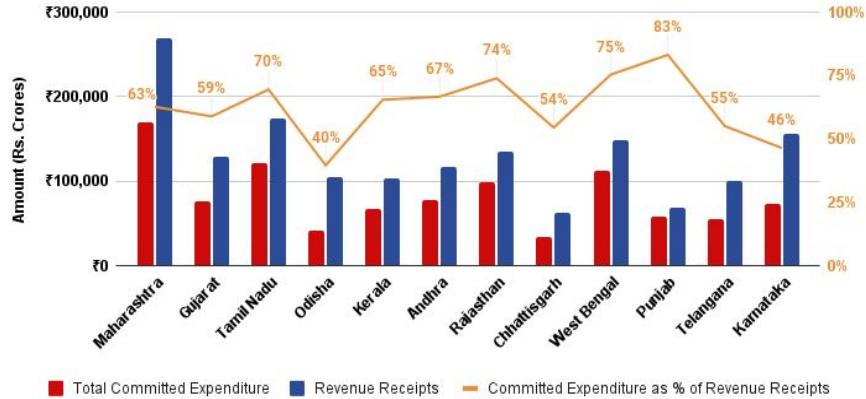
Why Growth Matters?

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

High Committed Expenditures*

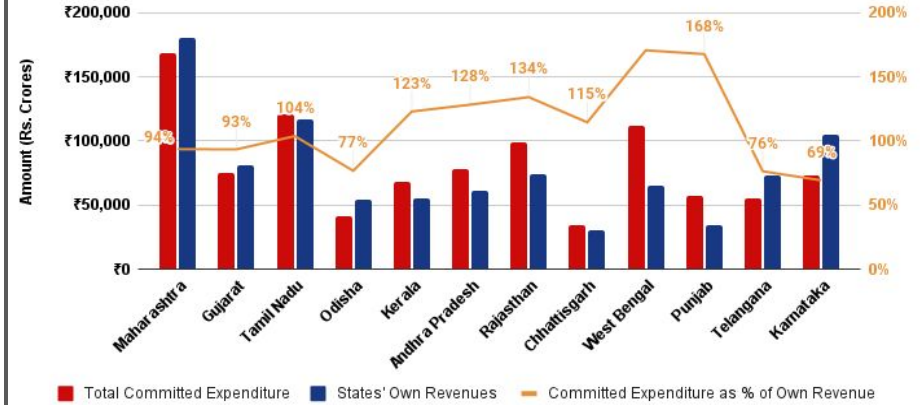
Committed Expenditure vs. Revenue Receipts in Select States, 2020-21

Sources: PRS Analyses of State Budgets, C&AG Reports. Chart prepared by: Foundation for Democratic Reforms



Committed Expenditure vs. Own Revenues in Select States, 2020-21

Sources: PRS Analyses of State Budgets, C&AG Reports. Chart prepared by: Foundation for Democratic Reforms



Committed expenditure accounts for **56%** of total revenues of states including Union transfers, and **125%** of the states' own revenue receipts, leaving little room for core governance functions

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

Rising Pension Burden

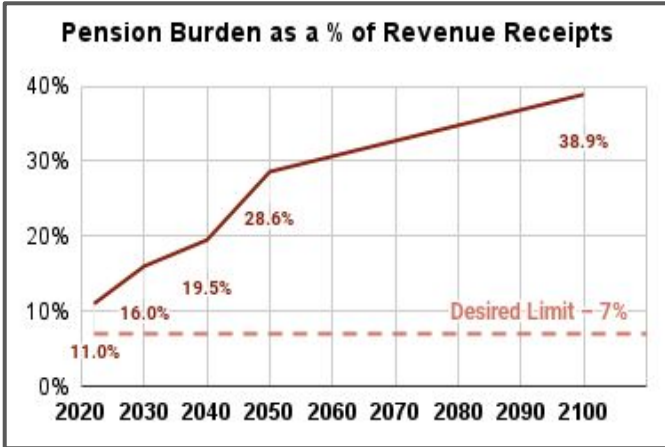
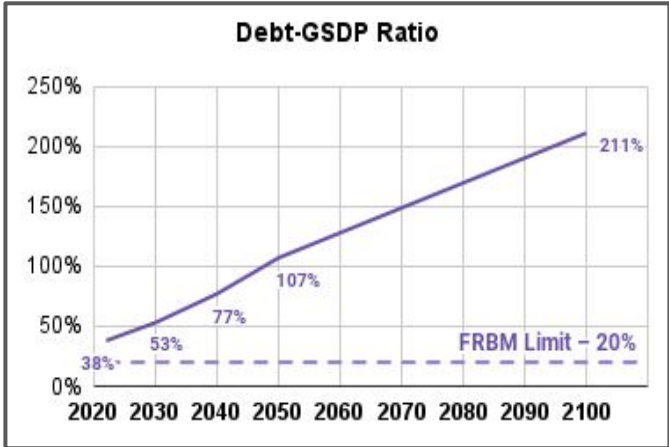
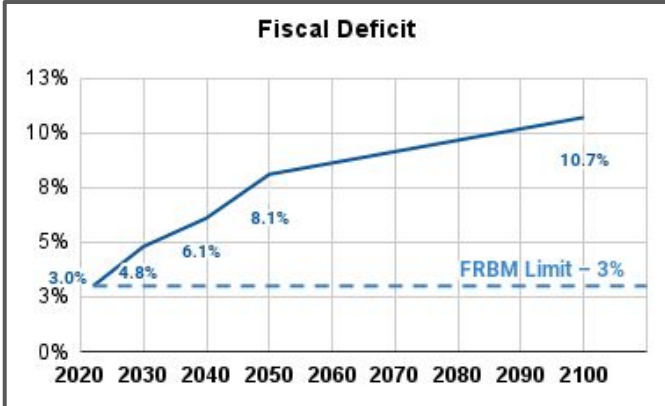
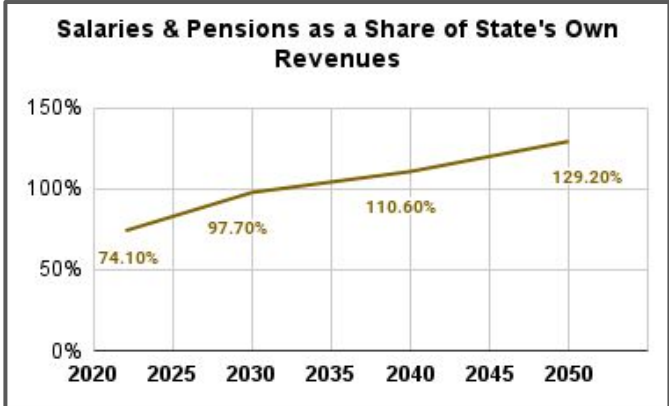
- The pension liability of state governments has almost **trebled in the nine year period from FY13 to FY22**, which is **13.2% as a share of all state revenue receipts**, and **29.7% of own tax revenues of states (FY 2021)**.
- Currently, 2% of the GDP is spent by the government, union and states combined, on pensions to its employees only, whereas the developed countries like USA spend around **4.9% of its GDP on Social Security** for *all workers* in the public and private sectors and it is **contributory**.

Pension Liability of Select States over the Years (Rs. Crores)					
State	2012-13	2019-20	2020-21	2021-22 BE	2022-23 BE
Andhra Pradesh	12089	17385	17470	17844	17267
Telangana	NA	11833	13599	10831	11385
Tamil Nadu	13162	30202	27115	28251	39508
Odisha	5379	14273	13629	17200	18221
Punjab	5966	10294	13680	11767	15146
Rajasthan	6858	20761	22440	25473	24439
Chhattisgarh	2412	6638	7136	6609	7603
West Bengal	11036	17462	21394	21263	22998
Maharashtra	11472	27741	32267	34428	45512
Himachal Pradesh	2747	5490	6088	7082	7790
Gujarat	7198	17663	18570	16843	17590
All States and UTs	145124	345505	NA	406867	NA

BE: Budget Estimates; NA: Not available

Only large country in the world with **unfunded, open-ended, index-linked, long-term, legal liability** of pensions **only** to government employees.

Horrendous Price with Old Pension Scheme



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

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

Rising Debt Burden of States

Debt Burden of Select States

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

GSDP: Gross State Domestic Product

As a result, borrowings resulting from excess of expenditure over income are mounting, and the Debt to GSDP ratio is growing to unsustainable levels.

The FRBM Act prescribes that the Debt to GSDP ratio should be at 40% for the Union and 20% for the states.

Fiscal Prudence and Political Stability - the Balancing Act by Odisha

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

Revenue Balance over the Years – TS, AP, TN & OD

Years	Telangana	Andhra Pradesh	Tamil Nadu	Odisha
2014-15	370.00	-24193.26	-6408	5862
2015-16	240.00	-7301.87	-11985	10136
2016-17	1,390.00	-17193.72	-12964	9259
2017-18	3,459.40	-16151.68	-21594	13367
2018-19	4,337.10	-13898.60	-23459	14190
2019-20	-6,254.06	-26440.52	-35909	2430
2020-21	-22,298.02	-35540.46	-62326	9076

TS: Telangana; AP: Andhra Pradesh; TN: Tamil Nadu; OD: Odisha

Note: Revenue Deficit (-), Revenue Surplus (+)

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

Mending the state of Public Finances

- Ensuring **zero Revenue Deficits - curb borrowing for current expenditures**
Realistic that all states can meet a zero revenue deficit target within 1-3 years, but the **Union may need upto 5 years on account of its *structural deficit***
- **Articles 293(3)** - union's consent required for states to borrow and **Article 293(4)** - union to impose conditions for granting consent
 - States should be required to meet and **maintain zero revenue deficit targets and later revenue surplus targets under Article 293(4) as a condition** for consent to borrow.
 - In case of states shifting to OPS, establishing a **sinking fund** to provide for government pensions should be mandatory.
- **Independent, credible institution to exercise functions under Article 293(3)** given the political sensitivity of the issue.
Can be entrusted to **Finance Commission making it a permanent body under Article 280** or establishing a **Fiscal Council** as recommended by FRBM Review Committee headed by N K Singh
- **Discontinuation of Revenue Deficit Grants** by the Finance Commission

Mending the state of Public Finances

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

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

Margaret Mead