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Growth and Public Finance in Bihar

Chirashree Das Gupta*

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Abstract

This paper explores the causal links between the role of public finance and Bihar's growth and development in the last decade; and argues that these links are tenuous. Bihar's growth acceleration precedes the 'policy reforms' in public finance based on the 'good governance' agenda initiated since 2005-06. However, the constraints on sustaining efforts to close Bihar's development gap with the rest of India stems from the nature of the growth process in its regional, sectoral and social dimensions and the contradictory means and ends of the 'policy reforms' in public finance. Together, this has not only prevented the economic growth to add to public coiffeurs of the state but also occluded the role of tax institutions.

Keywords: Good Governance, Growth, Bihar, Public Finance, Political Economy

JEL classification: O20, O40, P41, P43, R11, R58

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* Chirashree Das Gupta (chirashree@gmail.com) is Associate Professor at Ambedakar University, Delhi.

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INSTITUTE OF DEVELOPING ECONOMIES (IDE), JETRO
3-2-2, WAKABA, MIHAMA-KU, CHIBA-SHI
CHIBA 261-8545, JAPAN

I Recapitulating Bihar's Growth and 'Good Governance' Story

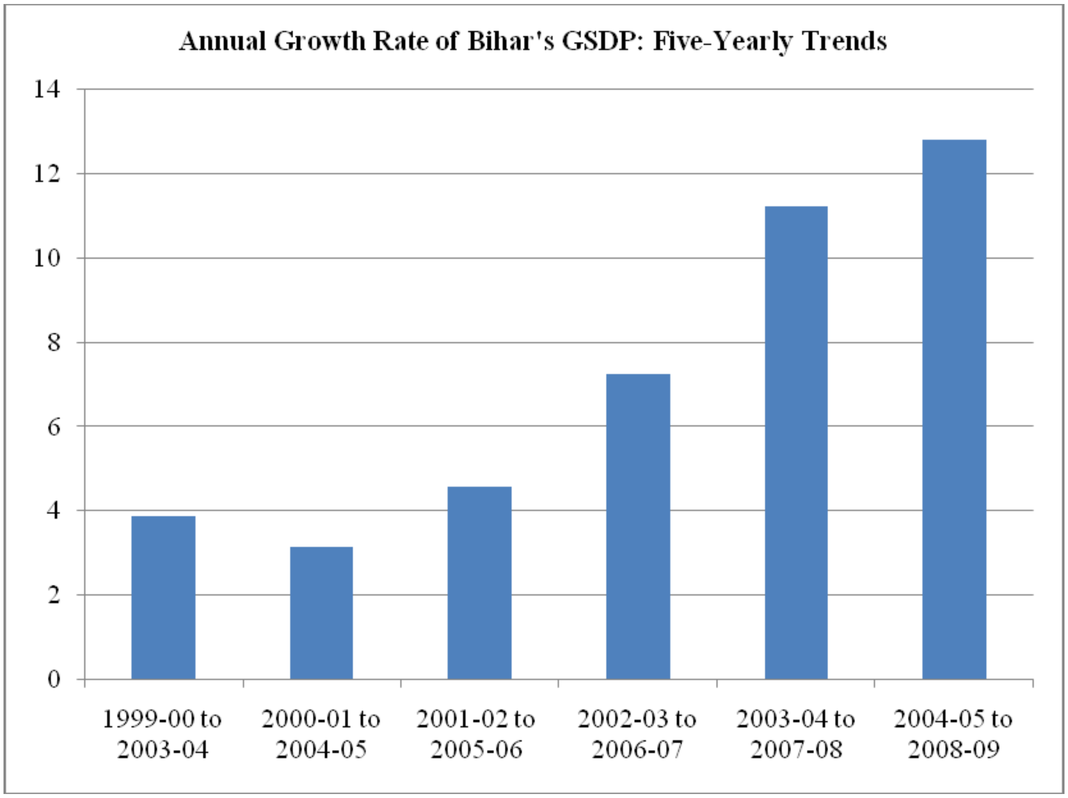
It is often argued that the NDA government under Nitish Kumar's chief-ministership since November 2005 has fared reasonably well on the growth front with a paradigm shift in the quality of governance and law and order in the state' with efforts to improve the delivery of service at all levels Kumar (2009). Such laudatory commentators believing in the resurgence of *sushasan* (good governance) have noted that the government has not been able to ensure that this 'development' paradigm '*percolate down to the masses* and emphasized the '*deplorable human conditions and high incidence of poverty*'. This has led to introspective assertion that '*much needs to be done to create an inclusive growth model*' (ibid: emphasis added). Such views are premised on an *article of faith* that indeed there has been an economic turnaround in Bihar through *sushasan* and it is now only a matter of time for the 'inclusion' of the more deprived castes and classes of Bihar society in this process of social and economic 'resurgence'. The growth is believed to have been an outcome of *sushasan* since 2005 because of improvement in law and order, increased public expenditure to build infrastructure and capabilities and creation of an 'investor-friendly' environment. This explanation is flawed as it is based on flawed periodisation and has severe analytical lacunae and data gaps. It is largely based on analysis of the year 2006-07 which is an outlier in the entire data set. Such analysis also fails to take into cognizance the new patterns of crime and the lack of visible investment as a result of the 'investor-friendly' environment and the social invisibility of growth beyond affluent parts of Patna, the capital of the state (Das Gupta 2010).

Bihar's economy saw a fluctuating pattern of growth in total GSDP since 2000-01. The primary sector has been growing at a highly volatile 3.4 percent with decline in sector share every year. The standard method of studying the broad classifications of primary, secondary and tertiary sectors and disaggregating each sector's share in GSDP shows that the decade since 1999-2000 has been primarily driven by growth in the secondary sector (13.9 percent) mainly due to growth and expansion in sector share of construction (trend growth at 26.5 percent and a 17.7 percent average annual increase in sector share) and a slower but less volatile growth in the tertiary sector (trend growth at 8.2 percent) due to growth and expansion of sector share in communication (trend growth at 23.1 percent and a 14.4 percent annual increase in sector share) and trade, hotel and restaurants (trend growth at 13.7 percent and a 5.8 percent annual increase in sector share).

Figure 1A demonstrates that the growth acceleration in Bihar had preceded the NDA government at least by two to three years as the acceleration in growth in this decade starts from 2002-03 and becomes pronounced in the period between 2003-04 and 2005-06 The first set of ‘reforms’ under *sushasan* started from January 2006 with time-lags for design, adoption, implementation and impact. So, if one has to look for structural breaks due to policy change, it would be more appropriate to look for growth trends since 2007.

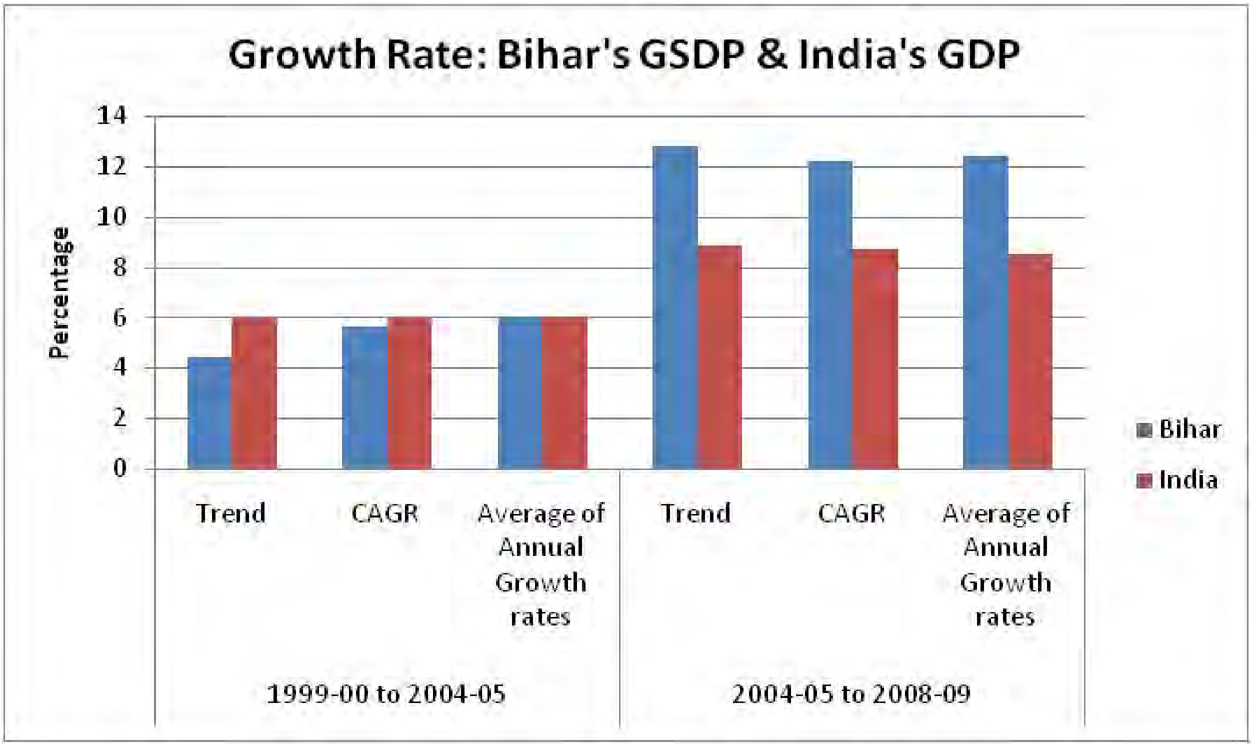
Figure 1A also shows that the period between 2005-06 and 2007-08 was the highest period of economic growth in Bihar. The period 2006-07 to 2008-09 – the three full years of NDA rule in the CSO dataset, shows a decline compared to the period 2005-06 to 2007-08, even if we go by the extraordinarily high figures reported for 2006-07. Thus it is difficult to find any indication of structural break after 2007. Economic growth trends do not map linearly to ‘regime change’. With these qualifiers, the growth period under consideration does not come across as a miracle. It reflects a continuum of 3-year systemic cycles in post-bifurcation Bihar since 2001-02, the year in which Bihar saw a sudden plummeting of its economy due to bifurcation. The years 2002-03, 2004-05 and 2006-07 are periods of more than 10 percent growth in this cycle even without any adjustment of the Central Statistical Organisation (CSO) data. If one takes into consideration that 2006-07 is an outlier (and the last two years in the series in the CSO are provisional and quick estimates and prone to change), one could conclude that there has been no major change under *sushasan* in the systemic cycle of economic growth in the last decade. In fact, between 1993-94 and 2000-01, Bihar’s economy had grown faster than the Indian economy. In this period, while India as a whole had recorded a longer period average growth rate of 5.75 percent, Bihar’s economy had grown at 6.09 percent (EPW Research Foundation 2009 p28 Table 8.2). This came to an abrupt halt due to the ‘economic shock’ of bifurcation of the state in 2000. Read with these patterns since 1994-95, the CSO data since 1993-94 till 2008-09 points to the possibility of a structural break in the early 1990s. Figure 1B shows that Bihar had already caught up with the national average in 2004-05 and overtook it in the subsequent period. Thus Bihar’s growth since 2002-03 can be interpreted as *the resumption of a long fluctuating and volatile movement towards a higher growth continuum that had started since 1994-95 but was interrupted by the impact of bifurcation in 2001-02* (Figure 1C).

Figure 1A



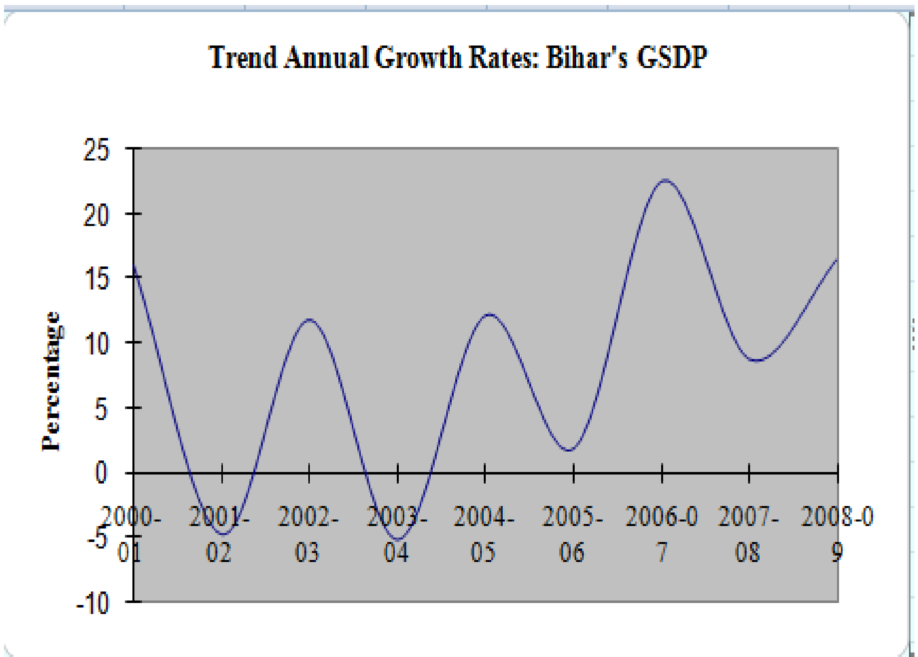
Source: Das Gupta (2010)

Figure 1B



Source: Das Gupta 2010

Figure 1C



More than 74 percent of the growth in GSDP in any period between 1999-2000 to 2008-09 consists of the sectoral contributions of four sectors – agriculture and allied activities, construction, communication, and, trade, hotel and restaurants; while the rest of the sectors together account for just a quarter of the growth process. Agricultural growth was much more important in the overall explanation of GSDP growth in the period: 1999-2000 – 2004-05 when it accounted for 17 percent of overall growth in GSDP. In the subsequent period, despite the inconsistent figure of 34 percent growth in agriculture and allied activities reported in 2006-07; in the three years from 2006-07 to 2008-09, agricultural growth only contributed to 6 percent of overall growth of GSDP along with a faster decline in sector share. Once we remove the inconsistent figures of 2006-07, sectoral volatility in the period after 2004-05 shows a four-fold increase. Thus the role of agricultural policy since 2005-06 can hardly be adjudged to have made any positive impact on the macroeconomics of agriculture. The contribution of construction in overall growth saw a remarkable rise from 11 percent between 1999-2000 and 2004-05 to 29 percent between 2004-05 and 2008-09. However, the peak period of share of construction in the overall growth process was in 2004-05. In the three years between 2006-07 and 2008-09, the contribution of construction to overall growth declined to 21 percent. Thus the growth spurt in construction precedes the policies adopted in and after 2005-06, and has very little to do with the pros and cons of the NDA government's public expenditure led construction drive. The contribution of communication to Bihar's overall GSDP growth doubled from 4 percent between 1999-2000 and 2004-05 to 9 percent between 2004-05 and 2008-09. However this leap is also in the year 2004-05 and remained at that level in subsequent years. This has also been one of the less volatile sectors of the economy all through the decade under consideration. The expansion in communication would find a more plausible explanation in the 'telecom boom' in India since 2004-05 than to any particular state-specific policy after 2005-06. The contribution of trade, hotels and restaurants to economic growth in is the single largest sectoral contribution to overall growth (36 percent between 1999-00 and 2008-09), consistently reflected over every period in the last decade (Table 1.1).

Table 1.1: Sectoral Contributions to GSDP Growth

Period	1999-00 to 2008-09	1999-00 to 2004-05	2004-05 to 2008-09	2005-06 to 2008-09	2006-07 to 2008-09
Percentage Growth in GSDP	7.5	4.4	12.8	15.1	12.6
Percentage contribution to overall growth of GSDP					
Agriculture	13%	17%	14%	17%	6%

Construction	24%	11%	29%	22%	21%
Communication	7%	4%	9%	7%	9%
Trade	36%	49%	33%	36%	41%
Rest	22%	21%	22%	20%	26%

Moreover, absolute contribution of trade, hotels and restaurants is reflected in the expansion of the sector by almost 6 percentage points in a decade-long secular expansion with sectoral volatility remaining relatively low in every period. In size, trade, hotels and restaurants is equal to the entire secondary sector in Bihar. Contrary to dominant explanations about the **causal link** of construction and communication spurt *incubating a boom* in small trade, the spurt in trade *precedes* the spurt in construction and communication. Neither can this spurt in trade be mapped linearly to 'feelings of safety' due to restoration of 'law and order' per se as the acceleration in trade precedes by many years the 'law and order' measures of the NDA government. In fact, trade had been the single driver of overall growth in Bihar till Bihar caught up with the 'communication boom' in 2004-05 and the subsequent spurt in construction with the rest of India. This robustness of trend in the growth of trade regardless of the nature of policy regimes has been a ‘peculiarity’ of India’s economic transformation (Mazumdar 2010). Bihar’s growth trajectory does not buck this trend.

The structural vulnerability in Bihar’s economy emanate from two sources: first, the ‘growth centres’ in this decade have been the more ‘integrated’ components of the service sector which is primarily driven by conditions beyond the remit of state governments and in face of volatility, the government has no writ or policy tools in its *sushasan* agenda to address the outcomes of such volatile fluctuations. Second, the *sushasan* agenda in its conceptual embedding in the 'efficiency' paradigm of 'monoeconomics' is committed to more 'integration' with growth-enhancement primarily based on large infrastructure building that facilitates this particular kind of growth. This 'efficiency' in the 'monoeconomics' of the dominant consensus (Hirschman 1981) can only be conceived in an economic paradigm where four assertions have to be valid - first, that society is an aggregation of individuals; two, individuals engage in maximizing rational behaviour (even if constrained by bounded rationality); three, this behaviour results in the creation and maintenance of equilibrium (though equilibrium can often only be analyzed at the microeconomic level); four, these behavioural premises imply that markets achieve (constrained) efficiency for all individuals and by aggregation for society. Skepticism is unavoidable about a policy approach that sees 'growth' as inter-temporal utility maximization by individual economic agents designated in their roles as savers, investors and consumers rather than a complex outcome of the interaction of movement in 'capital accumulation, labour force and technological progress' (McFarlane 1989).

II Public Finance in Bihar

The Bihar growth story coincided with a conjuncture in India's social transformation story with the mainstream recognition of the overwhelming evidence that India's growth since the 1980s had failed to generate adequate employment and improve aggregate productivity of labour rather than just in a few chosen sectors like heavy manufacturing in the pre-reform era and software, food-processing and low-value service areas like call centres in the post-reform period (Chandrasekhar and Ghosh 2002). This is the most obvious symptom of the lacuna in Indian economic development. Economic policy discussion in India had relegated employment generation to a subsidiary position since 1991 with the emphasis on 'efficiency'. By 2004, the debate had transformed to contend that in India 'liberalisation' needs a 'human face' and should be accompanied by greater concern for the plight of the 'masses' (Economic Survey 2004-05). to paved way for a soft version by the middle of the first decade of the 21st century in India with a synthesis of *policy advice* deriving from the contemporary humanist libertarian views of 'development as freedom' and the 'entitlements approach' (Sen 1982, 1999), Rawlsian approaches of giving priority to basic liberties over the more equality-oriented demands (Rawls 1971) and the post-materialist arguments derived from theorists like Inglehart (1977, 1997). This led to the coining of ‘inclusive growth’ as the consensual slogan of soft neoliberalism spanning international funding agencies, donor and recipient organizations working in the social sector, the federal and state governments in India. Thus the role of the state was instrumentally revised to focus on public finance with ‘development gaps’ measured in terms of gaps in Per Capita Development Expenditure (PCDE). Adopting this techno-managerial framework of ‘managing development’, 'catching up' on development expenditure was set out as a prime goal of *sushasan*. Thus stimulating growth through public spending, despite the techno-managerial policies deriving from *monoeconomics* that informed the *sushasan* agenda, were conceived on neo-Keynesian precepts of increasing development expenditure to enable structural economic transformation, reflecting an inherent contradiction in the political goals and the policies adopted to achieve the same based on sophisticated versions of neoliberal tenets emerging from new institutional economics and new political economy. The contradiction lies in the conflict between the very different means and ends of the neoliberal service delivery state and the neo-Keynesian transformative state. In a peculiar atrophy of reasoned causation, PCDE became a co-determinant of double-digit growth figures in Bihar (eg Gupta 2010) without any examination of the basis and direction of causation.

In spite of the quantitative gap in PCDE between Bihar and the rest of India (Figure 2A), the compound annual growth rate of PCDE in Bihar has been 16.8 percent since 2004-05, while that of PCDE for the country has been 13.9 percent (Table 2.1) . Thus PCDE was growing faster than the national average in Bihar. Sustaining this effort at public expenditure on ‘development’ is important, but attributing it to specifics of the policies of the NDA government needs qualification. 2004-05 and 2005-06 were exceptional years for Bihar’s fisc due to political reasons. The Rashtriya Janata Dal (RJD) government in Bihar fell in 2004-05, followed by President’s rule and elections. The results led to a hung assembly and a new government could not be formed. In the period of President’s rule and the months leading up to elections, there were strictures on spending. As there was no government in place by the end of the financial year, there was no proper sanctioning authority leading to low expenditure both in plan and non-plan components. The CAG Report (Civil) for 2004-05 noted that delays in submission in utilization certificates led to a low disbursal-low expenditure cycle. In 2005-06, Bihar was again under President’s rule. Elections were held in the last quarter of 2005 and the NDA government came to power in November 2005. A large part of expenditure was incurred only in the last quarter of the financial year due to preelection spending strictures. If this qualification is borne in mind, it would be clear from Figure 2.1 that the year 2004-05 is an outlier and the accelerated growth in PCDE dates back to 2002-03 and runs out of steam by 2007-08. Thus the sophisticated conjectures of the causal link between economic growth and *sushasan*, based on the official claims of substantial stepping up of development expenditure since 2005-06, is flawed. The causal inks between stepping up of development expenditure and economic growth is highly contested in the theoretical literature as the determinants of these two economic variables are different. The neo-Keynesian argument has often been premised on the impact of increased development expenditure on investment. This at best is a necessary condition but not a sufficient condition for increasing labour productivity and thereby leading to growth. The effectiveness of this causal link is dependent on the social structure of production and consumption of the economy (Fine and Leopold 1993). In the case of Bihar since 2005-06, investment has not really taken off in this period till date. Trends in labour productivity show hardly any significant structural break in the period of accelerated growth (Chanda 2011). The relative share of development expenditure in the state government's total expenditure increased since 2005-06 to reach a peak of 64.79 percent in 2007-08, but fell to 48.35 percent in 2008-09 and is expected to fall further to almost 2001-02 levels (41.83 percent) in 2009-10 (47.67 percent) and 2010-11 (43.67 percent), according to the state government's own budgetary estimates (Table 2.1).

Table 2.1: Development Expenditure in Bihar

	Development Expenditure* (Rs Crore)	Total Budgetary Expenditure (Rs Crore)	Percentage Share of Development Expenditure in Total Expenditure
2001-02	7898.80	18882.33	41.83
2002-03	9290.10	15505.53	59.91
2003-04	10127.00	22481.90	45.05
2004-05	9095.00	20058.00	45.34
2005-06	12988.00	22568.48	57.55
2006-07	17304.00	27136.47	63.77
2007-08	20456.00	31571.19	64.79
2008-09	17978.00	37181.26	48.35

2009-10 (Revised Estimates)	23622.00	49552.32	47.67
2010-11 (Budget Estimates)	25226.00	57758.55	43.67

Note: 1Crore = 10 Million;

Source: Government of Bihar: Annual Budgets, Various Years

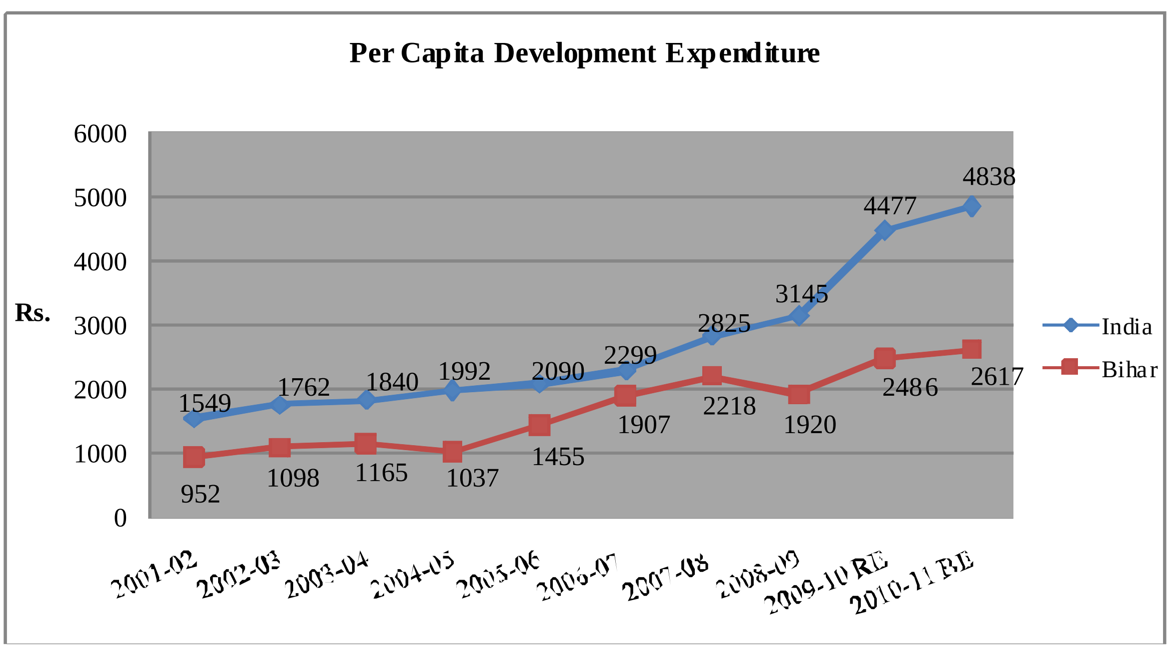
Table 2.2: Per Capita Development Expenditure of Major Indian States

State	Per Capita Development Expenditure (Rs.)						
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Goa	8861	9507	10578	11766	13247	15098	15250
Gujarat	3399	3007	3440	3508	3963	4615	4524
Haryana	3195	2829	3795	3287	4097	5857	5979
Punjab	2848	2514	3059	3133	3392	4947	5517
Karnataka	2702	2705	2842	3503	4073	5216	5936
Andhra Pradesh	2595	2542	2942	3132	3687	5026	6633
Maharashtra	2516	2741	3182	3740	4184	4658	4626
Tamil Nadu	2244	2591	2751	3173	3402	4711	5114
Kerala	2091	2769	3048	3054	3233	4222	4291
Jharkhand	1975	2439	2170	2790	3348	4046	3885
Rajasthan	1885	2002	2440	2534	2810	3230	3505
West	1858	1525	1799	1833	2039	2420	2633

Bengal							
Madhya Pradesh	1808	1872	2285	2757	2925	2885	3109
Chhattisgarh	1707	2059	4673	4130	3011	4409	4866
Orissa	1612	1713	2072	1795	1980	2653	3021
Uttar Pradesh	1112	1199	2278	1470	1793	2388	3007
Bihar	**943**	**1091**	**1168**	**1030**	**1447**	**2124**	**2184**

Source: State Finances: A Study of Budgets of 2008-09, Reserve Bank of India, 2008

Figure 2A:'Development Gap': Bihar and India



Beyond electoral equations and the specificities of social conditions in Bihar, the complete and absolute surrender to neoliberalism by the successive governments at the centre created a material basis for discontent at the state level on the question of development of low income states. But as long as the Rashtriya Janata Dal (RJD) of Laloo Prasad Yadav was in power, the full thrust of neoliberal policy implementation at the state level had been held at bay. Ironically, this had partly to do with the RJD's 'non-policies' itself at the state level that led to the perception of its 'failure to govern'. But it had much more to do with the centre's paradigmatic shift to neoliberalism. The RJD government bore the brunt of the fiscal crisis at the state level unleashed by central policies of fiscal cuts in the 1990s. While the impact on all state governments had been severe (Isaac and Ramakumar 2006), Bihar' crisis was compounded by its historically high fiscal dependence on the centre and a mismatch between post-bifurcation shares of assets and liabilities. The neoliberal assault on the state's fisc reinforced the conditions of 'backwardness' traceable to the pre and post-independence history of the state being at the receiving end of policies that deepened regional inequality (Guruswamy 2007), central policies before and after liberalisation that reinforced undermining of state level institutions (Ghosh 2007), the reinforcement of regional disparity through sectoral approaches that failed to address the specificities of the social in the regional (Ghosh and Das Gupta 2009) and the structural features of Bihar's primarily feudal agrarian society (Das 1983). The RJD government in its last tenure after presiding over the bifurcation of the state, remained trapped in fiscal crisis in a period of overall low economic growth and the check on expenditure after the 'fodder scam'.

The NDA government in contrast came to power at a time of buoyant central revenues and easing of the fiscal crisis of the states in a high economic growth scenario that again had very little to do with the state government's policies. This gave the necessary cushion for the NDA government to step up expenditure budgets and maintain the acceleration in development expenditure in its first two years. However, the biggest cushion came in the form of a revenue surplus accrued since 2003-04 due to the expenditure strictures till the NDA's coming to power which has been outlined above. However, in the face of its hurried adoption of 'fiscal responsibility' legislation immediately after coming to power, the fiscal room to sustain the increase in development expenditure ran out with self- imposed limits on the revenue deficit and the fiscal deficit in keeping with strictures and patterns of expenditure in other states of India under fiscal responsibility legislation (Isaac and Ramakumar op.cit). Expenditure compression became the norm for most budgetary outlays and the compression of outlays in development expenditure followed in Bihar as soon as the revenue surplus ran out in 2007-08 (Figure 2A (i) to 2A(iv)).

Figure 2A (i)

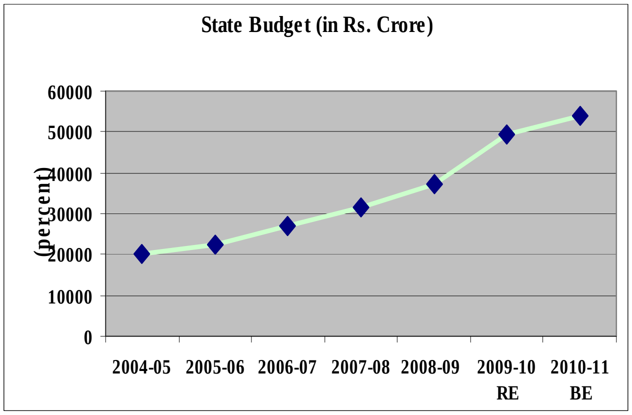


Figure 2A (ii)

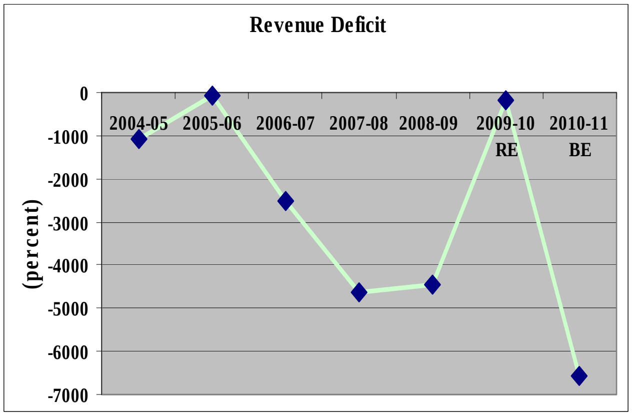


Figure 2A (iii)

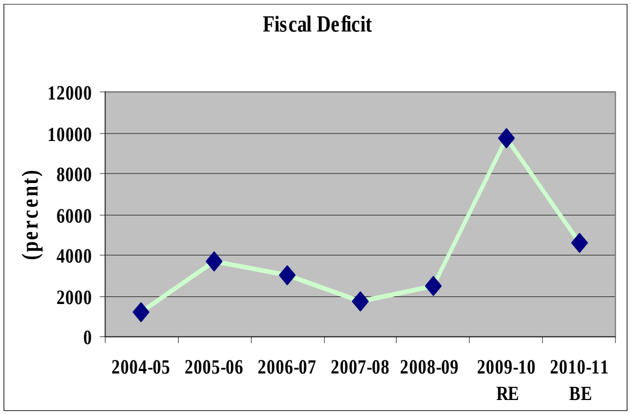
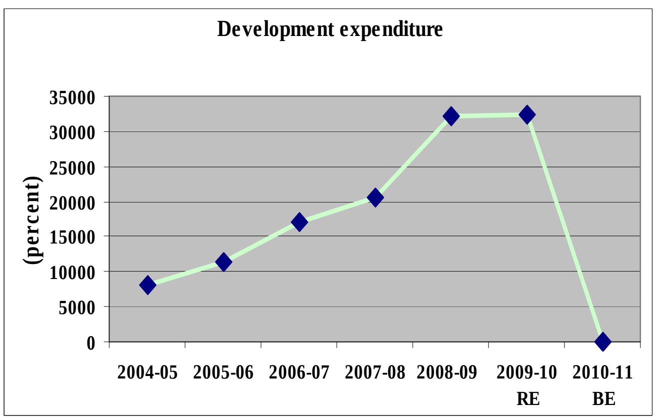


Figure 2A (iv)



Expenditure

Non-plan revenue expenditures on different major heads reflect the prioritization of maintaining existing social and economic institutions and infrastructure while revenue expenditure under plan heads reflect the recurring cost of creation of new institutions and infrastructure. The most significant and balanced increase in plan and non-plan revenue expenditure has been under the budget head of 'general education' but this has come at the cost of disproportional stagnancy in non-plan outlays and sporadic outlays in plan revenue outlays for existing infrastructure and institutions for medical and public health, water supply and sanitation (Figure

2B and 2C). The 'rhetoric' of policy announcements on 'technical education' is also not matched in the trend in budgeting priorities with stagnant revenue expenditure in the non-plan head. Thus the budgeting priorities reflect a move towards financial undermining of existing public institutions and infrastructure.

Figure 2B

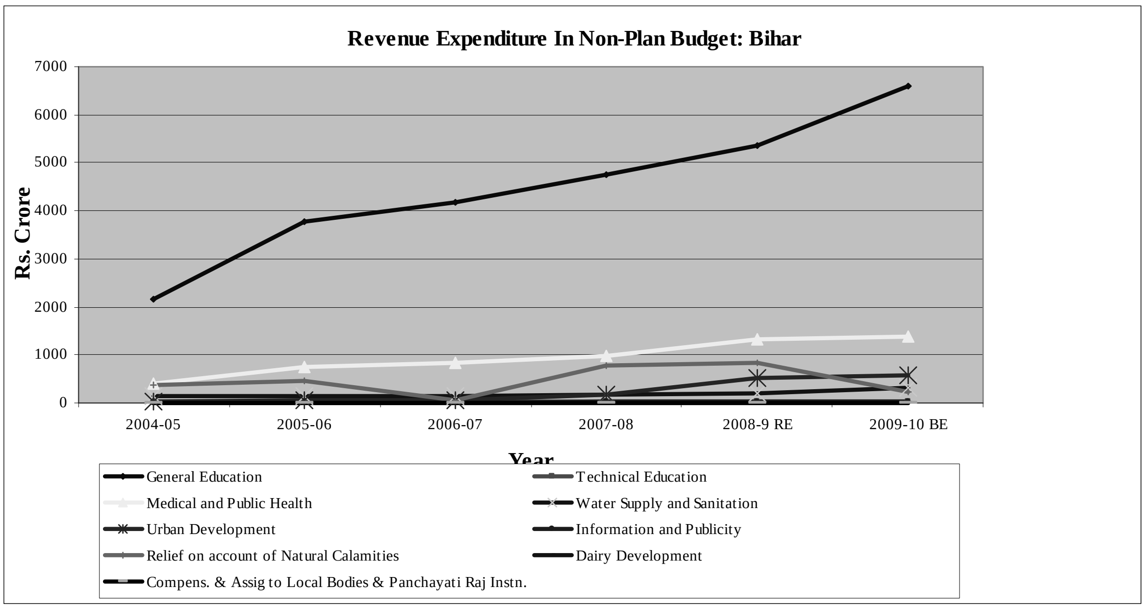
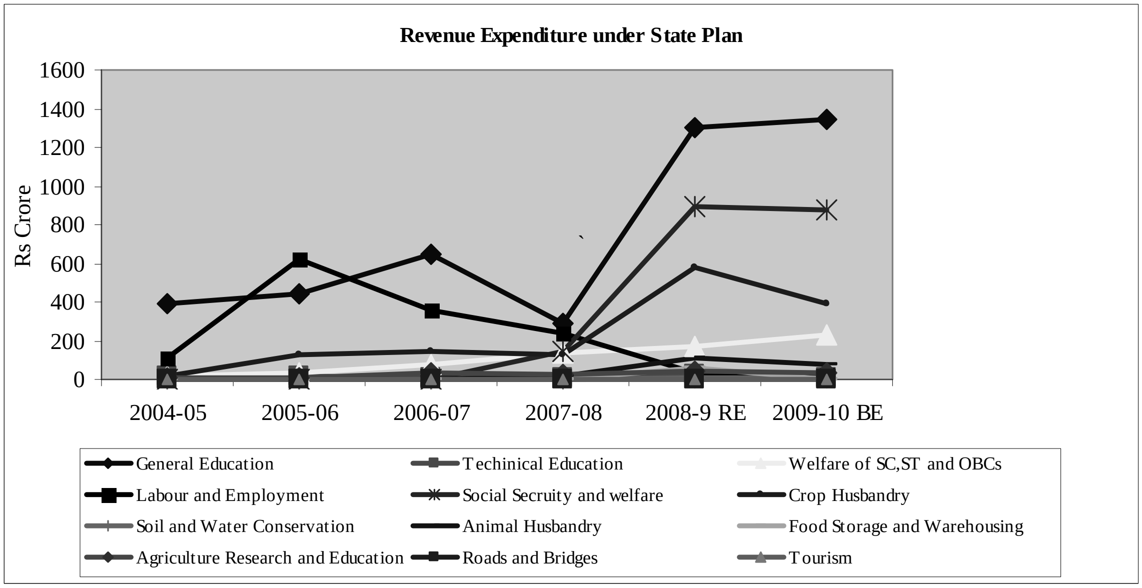


Figure 2C



The basis of distinction between revenue and capital expenditure has been questioned by economists, as both are overlapping in their functional purpose. Nevertheless, the capital outlays in plan and non-plan budget are exclusively geared towards creation of new infrastructure and resources. In the non-plan budget, the disproportional priority on policing in the state has led to falling public investment in public work and almost insignificant allocations to major irrigation (Figure 2D). In a state ravaged flood and majority of impoverished lives and livelihoods entirely dependent on monsoons, the low priority accorded to new investments in 'major irrigation' reflects the inherent methodological lacunae of the 'inclusive growth' agenda. The trend of decline in public work also reflects the low priority given to developing arterial infrastructure which is much more relevant in the sustaining of livelihoods and improvement of living conditions than point-to-point large scale infrastructure projects which accentuate disparities.

Figure 2D

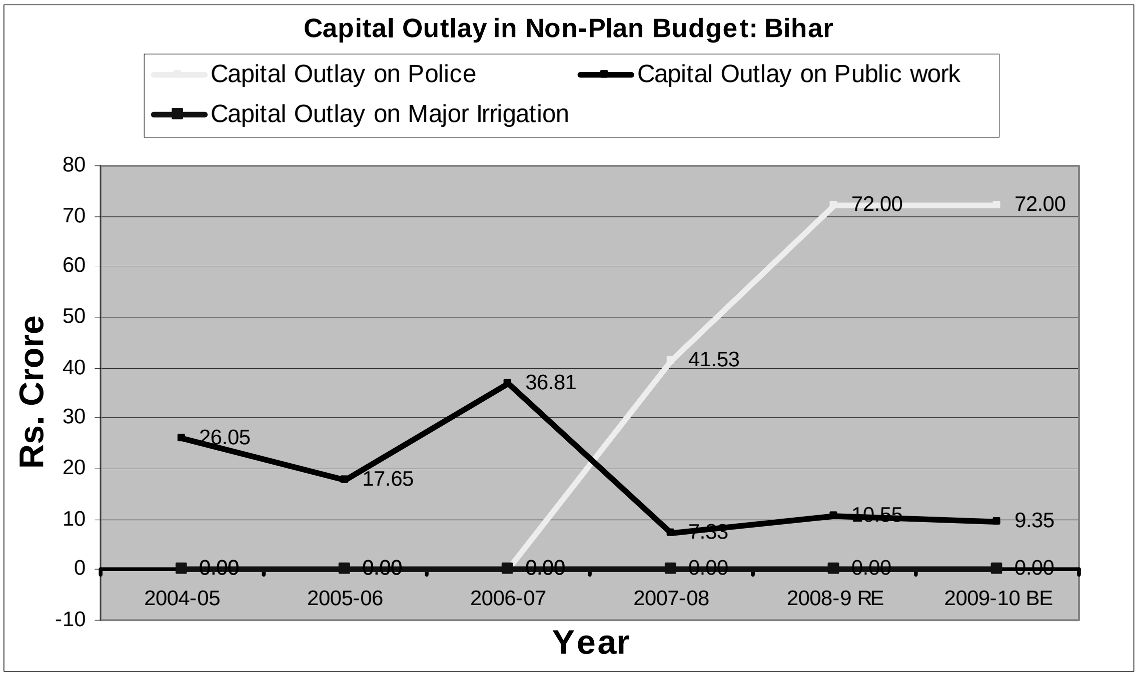
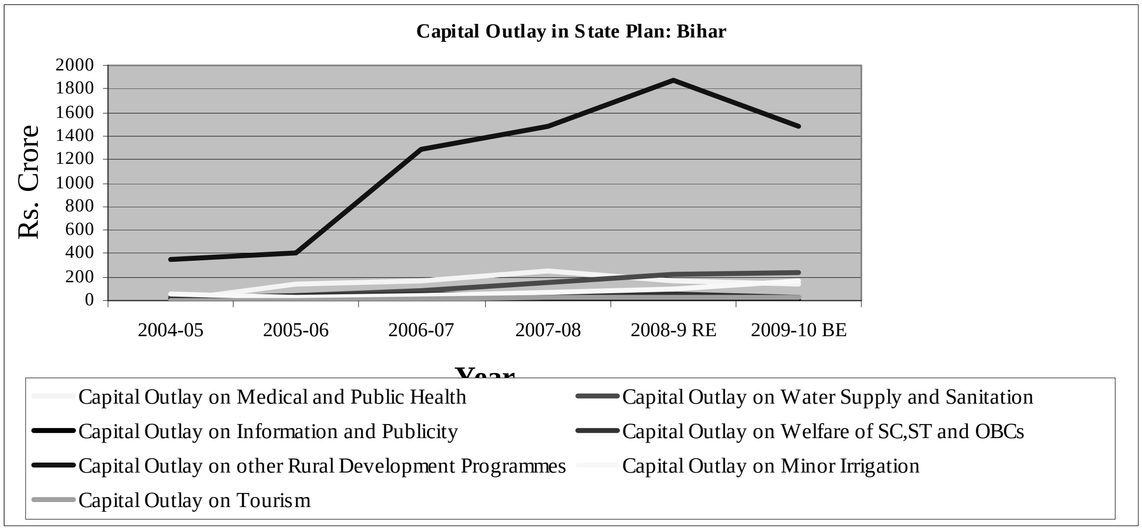

Capital Outlay in Non-Plan Budget: Bihar
Capital Outlay on Police
Capital Outlay on Public work
Capital Outlay on Major Irrigation
Rs. Crore
Year
80
70
60
50
40
30
20
10
0
-10
2004-05
2005-06
2006-07
2007-08
2008-9 RE
2009-10 BE
72.00
72.00
41.53
36.81
26.05
17.65
10.55
7.33
9.35
0.00

Figure 2E



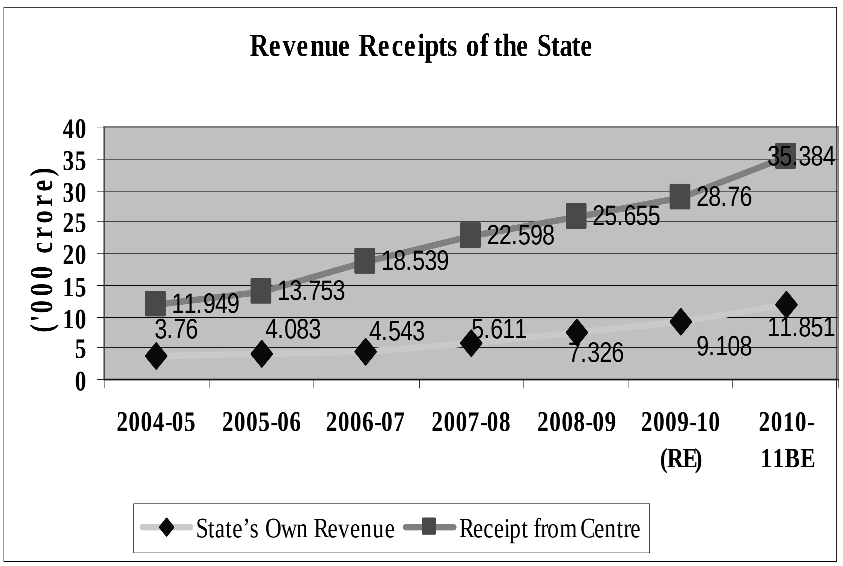
The capital outlay in the state plan reflects no significant 'investments' in minor irrigation, welfare of SC/ST and OBCS, medical and public health, tourism (which is supposed to be 'focus area of growth in the NDA policy objectives) and most importantly in Medical and Public Health. The only significant step up was on Rural Development Programmes with a plethora of schemes envisaged under the state plan. However, the decline in allocation in 2009-10 (budget estimates) to even this prioritized investment in 'rural development' head must be noted. The 'capacity to spend' depends on the functioning of institutions of the state. Bihar, where historically the expenditure on institution building has been low, capital outlays in 'rural development' through schemes cannot be effective unless the various institutions of the state involved in the operationalisation of these schemes are enhanced. Thus a balanced approach in capital and revenue outlays is a minimum necessary condition for the schemes to take off and be sustainable.

The government itself had argued that the adoption of fiscal responsibility legislation is primarily responsible for this scenario in its memorandum to the Thirteenth Finance Commission in 2008[1].

[1] For an overview of the fallacies of fiscal conservatism in the context of India's lop-sided development, see Bhaduri (2006); Patnaik (2000, 2006), Sethi (2009)

The other pillar of reforms has been based on the argument of accelerating ‘own resource mobilisation’ by the state government. However, it is precisely in the period of accelerated growth that the state’s policy reforms have had no impact on own resource mobilisation. The tax-GSDP ratio has been hovering around 5 percent for the entire period of growth acceleration. The dependence on the central government for the state’s revenues has increased (Figure 2F) from 40 percent in 2004-05 to 72 percent in 2008-09.

Figure 2F



Even though the structural constraints on the economy are such that the Committee of experts given the task of envisioning in the medium term of how to go about this has hardly been able to recommend anything substantive except improvement of tax collection and tax resource management through use of information technology. But once again the basic question is whether tax collection can be improved with no major change in expenditure patterns on the source of the largest tax head – tax from sales and trade (Figures 2G and 2H)?

Figure 2G

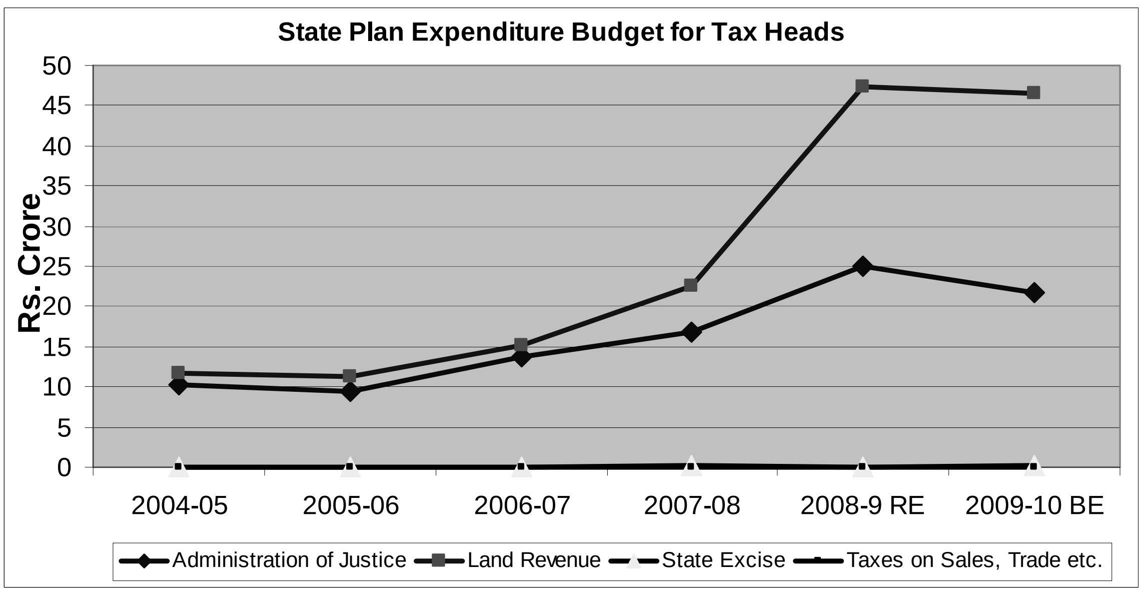
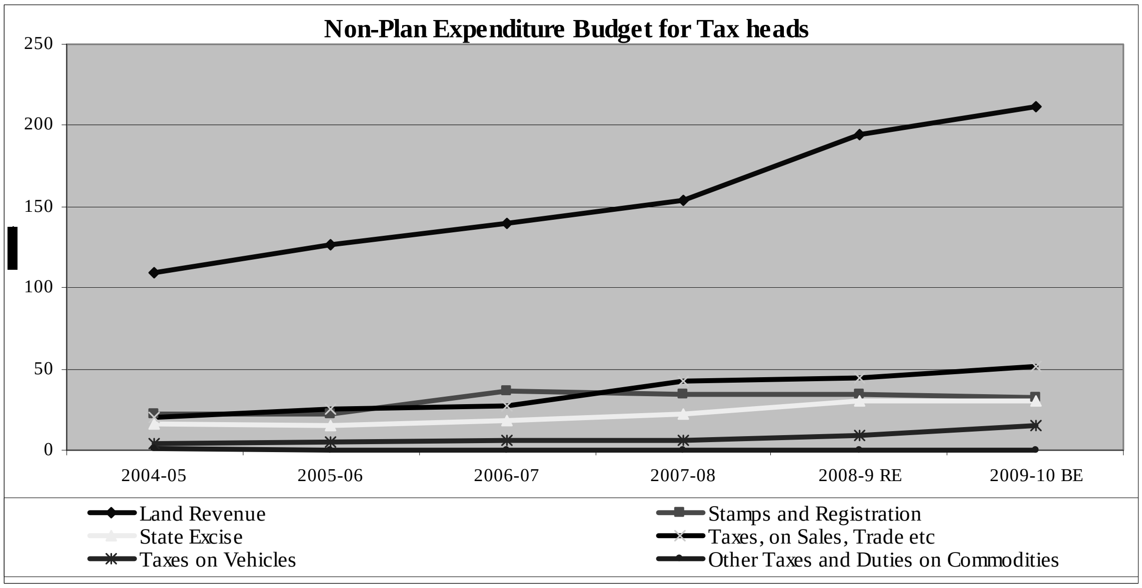
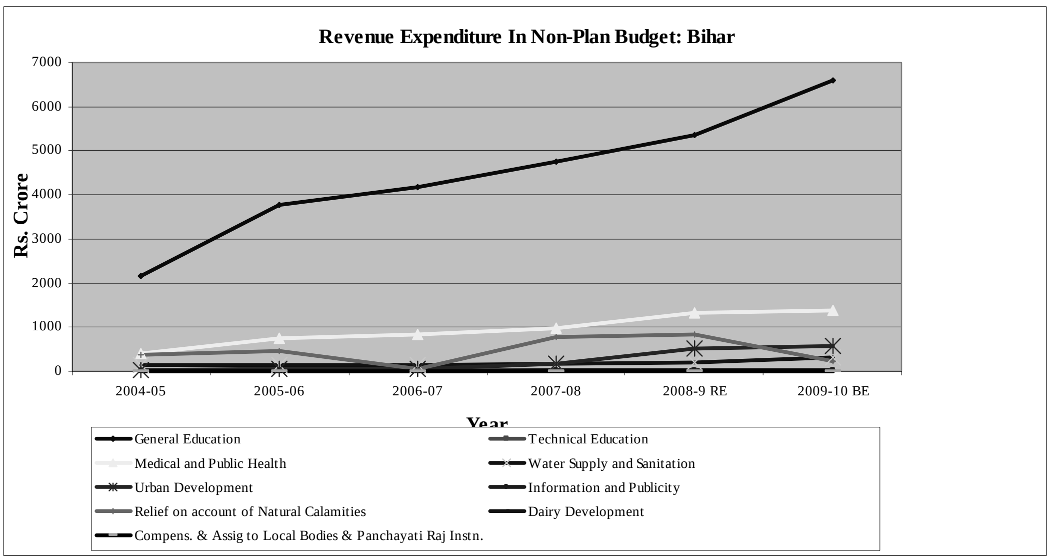

State Plan Expenditure Budget for Tax Heads
Rs. Crore
50
45
40
35
30
25
20
15
10
5
0
2004-05
2005-06
2006-07
2007-08
2008-9 RE
2009-10 BE
Administration of Justice
Land Revenue
State Excise
Taxes on Sales, Trade etc.

Figure 2H



The prioritization of expenditure in one basket 'land revenue' in both non-plan and plan heads over all other tax sources. Land revenue contributes between 1 to 1.5 percent on average to tax revenue of the government (Economic Survey of Bihar: Various Years). Since land has historically been the 'resource' which has been fundamental to accumulation in Bihar, public investment in land revenue mobilization could be considered to be pragmatic. However, the potential for land revenue mobilization cannot be ascertained, leave alone explored unless land records can be updated and the nature of property right over each piece of recorded land can be ascertained. The assumed 'neutrality' of the state in this process (discussed in Section I) is evident in the increase in allocation without any change in the existing structure of social institutions related to land. The NDA government soon after coming to power instituted a Land Reforms Commission which submitted its report in early 2008. The government has not implemented the recommendations of this report which among other issues delves into the institutional problems related to updating of land records. Under these circumstances, the demands from the early 1990s to allot land to the landless (largely the section of people accorded *Mahadalit* status by the NDA government through another commission) and give *parchadharis* the actual *kabza* of their lands has been resurrected in a muted form. However, the fear of 'land reforms' even in a watered down form in the shape of possibility of updation of land records instigated a panic amongst the traditional and the nouveau elite which became ascribed as the prime cause of the NDA's defeat in the by-elections in the state in September 2009 and the political leadership in government had to publicly assure the landowners of Bihar that there would be no land reform in Bihar.

Figure 2I



. Figure 2J

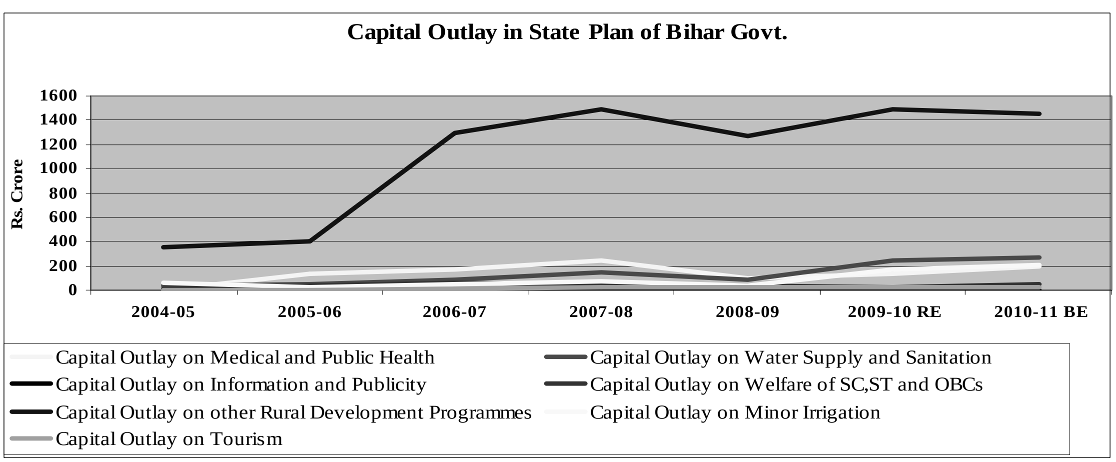


Figure 2K

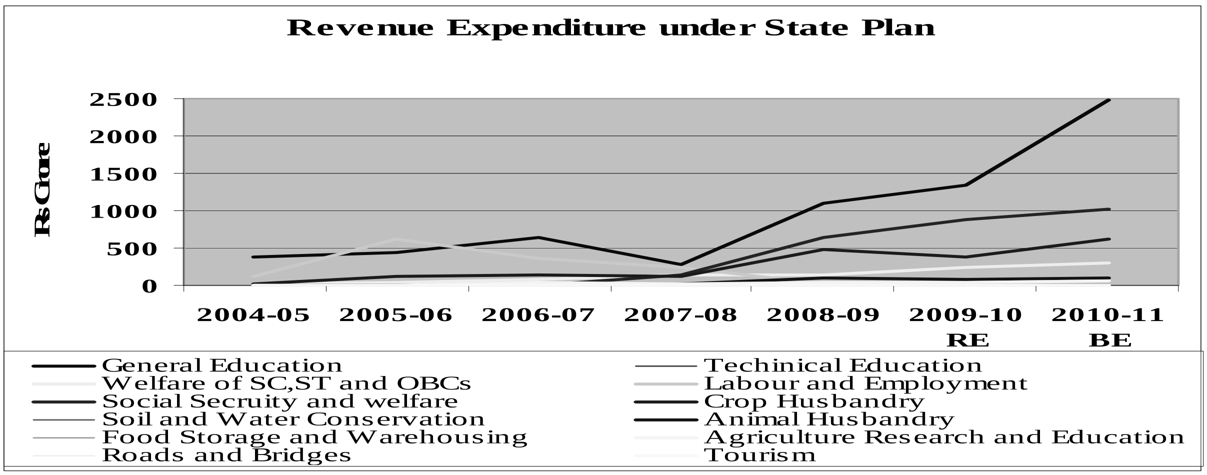
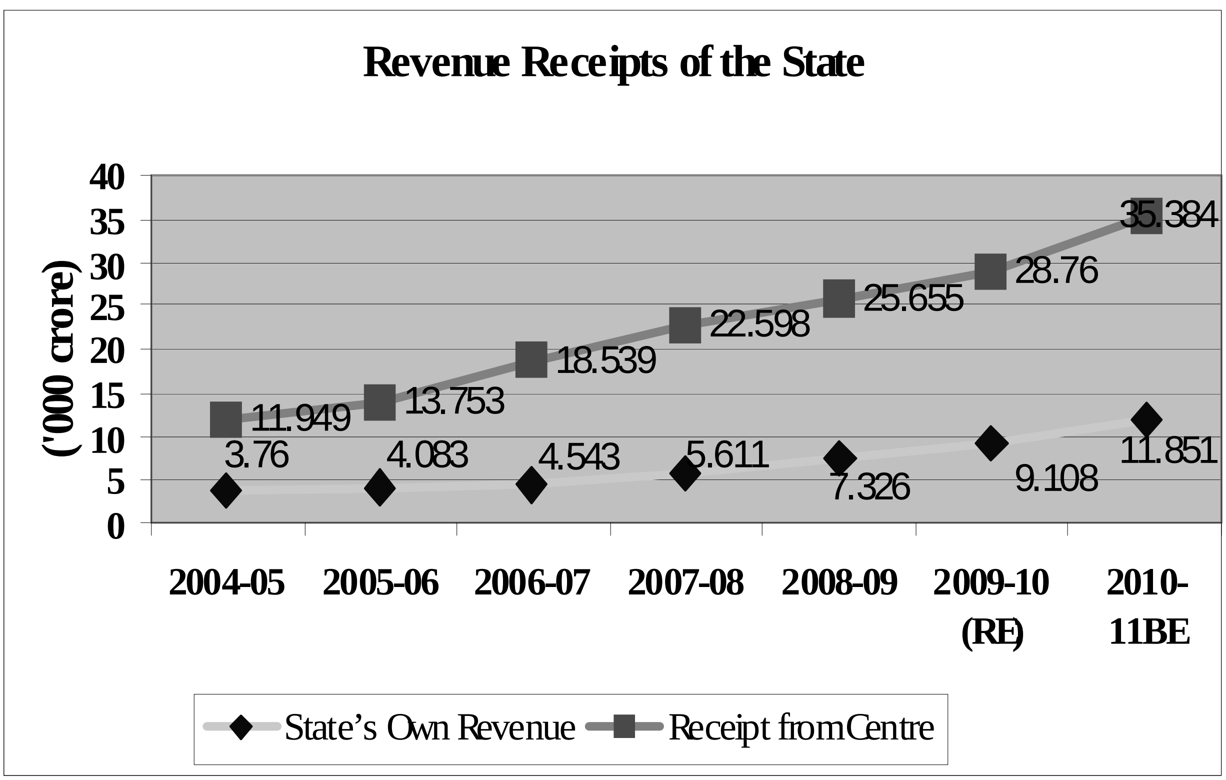


Figure 2L



Fiscal Responsibility Legislation and Expenditure Policy

Advocacy for fiscal austerity and cuts in expenditure since 1991 had paved way for 'fiscal responsibility and budget management' by 2004 through the aegis of the Twelfth Finance Commission. Thus hard ideology was paving way for a pragmatic techno-managerial approach (supposedly 'free of ideology') to structural socio-economic problems. One of the first legislations the NDA government adopted after coming to power was the Bihar Fiscal Responsibility and Budget Management (BFRBM) Act 2006 in February 2006 limiting the level of borrowing and setting targets to bring the fiscal deficit down to the level of 3 percent of GSDP and becoming a revenue surplus state by 2008-09. It must be noted that there is no economic rationale for the setting of the specific quantitative targets except a mechanical replication from the Maastricht Treaty of 1992 of the European Union (Govind Rao 2007). Why Bihar should be adopting fiscal targets that were developed in the specific context of the formation of the European Union is a question that the policymakers never grappled with. If the defense is that it just adopted the recommended draft of the Union Government in lieu of promises for writing off old debts, it is necessary to assess what benefits have accrued to the state as a result of the government fulfilling its targets. It is quite clear from the way that the BFRBM legislation was rushed through in Bihar within three months of the NDA government coming to power that there was any considered deliberation about the impact of this legislation on its promised agenda.

The Fiscal Responsibility legislation was part of a more comprehensive fiscal reform initiated since 2005-06 by the first NDA government. The states aim of these reforms had been to step up planned expenditure with a high component of capital expenditure as well as expenditure on operation and maintenance. The objective was to finance this expenditure as far as possible from internal resources without resorting to huge borrowing along with institutionalizing of fiscal responsibility norms based on the architecture of 'sound finance'

The concerns of policymakers who initiated the reforms were informed by the following fiscal outcomes: the fiscal deficit had been consistently hovering around 5.5 percent. The government was carrying large amount of unutilised funds. It took an enormous loan which remained unutilised. The state had a revenue surplus with low level of planned expenditure and even lower level of capital expenditure. Accumulated debt was rising.

The emphasis was clearly on expenditure rationalisation rather than revenue mobilisation as is evident from figures 2I to 2K with management of debt and deficit being the prime focus. This mismatch in stated political aims and adoption of neoliberal fiscal strategy reflects a severe constraint on autonomy due to the increasing financial centralisation at the level of the union government (and by-passing of the second tier of government) in the post-liberalisation period.

Sectoral Impact of Tax Reforms on VAT

The tax 'reforms' in Bihar started with the introduction of VAT on April 1, 2003[2]. The NDA government as part of its 'fiscal' reform expanded and rationalized the VAT in 2005-06. This was along with cut in stamp duties to fulfill federal government conditionality for grants towards the Jawaharlal Nehru Urban Renewal Mission. However there was no significant change in tax buoyancy in any category of the state government's taxes after 2005-06 except for a single year 2007-08 (Table 2.3).

Table 2.3: Overview of Buoyancy of Major State Government Taxes

Tax	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Sales Tax/VAT	1.31	-0.34	1.47	-0.88	0.86	3.48	0.75
State Excise Duty	0.10	-0.43	0.15	1.79	0.85	6.01	1.15

[2] Contrary to the dominant assertions within contemporary public economics in India, universal 'efficiency' considerations did not inform the design and implementation of VAT in various parts of the world. In metropolitan Europe, VAT was a mode of 'economic integration' of homogenous countries. In the transition economies of Eastern Europe, VAT was made a precondition to join the EU. In Latin America, VAT was geared towards the 'outward orientation' of economic policies. There is no VAT in the USA. Michigan has single business tax. USA has sales tax which varies across states from 5 percent to 10 percent). It is only in the developing economies of Asia and Africa – that the economic rationale of VAT – 'efficiency arguments' has been central to its adoption with a total occlusion of 'equity' VAT was also based on the rationale that it provides incentives for the unregistered sector to come into the tax net.

Stamp and Registration Duty	1.29	1.87	-0.42	6.99	0.37	1.29	1.87
Motor Vehicles Tax	-4.36	4.45	-1.71	8.09	0.35	-4.36	4.45
Taxes on Goods and Passengers	0.26	3.14	1.18	3.16	1.43	-0.06	0.26

Source: Economic Survey, Government of Bihar, 2009-10

Table 2.4: Commodity Base and Spread Of VAT in Bihar after Tax Reforms

Commodity	Contribution to Total Growth (%) in VAT Collection	Trend Real Growth Rate (%) in VAT Collection					Average Share in Total VAT Collection
			2006-07	2007-08	2008-09	2009-10	
Unregistered dealers and works contractors	16.91	70.99	36.65	46.91	127.86	80.31	3.46
Petro products	16.6	7.34	12.6	16.58	19.24	14.12	32.87
Cement	9.55	22.27	44.03	19.95	23.02	64.26	6.23
Telephone	7.17	39.58	58.19	151.79	45.74	-2.95	2.63
Indian Made Foreign Liquor	6.76	27.16	46.16	1.49	59.85	56.05	3.62
Works contract and tds	5.46	31.71	65.49	100.51	31.02	15.76	2.5
Four wheelers & chasis of automobile	4.97	18.46	94.59	27.4	12.35	57.04	3.91
Country liquor	3.63	39.52	26.54	68.15	33.2	63.64	1.33
Coal	2.73	20.56	34.23	66.31	13.83	25.36	1.93
Two and three wheelers	2.64	16.35	34.1	13.01	30.46	36.65	2.34
FMCG	2.48	8.85	31.53	15.67	22.79	15.91	4.06
Pan masala	2.04	131.6	38.27	280.36	161.83	59.1	0.22

Commodities (whose commoditywise contributions to total growth is less than 2 % but higher than 1%)	10.88	14.66	29.19	28.3	19.63	28.67	10.3
Various Commodities (whose commoditywise contributions to total growth is less than 1 %)	11.62	8.54	13.33	17.11	23.73	12.25	18.9
Commodities registering decline in total growth	-3.44	-9.55	29.32	24.79	-14.33	-6.35	5.7

Table 2.5: Commodity wise Contribution to Total Growth in VAT Collection

Contribution to Total Growth	2006-07 to 2009-10
more than 15%	Unregistered Dealer and Works Contractor, Petroleum Products
5% to 15%	Cement, Telephone, Indian Made Foreign Liquor, Works contract and tds
2% to 5%	Four Wheelers & Chasis Of Automobile, Country Liquor, Coal, Two And Three Wheelers, FMCG, Pan Masala
1% to 2%	Tobacco, Iron & Steel, Tractors, Ghee & Vanaspati, Drugs And Medicines, Electronic Goods, Biscuits, Food grain

0% to 1%	Tyres & Tubes, Tools, Beverages, Hosiery And Ready Made, Lubricants, Consumer Durables, Sanitary Fittings & Tiles, Electrical Goods, Computer, Battery, Paper, Asbestos, Not Tagged With Any Commodity, Furniture, Paints, Edible Oil, Auto-parts, Bicycle, Footwear , Fast Food And Cooked Food, Tea & Coffee, Hardware, Marble And Granites, Entertainment Tax, Grocery items, Others @ 12.5, Electricity Duty, Jewellery, Advertisement Tax, Crude Oil, Utensils, Stationery, Bricks, Glasses , Engine & Motors, Stone Chips And Ballast, Luxury And Hotel, Bhujia, Fertiliser & Insecticides, Sport Goods, Processed Vegetable & Food., Others @ 4%, Diesel Oil, Plywood, Watch & Clock, Plyboard, Matches, Spectacles, Hawai, Chappals, Commodities that are not listed
less than 0% (reflecting Decline)	Sewing Machine, Fire Works, Petrol, Gun & Rifles, Dry Fruits, Hide & Skin, Timber, Crockery, Cutlery, Glassware & Ceramic ware, Moulded Luggage, Kerosene, Others(Tax Free), Staple Yarn, LPG, Plastic Goods, Unregistered Dealer and Others

Contrary to the rationale of VAT, unregistered dealers (other than works contractors), have not found in VAT an adequate incentive. Almost 45% of the total growth in sales tax collection after implementation of the changes in VAT which were implemented in 2005-06 is accounted for by ‘sin goods’ - petro products, coal; and country liquor and other goods like electricity duties. These together accounts for around 50 percent of the existing sales tax collection in Bihar. Thus significant chunk of the tax net and tax base of Bihar’s consumption driven economy is in keeping with the typical patterns of a low-production low-consumption economy (Tables 2.4 and 2.5).

District Level Patterns of Economic Growth and Tax Collection

Table 2.6: District Composition of Growth in Bihar's Sales Tax Collection (2006-07 – 2009-10)

District	Contribution to Total growth in VAT collection	Average (%)Share of Total VAT collection	Annual Variation in VAT collection (CV)
Patna (75.99)	75.99	85.51	25.47
1% to <=3% Vaishali (2.16), Muzaffarpur(1.87), Darbhanga(1.49),W. Champaran(1.46), Purnea(1.26), Gaya(1.25), Katihar(1.13), Nalanda(1.10), Rohtas(1.09)	12.81	6.8	39.09
0.5% to <= 1% Begusarai (1.00), Saharsa (0.95), Saran (0.74), Aurangabad (0.72), Siwan (0.71), Bhagalpur + Banka (0.69), E. Champaran(0.64), Sheohar + Sitamarhi (0.63), Munger (0.55), Madhubani (0.55)	7.19	4.45	36.26
0% to <= 0.5% Jehanabad + Arwal (0.50), Bhojpur (0.46), Gopalganj (0.43), Jamui (0.41), Madhepura +Supaul (0.36), Kaimur (0.31), Khagaria (0.30), Nawada (0.26), Samastipur (0.24), Lakhisarai + Sheikhpura (0.24), Buxar (0.22), Araria (0.15), Kishanganj (0.13)	4.01	3.24	30.25

Total (100)	100.00	100.00	28.16

Table 2.7: District Wise Contribution to Economic Growth in Bihar

District	Contribution to Total Growth (%)	Average (%) Share of GSDP	CV
Single largest Contribution **Patna** (23.72)	23.72	24.09	12.37
4 %-5% Contribution Muzaffarpur (4.84), Bhagalpur (4.72), Madhubani(4.09)	13.64	12.3	13.6
3% - 4% Contribution Begusarai (3.8), Madhepura (3.42), Gaya(3.26), E. Champaran (3.26), Darbhanga (3.25), Saran (3.16) Rohtas(3.09), Katihar (3.06)	26.3	23.75	13.59
2% - 3% Contribution Purnea (2.74), Vaishali(2.54), Nalanda(2.37), W. Champaran (2.27), Bhojpur(2.05), **Samastipur** (2.04), Jehanabad(2.02)	16.03	17.48	11.67
1% - 2% Contribution Araria (1.9), Sitamarhi (1.89), Saharsa(1.88), Munger (1.84), Aurangabad (1.55), Gopalganj	19.46	19.64	12.41

(1.55), **Khagaria** (1.46), Nawada (1.33), Kaimur(1.26), Kishanganj (1.26), Buxer(1.24), Jamui(1.17), Lakhisarai (1.13)			
0 – 1% Contribution Siwan (0.85)	0.85	2.6	7.71
Total (100)	100	100	12.22

Table 2.8: Spread of Tax Buoyancy Across Districts

Tax Buoyancy estimate (from 2001-02 to 2009-10)	Districts
More than 1.3	Katihar , Jehanabad + Arwal, Madhepura +Supaul, Jamui , Sheohar + Sitamarhi
1.1 to 1.3	Madhubani, Bhojpur , Aurangabad , Saran, Muzaffarpur, Kisanganj, Saharsa, Darbhanga , Nalanda , Vaishali
1 to 1.1	West Champaran , Purnea, Munger, Rohtas, Araria , Nawada, **Patna**, Buxar , Kaimur, Gopalgang
0.5 to 1.0	Lakhisarai + Sheikhpura, Bhagalpur + Banka, East Champaran , **Samastipur**, Gaya **, Khagaria** , Siwan , Begusarai

Table 2.9: Classification of Districts According to Volatility of Commercial Tax Collection

High Volatility (Above 51)	Begusarai (126) /Madhepura +Supaul (98) /Araria (97) /Buxar (95) /Kaimur (94) /Bhojpur (80)/Samastipur (78) /Saran (76) /Katihar (73) /Sheohar + Sitamarhi (60) /Nawada (58) /Nalanda (57) /Saharsa (56)
Average Volatility (40-51)	Munger (51) /Aurangabad (51) / W. Champaran (46) /Gopalganj (45) / Purnea (42) /Bhagalpur + Banka (41) /Kishanganj (41)
Low Volatility (less than 40)	Lakhisarai + Sheikhpura (39) / Jehanabad + Arwal (34) / Madhubani (33) /Darbhanga (31) /Vaishali (26) /Gaya (25) /Rohtas (24) / E. Champaran (23) / Siwan (22)/Khagaria (19)/Muzaffarpur (16) /Jamui (7)/ Patna (4)

76 percent of the growth in tax collection after implementation of VAT rationalisation is accounted for by Patna district. The rest 37 districts together account for just 24% of the growth (Table 2.6 and 2.7). Post-VAT, there has been a negative impact on elasticity in most districts with significantly volatile tax collection patterns (Table 2.8 and Table 2.9). This is in keeping with the recent trend of led lopsided and highly volatile economic growth in its regional dimensions.

Consumption based rationale for VAT abstracts away from the issues of regional disparity within the state in its assumption of an uniform tax spread within the state in the projection of its potential gains. Thus it completely ignores the structural constraints of low-income states like Bihar with limited diversification of the economy. Such issues of spread are not just confined to low-income states like Bihar. Bulk of the resources of states like Andhra Pradesh and Maharashtra are accounted for by Hyderabad and Mumbai areas.

Together, the commodity and district spread demonstrates that the existing debate on a shift to Goods and Services Tax (where concerns of equity has been confined to polemics around whether food should be taxed) and the assumptions on which VAT had been implemented, has failed to take into account the structural limits of the consumption base of a primarily agrarian low income economy. It also demonstrates the tenuous links between economic growth and tax mobilisation.

III What Determines District Level Variations in Tax Collection in Bihar?

The following experiment is aimed towards ascertaining the causal determinants of district level variations in tax collection in Bihar. This exercise is based on a panel data comprising of district level commodity-wise commercial tax collection, dealer information and district level sectoral GDP for the last five years. Using simple regression techniques we construct three sets of indicators which would reflect the relative weight of the three factors:

1. Structure of the district's economy and its consumption base which would determine its taxable consumption base

2. The room for increasing administrative efficiency taking on board the constraints of path dependency

3. The impact of the revised VAT of 2005 on collections in the past five years despite 1 and 2 above.

Tax revenue in a predominantly rural agrarian economy like Bihar with sales and purchases being concentrated in small trading hubs at the district level mainly depends on the following:

1. Agricultural growth which determines purchasing power across social classes and thus determines the extent of private consumption.
2. Growth in major non-agricultural sectors which determines volumes of taxable transactions in the economy.

These two together determine what can be termed the quantum of 'growth effect' on the tax base.

However, there are two other factors which often tend to have a more determining role in the levels of actual tax collection. These are:

3. The role of the tax administration determined by complex institutional factors in mobilising tax resources in a particular tax administration unit or circle.
4. The assumed inherent efficiency of VAT in the existing policy framework as an incentive based tax which leads to higher tax mobilisation.

Method

Estimating the Growth Effect on Tax Collection

Step I

Agricultural Growth Factor (AGF): For each district, agricultural growth factor is calculated by multiplying trend growth rate of agriculture with average sector share of agriculture. The ratio of this product to trend growth rate of agriculture in Bihar is the first indicator of the relative importance of agricultural growth on the districts tax base.

Thus AGF for i^{th} district is

$AGF_i = (G^i_{agr} * W^i_{agr}) / G_{agr}$

where

G^i_{agr} = Trend growth rate of agriculture in ith district

W^i_{agr} = Average sector share of agriculture in the district's economy

G_{agr} = Trend growth of agriculture in the state.

Step II

Non-agricultural Composite Growth Factor (NACGF): For each district, the contribution of the major sectors which explain the economic growth pattern of the district and indicate the volume of taxable transactions is calculated as follows:

$NACGF_i = (G^i_{comp} * W^i_{comp}) / G_{comp}$

G^i_{comp}= Trend growth rate of output in manufacturing, trade, construction, electricity, transport & storage, communication, real estate and public administration in i^{th} district

W^i_{comp} = Average sector share of the above in the district's economy

G_{comp} = Trend growth of the output in the sectors mentioned above in the state.

Note: This sectors have been identified on the basis of the investigators' earlier work on Bihar's growth which show that these sectors together determine more than 90 percent of Bihar's annual growth (Das Gupta 2010). It must be noted that the purpose of this exercise is largely indicative and the numbers generated through this exercise show the relative impact of Bihar's agricultural and non-agricultural growth in every district (See Appendix II for a detailed algebraic account).

Further, the buoyancy factor at district level is incorporated in the growth factor; the AGF and NACGF are modified as follows:

Modified $AGF_i = AGF_i * TB_i$

Modified $NACGF_i = NACGF_i * TB_i$

where TB_i is Tax buoyancy of district i for the FY 2009-10

Estimating the Tax Administration's Impact on Tax Collection

Step III

Appendix I shows the lack of correlation between growth and tax elasticity at the district level in Bihar. Once the growth factor contributing to tax elasticity is estimated in Step 3, the importance of VAT performance at the district level can be isolated by the relative shares of each district in the state's total tax collection in the post-VAT period. This is estimated by:

$VATF_i$ = Share of District i in total tax collection during 2009-10

Step IV

For district i, average collection over the period of analysis (2006-07 to 2009-10) can be represented as

$TC_i = AGF_i*x_{1i} + NACGF_i*x_{2i} + VATF_i*x_{3i} + TAF_i*x_{4i}$

Where $AGF_i + NACGF_i + VATF_i + TAF_i = 100$

And x_{ji} (j = 1, 2, 3, 4) represents the contribution of each of the above factors to total tax base of ith district.

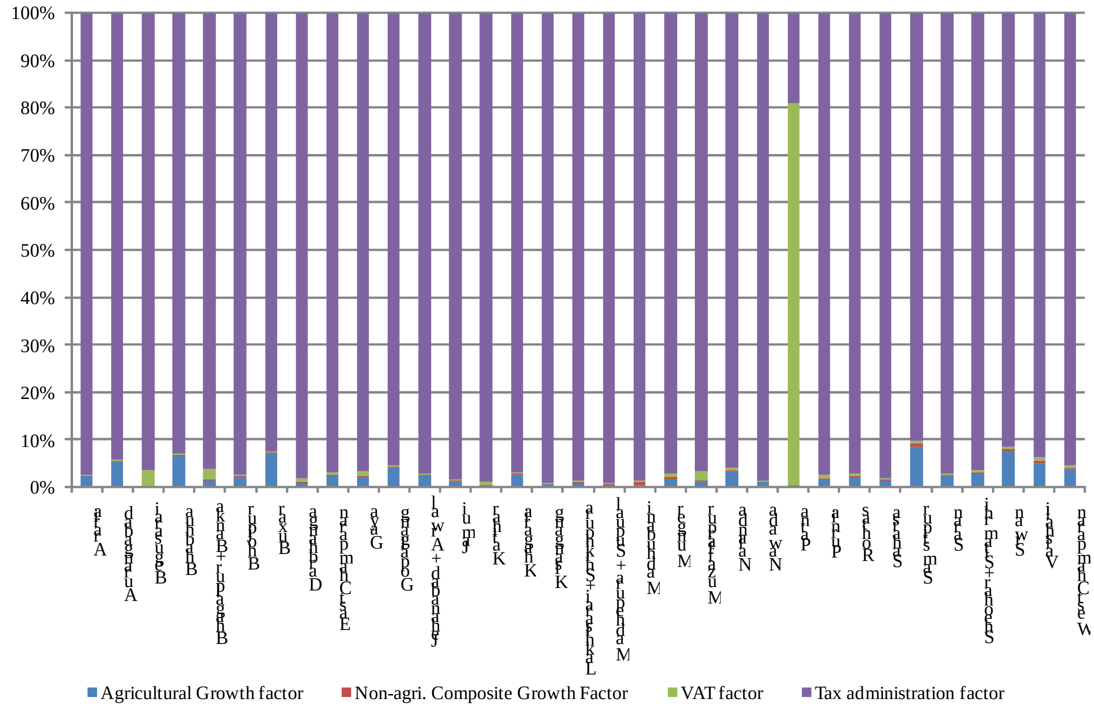
Data and Econometric Analysis

For this experiment, the following datasets have been used:

1. Projections of district level sectoral GDP figures (1999-2000 series) based on data from Directorate of Statistics and Evaluation, Government of Bihar.
2. Estimates of state level sectoral GSDP figures (1999-2000 series) based on data from Directorate of Statistics and Evaluation, Government of Bihar.
3. Circle wise and commodity wise commercial tax collection figures (2006-07 to 2009-10) based on actual figures sourced from the Department of Commercial Tax, Government of Bihar.Tax circle wise collection figures are mapped on to districts to enable analysis of growth impact.
4. We measure the composite impact of both trend annual changes (real growth/decline) in collection for each category for the period 2006-07 to 2009-10; as well as the relative share of each category in the total VAT/Bihar Sales Tax pool of Bihar.
5. We measure buoyancy trends at the district level for the period under consideration after adjusting for inflation.

Result

Figure 3A Combination of Factors in Each District in Explaining Tax Mobilisation



The results of the experiment overwhelmingly reflects that apart from Patna, which is the relatively developed trading centre in Bihar, the incentive impact of VAT has not had any substantial impact in explaining tax collection patterns at the district level in Bihar. The impact of the non-agricultural composite growth factor which includes the sectors leading Bihar's growth (outlined in Section I) have had no significant impact in mobilisation of tax resources. The agricultural growth factor is mildly significant in a few districts. The single most factor which stands out in explaining district level variations in tax mobilisation is the role of the district level tax administration. Given the lack of significant outlays on institutions of taxation outlined in Section II above,

To conclude, the link between economic growth and policy reforms in public finance in contemporary Bihar are tenuous. Bihar's growth acceleration precedes the ‘policy reforms’ in public finance. This public finance paradigm based on the ‘good governance’ agenda initiated since 2005-06 has been largely ineffective. The two key constraints on sustaining efforts to close Bihar’s development gap with the rest of India stems from the nature of the growth process in its regional, sectoral and social dimensions and the contradictory means and ends of the ‘policy reforms’ in public finance. Together, this has not only led to a situation where economic growth has not added any resources to the public coiffeurs of the state but has also led to the ineffective role of tax institutions of the state due to occlusion in public policy.

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