

# 02 Building Institutions and Improving Performance

The centrality of improving institutional capacity of the state to achieve inclusive and sustainable growth was highlighted in chapter 1. While some aspects of institution-building (creation of norms and values, efficiency-culture, competitive democratic polity) demand a longer time horizon,<sup>38</sup> others (creation of new an organizational set-up, rules of business, effective system of monitoring and statistical strengthening, public-private partnership, local-level participation and improved service delivery) can be addressed in the medium term. In fact, certain institutional changes such as those relating to law and order, accountability of public administration, and greater involvement of local-level organizations are imperative. To address the challenges of institution- building faced by the state, apart from sector-specific governance issues, four areas have been identified.

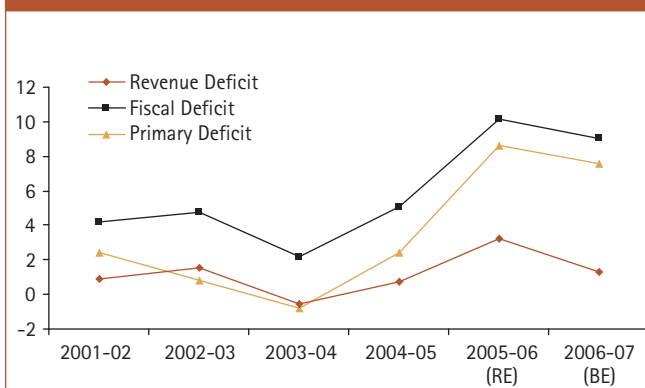
*First*, strengthening state finances and linking allocation of resources to improvements in the delivery of services is essential for improving human development indicators in the state. *Second*, an efficient and transparent administrative system at all tiers of government is a prerequisite for improving service delivery. *Third*, the state needs to manage infrastructural investments effectively to maximize the growth impact and make it more inclusive. These are discussed in chapters 3 and 4. And fourth the management and governance of minerals and environment assumes heightened importance in a state like Jharkhand, which has a huge mineral endowment and large forest cover. Issues, constraints and diagnostics of these challenges are discussed briefly below.

<sup>38</sup> North (1990).

## Fiscal and Financial Governance State's Fiscal Performance

There are already some disturbing trends in the state's fiscal balances. This is in addition to the pre-existing structural weaknesses in the financial management system that the state inherited from Bihar. Since the state came into existence in November 2000, financial figures are available only from 2001/02. The fiscal deficits have been rising at an alarming rate (Figure 2.1). The state is unlikely to meet most of the performance criteria posited by the Twelfth Finance Commission (TFC) for debt relief and may lose out on substantial fiscal receipt on that count. This does not augur well as the state faces major challenges in its development strategy, which requires increased public sector allocation to infrastructure and human resource

Figure 2. 1: Deficits as Percentage of GSDP



Source: GoJ, Budget Documents.

development. Thus the need is urgent for improving resource mobilization, increasing cost effectiveness of expenditure, and rationalizing the budgetary processes.

Except for one year, 2003/04 (when the central elections took place and the model code of conduct was in place), fiscal deficits have been rising rapidly in recent years reaching an alarming level of 10.1 percent of GSDP in 2005/06 (RE). The biggest increases are evident on the expenditure side -- in particular, transfers and capital expenditure -- which may well be in line with a desired development strategy but which have not been matched by increases on the revenue side. This is typical of a new state, as observed with other new states, where finances are better in the first few years and then deteriorate in the following years as the division of assets and liabilities occurs and as new hirings start to take place to fill in gaps in capacity.

Actual figures show a decline in the fiscal deficit by two percentage points (from 4.2 percent to 2.2 percent of GSDP) between 2001/02 and 2003/04 (Table 2.1). There was a revenue surplus and a primary surplus of 0.6 percent and 0.8 percent of GSDP respectively in 2003/04. However, the stock of debt continued to increase from 23 percent to 25.5 percent of GSDP during the same period. The low levels of deficit during this period were largely due to low levels of spending, a reflection of the lack of capacity in the government. This picture changes very rapidly from 2004/05, with the fiscal deficit more than doubling from 2.2 percent in 2003/04 to 5.1 percent in 2004/05. All fiscal indicators show a substantial deterioration with the fiscal deficit budgeted at 9.0 percent, revenue deficit at 1.3 percent and primary deficit at 7.6 percent of GSDP. Debt levels are at 30.8 percent of GSDP in 2005/06.

Table 2.1: Fiscal Summary of Jharkhand  
(Percent of GSDP)

State Government	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	Actuals	Actuals	Actuals	Actuals	RE	BE
Revenue Receipts	13.7	13.6	14.2	15.2	16.9	18.8
A. Tax Revenue	9.7	9.5	10.0	10.9	10.6	12.9
States' Own Tax Revenue	4.8	4.8	5.0	5.5	5.9	5.8
Share of Central Taxes	4.9	4.6	5.0	5.4	4.6	7.1
B. Non-Tax Revenue	4.0	4.1	4.2	4.4	6.4	6.1
State's Own Non-Tax Revenue	2.6	2.7	2.8	2.4	2.9	2.8
Grants from Center	1.4	1.4	1.4	2.0	3.5	3.3
Revenue Expenditure	14.7	15.1	13.6	16.0	20.1	20.2
Salary	6.3	6.5	6.0	6.0	6.7	6.1
Interest	1.7	3.9	3.0	2.6	1.5	1.4
Pension	1.6	1.4	1.4	1.4	1.6	1.5
Subsidy	0.1	0.3	0.2	1.1	1.0	0.2
Transfers	4.8	2.9	2.9	4.8	9.2	10.7
Operations and Maintenance	0.2	0.2	0.1	0.2	0.3	0.2
Capital Expenditure (net)	3.2	3.2	2.8	4.3	6.9	7.7
Revenue Deficit	-0.9	-1.6	0.6	-0.8	-3.2	-1.3
Fiscal Deficit	-4.2	-4.7	-2.2	-5.1	-10.1	-9.0
Primary Deficit	-2.4	-0.8	0.8	-2.5	-8.7	-7.6
Debt	23.0	23.6	25.5	29.6	30.8	36.3
Total Expenditure	17.9	18.3	16.4	20.3	27.1	27.9

Source: Finance Accounts and Budget Documents.

Note: Rs. 2,234 billion (0.3 percent of total expenditure) of grants-in-aid to local bodies was wrongly classified as capital expenditure in 2004-05 in the Finance Accounts. This amount has been reclassified as revenue expenditure in this report under transfers.

## Revenue Receipts

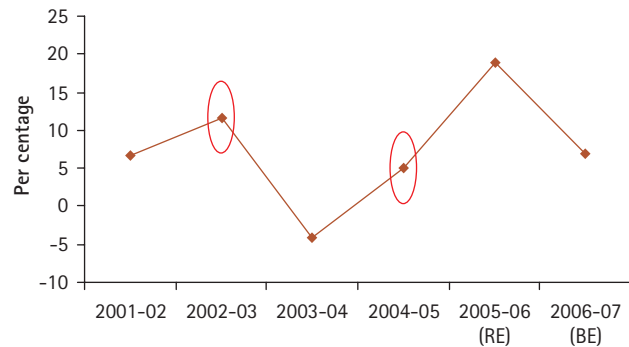
Approximately 55 percent of the total revenue receipts are on account of the state's own tax and non-tax revenue collection efforts. This figure remained more or less constant from 2001/02 to 2003/04, but declined to 52 percent in 2004/05 and 2005/06 and is estimated to decline further to 46 percent in 2006/07. Total non-tax revenue is likely to increase by 61 percent in 2005/06 according to the revised estimates, with most of the increase coming from increased tax through mining and doubling of grants from the center. Being a new state, most of the changes introduced in commercial taxes focus on providing impetus and incentives to different sectors through lower tax rates and providing tax rebates to industry and exporters. The abolition of additional tax and taxes on several utility items, complete tax rebate on 100 percent exports, reduction of entertainment tax from 110 percent to 60 percent and increase in the limit of gross turnover of sales from one lakh to 7 lakh are amongst the changes introduced. A tax rate of 4 percent on mobile handsets and 8 percent on spare parts and accessories of mobile handsets has been imposed with effect from September 2005. The net impact of these changes will be known in a year or two as most of these changes are fairly recent.

Based on a single monitorable indicator, namely, a 5 percent decline in revenue deficit to revenue receipts ratio year on year for the five-year period from 2000/01 to 2004/05, the state was entitled to an award of Rs. 105.47 crore. Even though the state did not achieve the target in 2002/03 and 2004/05, it got the full award from the Gol (Figure 2.2).

## Revenue Expenditures

The growth rate of expenditures has outstripped that of receipts, leading to a worsening of the fiscal deficit. After reaching a low of 13.6 percent in 2003/04, revenue expenditure as a percentage of GSDP has increased substantially to 20 percent of GSDP in 2005/06. Salaries, pension and interest payments accounted for 76 percent of revenue expenditure in 2003/04, leaving little head-

Figure 2. 2: Revenue Deficit/Revenue Receipts



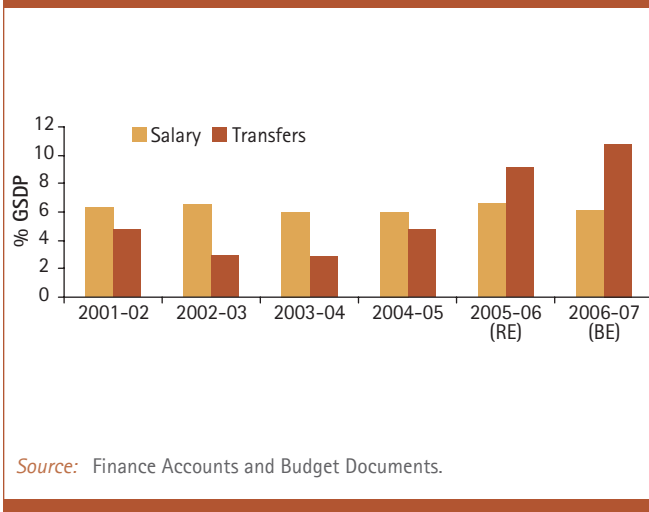
Source: Finance Accounts and Budget Documents.

room for other expenditures. This is expected to fall to 44.5 percent in 2006/07. While the proportion of salaries and pensions in GSDP has remained relatively stable,<sup>39</sup> interest payments, which were high during the period 2002/03 to 2004/05 seem to be stabilizing back to the 2001/02 levels. Subsidies, while low, have fluctuated over time. Despite the TFC's recommendation to states to start acknowledging their loans to state electricity boards as subsidies in the interest of transparency, Jharkhand has not done so as yet. The proportion of transfers has nearly doubled from 4.8 percent of GSDP in 2001/02 to an estimated 9.2 percent of GSDP in 2005/06 (Figure 2.3). This figure is expected to go up further to 10.7 percent of GSDP in 2006/07. The operations and maintenance figure has fluctuated between 0.1 percent of GSDP in 2003/04 and 0.3 percent of GSDP in 2005/06. This is a woefully inadequate figure given the infrastructure requirements of the state, especially in the light of the new push towards attracting capital investment through the various memoranda of understanding (MoUs) that have been signed.

Salaries have grown rapidly in nominal terms. The large increase in salary expenditure can be attributed

<sup>39</sup> The Government of Bihar claims that the GoJ is not contributing enough towards the pension liability after the split. This may lead to litigation whereby the GoJ may have to make a large one-time settlement in the future.

Figure 2. 3: Main Components of Revenue Expenditure



to a substantial rise in recruitment since 2002/03. The state government has hired over 6,000 teachers, 2,000 doctors and health workers and 5,000 policemen. Pending promotions, the merging of 50 percent dearness allowance (DA), an increase in house rent allowance (HRA) and accumulated salary arrears have contributed to the increased salary bill. Even after these appointments, there are several vacancies in the education, health and police departments, and if the government continues to fill these, the salary bill can be expected to increase further in the coming years.

In nominal terms, transfers have gone up nearly four times since bifurcation, with large increases being registered in 2005/06 and 2006/07 after the state elections. Transfers increased from 4.8 percent of GSDP in 2001/02 to 9.2 percent in 2005/06 and are projected to increase to an alarming 10.7 percent of GSDP in 2006/07. Expenditures under this category need to be scrutinized and understood in greater depth to enable the government to take corrective measures where required as such increases in spending are not sustainable. Some of these expenditures can be attributed to proposed new schemes benefiting mainly the SC/ST population of Jharkhand, such as proposals to issue caste certificates, health cards to all tribal members along with other health benefits, provision

of jobs to all ST graduates etc. However, these remain largely unexplained.

## Capital Expenditure

**Capital expenditure is expected to nearly double in two years as a result of planned investments in infrastructure.**

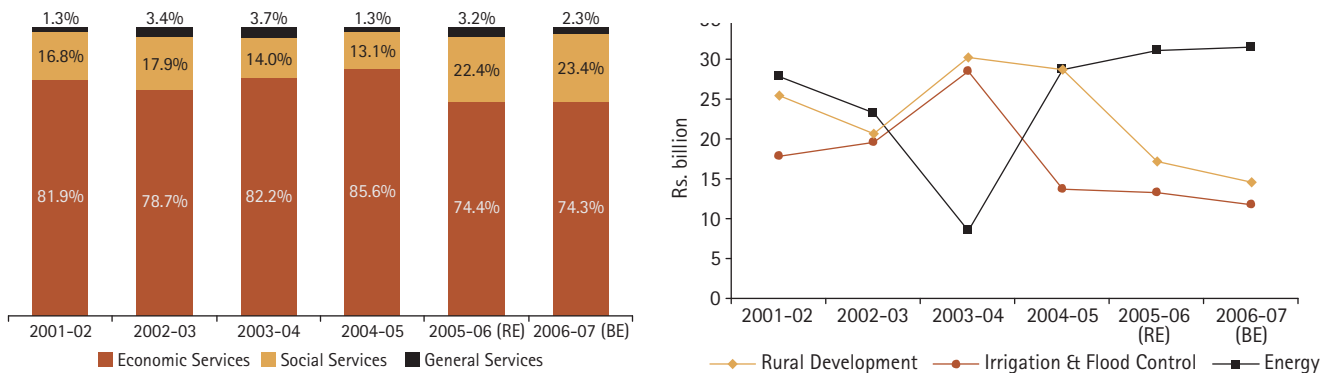
Jharkhand's capital expenditure has increased from 2.8 percent of GSDP in 2003/04 to 4.3 percent in 2004/05 (Figure 2.4). It is further expected to increase to an estimated 7.7 percent of GSDP by 2006/07 according to budget estimates. Within capital expenditure, the share of social services has increased by 5 percent since 2001/02 with the increase going to the education, health and urban development sectors. The decline in economic services is mainly on account of decline in allocations to the rural development sector (which had huge unspent balances in 2003/04, due to lack of good projects or proposals) and irrigation.

## Debt Management

The public debt of Jharkhand consists of: (i) internal debt, that is, domestic market borrowings from banks and financial institutions as well as the special securities issued to the National Small Savings Fund (NSSF) of the central government; (ii) loans from the central government; and (iii) National Small Savings collection in the state given by Gol as loans and provident funds. The composition of public debt of the state is given in Table 2.2. At the time of the bifurcation of Bihar into Bihar and Jharkhand, the debt stock of the undivided state was divided on the basis of population. Certain items such as insurance and pension funds remain undivided and contested by the two states. As a result Jharkhand, which had a smaller population, inherited smaller debt stock relative to its GSDP (23 percent) as compared to post-bifurcation Bihar (61.9 percent).

Overall, the debt stock is expected to reach 35 percent of GSDP by 2006/07. Internal debt has grown rapidly since bifurcation and is expected to reach nearly 30 percent of GSDP in 2006/07. Within internal debt, market borrowings and the special securities issued to the NSSF are the major components, while loans from financial institutions are minimal.

Figure 2. 4: Composition of Capital Expenditure



Source: Finance Accounts and Budget Documents.

Note: Rs. 2234 billion (0.3 percent of total expenditure) was wrongly classified as capital expenditure in 2004/05 in the Finance Accounts. This amount has been reclassified as revenue expenditure in this report and accordingly reduced from social services in capital outlay.

Loans from the central government, which were market loans raised by the Gol at the prevailing interest rates and on-lent to the states at higher rates, have declined since bifurcation. Based on the TFC's recommendation, already accepted by the Gol, the central government will no longer provide loans to the states and thus with repayments, this component will decline further.

The third group of debt, namely, small savings, provident funds etc., comprises mainly of the provident fund of government servants and balances under the state government employee's group insurance scheme and is

marginal. The apportionment of the balance of the latter as on November 14, 2000, that is, immediately prior to bifurcation, between Jharkhand and Bihar, remains to be done.

The division of assets and liabilities between the two states, including guarantees, is an outstanding issue, disputed at various levels in different sectors. At the time of bifurcation, the division was to be on the basis of a population proportion of 75:25. However, this ratio was often contested in the Supreme Court and alternate arrangements made. Hence, some of the contested

Table 2.2: Public Debt of Jharkhand: Stock and Composition (in Rs. billion and as a percent of GSDP)

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
					RE	BE
Debt Stock	75.2 (23.0)	86.0 (23.6)	101.4 (25.5)	129.2 (29.6)	146.4 (30.2)	188.9 (35.1)
Internal Debt	35.3 (10.8)	48.8 (13.4)	67.3 (16.9)	96.5 (22.1)	115.2 (23.8)	160.3 (29.8)
Loans from the Center	40.1 (12.3)	35.6 (9.8)	31.5 (7.9)	29.9 (6.8)	28.4 (5.9)	25.8 (4.8)
Small Savings, Provident Funds, etc.	-0.2* (-0.1)	1.6 (0.4)	2.6 (0.7)	2.8 (0.6)	2.8 (0.6)	2.8 (0.5)

Source: Finance Accounts and Budget Documents.

Note: RE – Revised Estimates; BE – Budget Estimates; Numbers in parenthesis are percent of GSDP.

\*: Negative balance is due to non-allocation of balance for insurance and pension funds component between Bihar and Jharkhand on bifurcation.

liabilities such as the State Transport Corporation (STC) and power losses are not on the books of the state government as yet. Once settled, this settlement may impact the financial position of the state either way. Actual fiscal outcomes year on year will be subject to one-time shocks of settlement till such time that this division is completed.

The central government formulated the debt swap scheme for state governments in 2002/03, wherein the participating states were allowed to raise additional market borrowing to repay high-cost block loans to the central government. The GoJ took advantage of this in all three years: 2002/03, 2003/04 and 2004/05.<sup>40</sup>

The Eleventh Finance Commission had defined a state to be "debt stressed" if the ratio of its interest payments to revenue receipts exceeds 20 percent while the TFC has recommended reducing this ratio further to 15 percent. Interest payments were made on an ad hoc basis in the first few years after bifurcation and only stabilized later. Interest payments as a percentage of revenue receipts were at a high of 28.7 percent in 2002/03 and have declined steadily since then; they are expected to be as low as 7.7 percent in 2006/07.

### Twelfth Finance Commission Award: Implications for the State

According to the TFC award, Jharkhand's share in the pool of taxes is 3.36 percent (excluding service tax) and 3.4 percent for service tax. This is slightly higher than what had been decided under the Eleventh Finance Commission award wherein Jharkhand was given 3 percent of the

<sup>40</sup> In 2002/03, two state development loans (SDLs), totaling Rs.2.05 billion with 6.75 percent interest and repayable in 2013, were raised and the proceeds were allocated towards repayment of block loans bearing higher interest. Also further repayment of Rs.1.16 billion was made under the debt swap scheme in 2002/03. In 2003/04, SDLs totaling Rs.4.23 billion at 5.9 percent interest and repayable in 2017 were raised for repaying block loans and also a further Rs.2.56 billion of block loans were repaid. In 2004/05 SDLs totaling Rs.2.28 billion bearing average interest at 6.03 percent and repayable in 2014 were raised to repay block loans and also further repayment of block loans of Rs.2.47 billion was made.

14.6 percent for undivided Bihar. The total grants-in-aid to be received by the state over the next five years are shown in Table 2.3.

Apart from taxes and grants-in-aid, a major incentive to all states is linked to the passing of the Fiscal Responsibility and Budget Management Act (FRBMA). On enactment of the FRBMA, Jharkhand will get debt relief of Rs.659.43 crore on account of rescheduling of loans (contracted before March 2004 and outstanding as of March 2005) at a lower rate of interest of 7.5 percent per annum. Of this Rs. 205 crore is on account of lower principal repayment and Rs. 454.5 crore on account of lower interest payments.

While the FRBMA has been drafted, it has not yet been passed. Although, the state government intended to pass the act during the budget session before the close of the financial year 2005/06, political developments led to a state of "sine die" which means that the state assembly was neither in session nor adjourned immediately prior to the end of the financial year. Therefore, the FRBMA could neither be passed as an Act in the assembly nor through an ordinance since the house was not adjourned. Since the FRBMA will now technically be passed in 2006/07, this raises the question of whether the state will be entitled to the interest relief of Rs. 103 crore for 2005/06. The state may either get the award for two years together or it may lose the first year's award. Further, the state is unlikely to benefit from the TFC's debt waiver linked to the reduction of revenue deficit (Box 2.1).

A reduction in revenue deficit from -1.3 percent to zero in two years and a 6 per cent correction in fiscal deficit may be very difficult for the state. Even with such a steep correction, it is not clear whether or not the state will meet the "consistent performance" criteria laid out by the TFC.

The state seems to be well on its way to meeting the other two criteria suggested by the TFC, namely reducing the ratio of interest payments to revenue receipts below 15 per cent and containing the salary bill as a proportion

Table 2. 3: Grants-in-Aid on the Recommendation of the Twelfth Finance Commission

(Rs. billion)

	2005/06	2006/07	2007/08	2008/09	2009/10	Total
<b>Total</b>	1.71	4.15	4.34	4.54	4.77	19.51
Non-Plan Grants	1.65	3.24	3.43	3.63	3.86	15.81
Plan Grants	0.06	0.91	0.91	0.91	0.91	3.70
Grants to Local Bodies	1.16	1.16	1.16	1.16	1.16	5.80
Panchayats	0.96	0.96	0.96	0.96	0.96	4.82
Municipalities	0.20	0.20	0.20	0.20	0.20	0.98

Source: Twelfth Finance Commission Report.

of revenue expenditure less interest and pensions to 35 percent by 2008/09.

### Measures for Expenditure Control

Huge expenditures without commensurate increase in revenues are responsible for rising fiscal deficits in the state. While large increases in expenditures on infrastructure and social development of the underprivileged groups in the state are warranted, it is important to ensure that these are within the absorptive capacity of the state. A good monitoring mechanism needs to be put in place to ensure that there are no leakages in the system. The consolidation of schemes will help cut down administrative costs. Some common expenditure control measures for consideration include: (i) restrictions on the creation of new posts; (ii) rationalizing of existing posts; and (iii) ceiling on contingent liabilities.

Improving public procurement should also play an important role in enhancing the effectiveness of public

spending while at the same time reducing unproductive expenditure. The existing mechanisms by which the state purchases goods, works, and services from the private sector are confusing as well as inefficient. The relatively poor functioning of the procurement system is especially worrying given the vast increase in procurement that is planned during the coming years with the expected doubling of investment spending. Experience from other countries, as well as other states in India, suggest that it is possible to improve the quality of spending while reducing the cost of procurement by 20–40 percent by simplifying rules, adopting standard procedures that incorporate the use of electronic procurement, and increasing supervision and monitoring of procurement practices and outcomes. These actions, combined with a training program to boost the skills and expertise of officials involved in executing and overseeing procurement, could make a major contribution to improving the quality of spending and achieving the fiscal responsibility targets.

### Box 2.1: Will Jharkhand Miss the Boat on TFC's Debt Waiver?

According to the Gol's scheme, repayments that are due to central loans from 2005/06 to 2009/10 will be eligible for write-off, linked to an absolute amount by which the revenue deficit is reduced year on year from the base level. The base level has been taken as the average of revenue deficit for the state from 2001/02 to 2003/04. This poses a major problem for Jharkhand whose base level is very low as the state had a revenue surplus in 2003/04. According to the debt relief formula, Jharkhand is entitled to a debt write-off of Rs. 2.69 for every rupee of reduction of revenue deficit, provided the revenue deficit is below the baseline (-2.45 billion) and fiscal deficit is below the level in 2004/05 (5.1 percent of GSDP). Actual figures for 2004/05 show a deterioration of revenue deficit (-3.38 billion) from the base level (-2.45 billion). Therefore the state does not qualify for performance-based debt waiver for 2004/05. Revised estimates for 2005/06 show a worsening of the revenue deficit to -15.53 billion. However, the final figure is likely to be much better as this figure does not factor in the FRBMA award and the increased share of the state in central taxes. In order to qualify for the TFC debt relief award in future years, Jharkhand needs to follow the fiscal path given in Table 2.4.

Table 2.4: Fiscal Correction Path Required to Meet the Targets set by Twelfth Finance Commission

		2004/05	2005/06	2006/07	2007/08	2008/09
	Baseline (as per TFC)	Actuals	RE	BE	Projected	Target
Revenue Deficit (Rs. billion)	-2.45	-3.38	-15.53	-7.13	-2.4	0
Revenue Deficit (% GSDP)		-0.8	-3.2	-1.3	-0.4	0
Fiscal Deficit (Rs. billion)		-22.18	-49.18	-48.65	-30.47	-19.9
Fiscal Deficit (% GSDP)	-5.1	-5.1	-10.1	-9.0	-5.1	-3.0
GSDP		436.87	484.93	538.27	597.48	663.2

Source: Finance Accounts and Budget Documents and staff estimates.

Notes:

- (i) GSDP estimates for 2004/05 from CSO, others calculated using 11 percent nominal growth rate suggested by the Twelfth Finance Commission.
- (ii) In order to fulfill the condition that cumulative reduction in revenue deficit must exceed the cumulative interest relief, there must be a revenue surplus of Rs. 0.64 billion in 2007/08 and Rs. 1.42 billion in 2008/09 (assuming that the state receives interest relief for 2005/06).

## Measures for Additional Resource Mobilization

Together with expenditure control some additional resource mobilization measures can be adopted to put the state finances back on track. While the tax cuts that the state has introduced for additional investment and income generation may eventually lead to higher tax collection, it cannot be taken for granted. It is advisable to review these tax cuts carefully and retain only those that prove their intended efficacy. Other resource mobilization measures are noted below.

*First*, there is considerable scope for enhancing resource mobilization through better tax administration and compliance. The GoJ has taken the first step in this direction through its decision to implement the value added tax (VAT) in the state from April 2006. The Jharkhand VAT Bill, 2005 has been approved by the governor and the assembly. Sixty-two items have been listed under the tax-exempt category under the VAT system, of which nine were selected on the basis of local or social importance. The state has taken a number of steps to prepare for implementation of VAT, including training of officers and the launch of public awareness campaigns covering all major trade unions, chambers of commerce and industry organizations which will focus on the rules, laws etc. of VAT. While this is expected to lead to an increase in tax revenues, a clearer picture of the impact of VAT will emerge only by end-2006 depending on how well it is administered.

*Second*, the GoJ is likely to benefit from enhanced mineral revenues if the central government accepts the TFC's recommendation that mineral royalties to states should be on an ad valorem basis. The initial benefits of this change will depend on the rate at which the royalty is fixed, but over the medium to long run, revenues will go up as prices of metals and minerals, especially coal and iron ore, are expected to increase.

*Third*, the state should make every effort to get the full benefit of the TFC award (discussed above), including passing the FRBMA.

*Fourth*, the state should endeavor to get maximum benefit from central schemes targeted at underprivileged communities, of which Jharkhand has a large share.

*Fifth*, given the high level of poverty, the state could seek support of international donor agencies for grant funds for capacity building and put in place an appropriate incentive structure to involve the private sector (including NGOs) in funding the infrastructure and social development programs in the state.

## Capacity Building for Budget Planning and Execution

In order to better manage its finances, and enhance accountability and transparency in spending, the GoJ needs to focus on the budgeting process. At present, the budget does not reflect a realistic picture of the financial

position of the state. A lower fiscal deficit and a revenue and primary surplus in 2003/04 is not reflective of better fiscal management but huge savings of Rs. 3495 crore, of which nearly 50 per cent occurred in two departments – education and rural development – both of which are priority sectors for the government. While the overall level of debt is known, other disclosures such as large outstanding pension liabilities and contingent liabilities (committed contracts, guarantees, bad debts etc.) are not known.

The government needs to prepare a medium-term expenditure plan and place its annual budget preparation within the context of this plan. This plan should be prepared in consultation with the line departments and be consistent with resource mobilization efforts to ensure fiscal discipline in the medium to long term. Other immediate steps include drawing up of a “Medium-Term Fiscal Reforms Program” incorporating incentives outlined in the TFC award.

The state has taken some initial steps for enhancing financial discipline such as: (i) revision of budget construction and allocation procedures to facilitate intensive scrutiny and speed up budget execution; (ii) speedy financial approvals; and (iii) a cut in non-plan expenditure. Going forward, the state could consider the creation of a finance and accounts cadre that would help meet the requirements in specialized departments such as treasuries, the budget division and the internal audit division and would enable heads of departments (HoDs) to take the right decisions for better financial management of the state's resources. The state needs to build capacity in the finance department and modernize its treasury functions along the lines of states like Karnataka.

A progressive finance department would like to follow a process of realistic budgeting, which involves line departments and reflects policy objectives. This would eventually lead to performance-based budgeting. This needs to be backed by a strong internal audit function,

which could be outsourced to professional audit firms as is being done by some states like AP and Karnataka.

## Administrative and Local Governance

**Jharkhand faces serious challenges in the area of governance stemming from the lack of political stability and an inefficient administrative system.**

The *first* challenge is to evolve a political consensus involving Jharkhand's disparate parties and factions on key reform issues. The *second* is to improve the efficacy of the civil service by: (i) rationalizing departments and schemes; (ii) curbing premature transfers; (iii) improving performance and career management; and (iv) strengthening the presence and quality of block administration. The *third* is to encourage more accountability and transparency at all levels through greater use of e-governance, full implementation of the right to information legislation, and decentralization. Political decentralization will have to be complemented by administrative and fiscal measures to devolve real power and resources to PRIs. A *fourth* challenge is to establish genuine rule of law, which means curbing organized mafias and enforcing the law universally. The government should work closely with Jharkhand's many civil society groups to achieve these ends not only through consultation, but also by using their skills. This will help to implement programs better, train PRI representatives after elections, and conduct the evaluation of public services.

## Political Governance

**The fact that none of the major parties has a secure majority has allowed small parties and independents to control the balance of power.** The risks of this delicately poised political situation are obvious: policy incoherence, political gridlock, and uncertainty. Clearly, there is a pressing need to develop political consensus on key issues important to Jharkhand's development. One symptom of the lack of political consensus is the growing activism of the judiciary in responding to

governance challenges. Since the creation of Jharkhand, the courts have issued rulings – in response to public interest litigation – ordering the state to take action on a variety of fronts including: (i) holding Panchayati Raj elections; (ii) unbundling the Jharkhand State Electricity Board (JSEB); (iii) implementing a cooked mid-day meal program in schools; (iv) curbing leakages in the PDS; and (v) hiring doctors and para-medics on contract to fill vacancies.

## Administrative Governance

Jharkhand's civil service continues to use procedures and systems inherited from Bihar. The revision of old manuals could be used to rationalize the structure of departments. Jharkhand's Rules of Executive Business provide for 40 departments; yet Jharkhand has only 12 ministers. This provides an opportunity to cluster departments in ways that improve functional efficiency with a minister and principal secretary responsible for each cluster. Manuals could be revised to accommodate the greater use of information technology, and secrecy provisions recast to ensure consistency with the recently passed Freedom of Information Act (2005).

There are ways to tackle the problem of frequent premature transfers that undermine service delivery. At lower levels of the civil service, particularly Grade III teacher positions, some states, such as Karnataka and Tamil Nadu, have experimented successfully with computerized transfer processes. At higher levels of the system, interference in transfers can be curbed by creating a statutory civil services board, an idea endorsed by the Chief Secretaries conference as early as 1996 to screen transfer requests. The government would have to furnish reasons for transferring an officer prematurely and the Board would have the right to refuse such requests. A computerized database could be established to track transfers over time, as Karnataka has already done, to monitor compliance with a three-year average tenure norm. Quantitative caps can be imposed to limit transfers: Karnataka, for example, has placed a cap of 5 percent of total civil service strength on annual transfers.

The government has an option to move towards a merit-based civil service, possibly starting with an improved performance management system of Grade I and Grade II officers first. Results expected could be specified at the beginning of the year. Officers could be graded on the basis of their ability to achieve these results in Annual Confidential Reports (ACRs). Negative ACRs can then be used to weed out non-performers through compulsory retirement. Promotions would then reflect prior performance rather than being the outcome of serving time. At the same time, the government should resist the temptation to create new posts to accommodate demands for promotion. The government might consider new pay policies to link performance and merit-based salary increases more clearly.

A zero-based review of all schemes will help to screen out schemes of marginal value, curtail unproductive expenditure and make monitoring more effective. For instance, the welfare department has approximately 120 schemes operating simultaneously, each receiving little attention, with a large proportion of expenditure devoted to salaries and establishment costs. Deputationists running welfare department schemes, for example, are less amenable to departmental control and often hold additional charges, resulting in a low attention span. Scheme administrators also complain of frequent transfers in programs, such as SSA. At another level, the problem reflects a growing vacuum in governance, particularly at the block level. Officials, citing insurgency problems, no longer reside in many blocks, visit block offices infrequently, and do not travel within their blocks regularly.

There are serious concerns about leakages. In the PDS, the Supreme Court's adviser in Jharkhand states that the diversion of foodgrains intended for the very poor under the Antyodaya Scheme is in the range of 40 percent to 50 percent. It is not clear how accurate the beneficiary lists are for most schemes. In the absence of strong PRIs, beneficiary lists are known to have been influenced by powerful locals at the expense of the needy. Several projects have experienced corruption in the process of

tendering and procurement. Most schemes also lack an independent monitoring mechanism.

The GoJ has introduced some reforms, including streamlining the approval process, selective procurement procedures and third party inspections for a few schemes. The process of securing Cabinet approval for schemes has been streamlined, allowing for expenditure immediately after approval by the Cabinet and the State Assembly. The women and child department has revamped the procurement process for nutritional supplements by asking women's self-help groups (*mahila mandals*) to supply good-quality food from local markets, and allowing elected *anganwadi* workers to procure food from the block or district headquarters as well. With respect to third-party monitoring, the Xavier Institute for Social Sciences (XISS) is currently conducting a review of the Integrated Child Development Scheme (ICDS), while the Xavier Labor Relations Institute (XLRI) is doing one for SSA at the request of the central government. Finally, the inspection regime requires reinvigoration. Senior government officials need to visit their districts and blocks regularly. An energetic inspection regime can play a role in curbing corruption in schemes in the state's 211 blocks; the regular presence of government officials will fill the administrative vacuum currently exploited by extremists in some blocks.

## Enhancing Accountability and Transparency

A multi-pronged anti-corruption strategy with preventive and enforcement measures to discourage corruption at all levels will send a signal that the government is serious about tackling the problem. Such a strategy should be based on extensive consultation with civil society and industry. Orissa has done well in framing a credible anti-corruption strategy and surveys indicate that the re-election of the NDA in Orissa was at least partly due to the government's relatively clean image.

### **Preventive strategies to reduce corruption and strengthen accountability**

- ▶ **E-governance combined with business process re-engineering to simplify transactions and**

### **make them more transparent can play a vital role in reducing opportunities for corruption.**

The computerization of land records in Karnataka, E-sewa centers in Andhra Pradesh and the introduction of computerized file monitoring in the Karnataka Secretariat are examples of successful e-governance initiatives. The application of e-governance, along with business process changes, such as banning the use of stamp paper, placing guideline values on the internet and creating model deeds, have improved the registration department in Maharashtra.

Jharkhand could consider applying IT solutions to agencies with an extensive public interface, particularly the provision of land records, the development of urban and rural single-point delivery kiosks (using wireless technology when necessary), and the creation of information systems to centrally monitor schemes and the provision of other services. Experience from other states shows that e-governance solutions work best when a mix of factors prevail, particularly tenurial stability for administrators supervising the project, line department ownership, and high-level political support. A public-private partnership model usually works better than in-house efforts by bridging gaps in technical capacity and funding as well as injecting new management skills that might not be readily available in government. User fees retained by providers may be necessary to ensure the long-run sustainability of such initiatives.

- ▶ **Access to information can be a powerful tool to demand accountability in government programs, especially at the grass-roots level.** In Rajasthan, the Mazdoor Kisan Shakti Sangathan (MKSS) sought to uncover corruption in local public works by securing employment rolls, vouchers, beneficiary lists, and completion and utilization certificates. These were turned over to villagers for scrutiny at open public hearings called *Jan Sunwais* in the presence of the

media and a panel of eminent persons. The key irregularities that emerged in public hearings were (i) hiring ghost-workers and pocketing the proceeds at the expense of real workers; (ii) paying for work not completed or not done at all; (iii) false bills and vouchers; (iv) the use of inferior materials for constructing local roads or public buildings; and (v) manipulating beneficiary lists for social programs. In Delhi, Parivartan used Delhi's Right to Information (RTI) law to expose corruption in the state's PDS by insisting on access to stock registers for comparison with household usage. The Gol has recently passed a forceful Freedom of Information (FoI) Act that applies to all state governments as well. This new law needs to be aggressively implemented and publicized in Jharkhand to improve accountability at the grass-roots level. Citizens' charters based on wide consultation could be introduced in major public agencies.

- ▶ **Decentralization in Jharkhand, can not only reinforce local-level accountability mechanisms, but open up new spaces for participation for groups hitherto excluded from the system.** Decentralization is a powerful tool for enforcing accountability if panchayats are empowered administratively and fiscally. In MP, for example, the state government's decision to place teachers under the supervision of GPs has reduced absenteeism to only 17 percent compared to 39 percent in Jharkhand in 2004 (World Bank, 2005). The GPs in MP were empowered with the capacity to recruit local teachers, authorize and withhold salary payments, and remove teachers in the event of non-performance. Madhya Pradesh now has the third lowest rate of teacher absenteeism in India after Maharashtra and Gujarat, despite being a low-income state like Jharkhand.

that, unlike in MP, Jharkhand lacks strong political support for decentralization. Now that elections have been put on hold by a court order because of legal challenges over the state's reservations policy, there is a danger that elements opposed to holding these elections could seek to delay them indefinitely. If elections are delayed for a long period, Jharkhand will lose a crucial opportunity to improve the quality of governance where it counts — at the local level and in the countryside. The key priority is therefore holding elections as quickly as possible.

When elections are held, a staggering 50,375 representatives will be chosen, including 13,894 women from a ST, SC, or Other Backward Class (OBC) background. In scheduled areas, the gram sabha will be vested with strong powers including the right to approve programs and projects, select beneficiaries, and certify the correct use of funds by the GP in the form of a utilization certificate, as per both PESA and the 2001 Jharkhand Panchayati Raj Act. Some activists have asked, and with good reason, why these powers specific to scheduled areas cannot be extended to all gram sabhas across the state. Yet, in other ways, the Jharkhand Act does not fully implement the provisions of the PESA Act. If the central PESA Act grants the gram sabha and panchayat "ownership" of minor forest produce, the Jharkhand Act vests panchayats with the right to "manage, collect, store, and market" minor forest produce, but not own it. If the central PESA Act allows the gram sabha and panchayat the right to prevent land alienation, the Jharkhand Act only allows the zilla parishad (ZP) the right to restore land alienated unlawfully. Finally, the central PESA Act makes it obligatory for state officials to consult the gram sabha or panchayat before granting leases for minor minerals and acquiring land for development projects; neither of these provisions finds mention in the Jharkhand Act. These inconsistencies are likely to breed more court battles once PRIs begin to function in the state.<sup>41</sup>

Jharkhand announced elections for PRIs, beginning September 26, 2005. The fact that this decision was made under pressure from NGOs and the High Court indicates

<sup>41</sup> For a discussion of these issues, see PRIA (2004); Ekka (2003); Menon and Sinha (2003). See also, Government of Jharkhand, Law Department, Jharkhand Panchayati Raj Act, 2001 (Ranchi: Government of Jharkhand, 2005).

In order to promote the effective functioning of PRIs, beyond holding elections, the GoJ should consider the following steps:

- ▶ Amending the existing state legislation in different areas that contradicts either the central PESA Act or the Jharkhand Panchayati Raj 2001 Act, and within the two acts, to ensure compatibility.
- ▶ Clarify the powers of different tiers of the PRI system through an activity mapping exercise involving critical line departments, elected PRI representatives, and NGOs. Jharkhand should seriously consider placing teachers, para-medics, and doctors at the Public Health Center (PHC) level under the direct control of PRIs with the power to recruit, monitor, and remove such staff. Jharkhand could begin the process by placing 60,000 contract teachers and 1,600 contract doctors under PRI control.
- ▶ A recent survey by the Indian Social Institute reveals widespread ignorance of the powers of panchayats and gram sabhas conferred by the central PESA Act across villages. The GoJ should take action to publicize these powers through training sessions with elected representatives, district-level officials, and NGOs, as well as the print and electronic media, to equip them to function within the new system.
- ▶ The financial basis of the emerging PRI system in Jharkhand remains unclear. The State Finance Commission has begun its work, but currently has only one chairperson and no members in harness.

### ***Enforcement strategies to reduce corruption and strengthen accountability***

- ▶ **Strengthening the Rule of Law.** Jharkhand, like many other states, has faced serious threats to the rule of law in various ways. One reason for this is the protection afforded by certain political

figures to local mafias centered around the state's rich mineral, forestry, and land resources, making it more difficult for the police to take action. A few well-publicized actions to enforce the law would send a strong signal that the government is serious about doing so. Reinforcing the operational autonomy of the state's police force is therefore a key element in the strategy to ensure the rule of law. The National Police Commission recommends several useful steps to enable the police to function in a more autonomous and professional fashion, including:

- ◆ The creation of an independent state police commission to: (i) establish clear guidelines for the functioning of the police; (ii) provide a forum for appeals against arbitrary decisions; and (iii) review the performance of the police through an annual report placed before the state assembly, for example.
- ◆ The Director General of Police in a state should be selected only on the basis of objective criteria possibly through the Union Public Services Commission (UPSC) and given a fixed tenure of three years by law.
- ◆ Appeals to the State Police Commission should be possible against mala-fide transfer or suspension orders. The authorities vested with the right to issue such orders should be clearly specified in the state's transfer policy.

The persistence of insurgency in several parts of the state also poses a danger to the rule of law and underlines the importance of developing a coherent strategy for tackling such issues. This includes: (i) greater political decentralization to absorb forces currently operating outside the formal political system; (ii) cracking down on corruption in government schemes and programs that hurt the poor the most; and (iii) bolstering administration in the state's taluqs.

► **Staffing and providing operational strength to the Lok Ayukta.** While Jharkhand has established an office of the Lok Ayukta (ombudsman) to provide an independent vehicle to combat high-level corruption, the office has yet to begin functioning properly. The Jharkhand Lok Ayukta Act allows the Lok Ayukta to investigate and recommend action in cases involving both corruption and public grievances. The Lok Ayukta can take *suo-moto* cognizance of such cases even without the filing of a formal complaint on the basis of media reports. Yet, the absence of investigating staff means that the Lok Ayukta has to depend on the government-controlled vigilance department to conduct investigations often at its own pace. The Lok Ayukta also claims that the government is slow to respond to their reports and has not cooperated fully in investigations

involving officers of the Indian Administrative Service (IAS). There is no website to inform the public about the powers of the Lok Ayukta or the procedures for filing complaints, as is the case in Karnataka.

► **Enhancing the effectiveness of the vigilance department.** The vigilance department operating under the Prevention of Corruption Act (1988) is responsible for pursuing corruption cases against officials. As a government agency, it cannot pursue investigations against senior officials or prosecute them without permission from the Chief Minister. This is an important structural weakness not unique to Jharkhand: the freedom to pursue investigations is a key element in strengthening institutional capacity to combat corruption. The vigilance department has also been short of investigative

### Box 2.2: Whither Panchayati Raj Elections in Jharkhand? The Legal Imbroglio

The path leading up to the notification of PRI elections – and the subsequent reversal of the decision to hold them – was beset with controversy. Some tribal interests argued that the Jharkhand Panchayati Raj Act (2001) was not fully consistent with the central PESA Act designed to extend the 73rd constitutional amendment to scheduled areas, while some non-tribal interests objected to elections on the ground that 667 panchayats notified as part of the scheduled areas were fewer than 40 percent tribal in population, but subject to tribal reservations as stipulated by the PESA law. Others complained that the Jharkhand 2001 Act had been poorly drafted in the absence of adequate public consultation. In the end the High Court – responding to several public interest litigation suits – blocked the holding of PRI elections scheduled to begin on September 26, 2005 because of concerns over the state's reservations policies including:

- (a) The decision of the state government to allow 80 percent reservation of seats for election to the GP in scheduled areas to accommodate not just members of scheduled tribes (entitled to 50 percent of all seats under the PESA law), but those belonging to SCs and OBCs as well. The High Court ordered that under the law, reservations could cover no more than 50 percent of all seats, as per Supreme Court directives.
- (b) The failure of the Jharkhand Panchayati Raj Act (2001) to reserve one-third of all chairperson positions in panchayats at the village, block, and district levels for women in general and scheduled areas. The Act allows for a reservation of 50 percent of these posts for members of STs in scheduled areas, but not specifically for women STs. In general areas, chairperson posts are open to all under the State Act.
- (c) The High Court's decision to strike down a provision of the central PESA Act allowing for the reservation of all chairperson posts in scheduled areas for ST members on the ground that this violated Article 14 of the Constitution, which guarantees citizens equal protection under the law.

The root cause of the controversy is the fact that Jharkhand's tribal population is spread out over several districts, rather than concentrated in a few, creating the anomalous situation of several areas officially classified as scheduled with only a minority tribal population. De-scheduling these areas is likely to be a highly contentious and time-consuming process requiring presidential assent. The High Court's ruling has now been challenged in the Supreme Court; in the meantime, however, the government decided to cancel the decision to hold elections indefinitely, despite the High Court's order asking the government to show compliance with its ruling and hold elections by October 31, 2005.

staff but progress has recently been made in filling vacancies, particularly at the level of deputy superintendents of police (DSPs).

The government intends to amend the Vigilance Bureau Manual to set time limits for completing early investigations. It may be useful for the government to set time limits, as it has on many occasions in the past, for the completion of departmental inquiries as well as monitor compliance closely. Of the 680 departmental inquiries initiated since the creation of the state in 2000, approximately 60 percent are still pending. Government orders that date back to the 1950s assign a maximum time of three to four months to complete an inquiry and impose either a minor or major penalty after appeals.<sup>42</sup> Officers leading inquiries should as a rule always be senior to the officer under inquiry and not hold other responsibilities that render them incapable of conducting swift disciplinary proceedings.

Both the vigilance department and the Lok Ayukta's office could profitably turn their energies to focusing on corruption and grievances in government programs and schemes as well as service delivery. Such a strategy is likely to aid common citizens more effectively. The Karnataka Lok Ayukta, for example, has played an important role in rooting out corruption in drug procurement, urban municipalities, and hospitals and emerged as a key channel for resolving complaints relating to service delivery.

## Mineral and Environmental Governance

**The state's encouraging mix of natural resource endowments makes it an ideal destination for investment that could unleash growth and job creation.** Jharkhand means the "land of forests" and true

to its name the state is endowed with vast forests and a rich assemblage of floral and faunal biodiversity. Few states in India can match the scenic landscapes and rich biodiversity of Jharkhand. The state is also home to a large tribal population who are heavily dependent upon forest resources for their livelihoods. Jharkhand has vast mineral reserves, with 33 percent of India's coal deposits, 47 percent of its mica and 34 percent of its copper. Creating a diverse and inclusive economic base calls for harnessing not just its comparative advantage in mining, but also the untapped opportunities for growth provided by tourism.

**However, the transition to industrialization, particularly mining-led growth requires strong government institutional structures to mitigate the associated environmental and social risks.** The development thrust of the state emphasizes growth in the mining sector, followed by improving agricultural productivity. A mineral-led growth strategy could provide the foundations for development provided the risks are well managed. Most of Jharkhand's mineral deposits are located in forests that are inhabited by tribals. Mineral development has therefore involved the destruction of forests, displacement of a large number of tribals dependent on the forests and high levels of pollution that have adverse health effects. Ignoring the environmental effects of mineral development has therefore fueled social conflict and discontent. This in turn is known to increase business risk and deter investments that are necessary for development. Agencies involved in environmental issues therefore have a crucial role to play in addressing these negative externalities to create social consensus needed for a sustainable flow of investment and growth.

**An environmental governance structure is in place with the respective roles of the central ministries, state departments and agencies well defined.** In Jharkhand the environmental regulatory framework is closely aligned with and embodied in the major central Acts of Parliament (such as the Environmental Protection Act and the Forest Act). Most of these policies are aimed at defining acceptable environmental standards and

<sup>42</sup> See for example, the GO issued by L.P. Singh, I.C.S., Chief Secretary of Bihar, 1953. Government of Bihar, Appointment Department, "Speedy Disposal of Disciplinary Cases against Government Servants" (Patna: January 9, 1953) reprinted in Bihar Board's Miscellaneous Rules, 1958 (Patna: Malhotra Brothers, 2004), pp. 153-154.

strengthening the enforcement authority of the state regulatory agencies. Under the Indian constitution, the states and central government share jurisdiction over forests. The Ministry of Environment and Forests is the lead central agency that defines national policy goals and sets the legal framework for controlling forest use. The state forest department is the dominant public agency responsible for implementing these laws and managing the state's forests. Projects that require clearance of forests in excess of 25 ha must undertake an environmental impact assessment. Application for forest clearance is invariably granted, but is conditional upon reforestation of an equivalent area of land through a process known as the Compensatory Afforestation Scheme (CAS). These policies are complemented by regulations on pollution levels that are enforced through the State Pollution Control Board (SPCB). The SPCB is charged with monitoring emissions, enforcing compliance and providing the legal "Consent to Establish" and "Consent to Operate" permits.

34 | **While the overall legislative framework for environmental protection is well established across India, implementation of these policies remains a challenge in many Indian states.** This is particularly true of the newer states like Jharkhand, where environment agencies such as the SPCB are nascent and relatively weak. Evidence suggests that once the license to operate has been granted, there is limited monitoring of compliance levels. Hence numerous studies report that environmental regulations are routinely breached. Examples include forest clearance in excess of sanctioned levels, unsafe disposal of hazardous waste (e.g. asbestos at Roroburu), uncontrolled pollution of waterways, adverse health impacts and the economic exclusion of communities affected by mining. The CAS has also not lived up to its promise with indications that few such schemes have been satisfactorily implemented.<sup>43</sup> The depletion of forest resources remains a primary development concern in a state such as Jharkhand where a substantial proportion of the population relies on forests for their livelihood needs.

<sup>43</sup> Kumar (2005).

**The capacity, incentives and institutional design of the environmental agencies in Jharkhand need to match the growing demands placed upon these agencies by a mineral-intensive growth strategy.**

There are large gaps in staffing the forest department with a 30 percent vacancy rate at the forest guard level. At the same time, the present system emphasizes top-down approaches that focus on administrative processes rather than environmental outcomes, thereby limiting the initiative and effectiveness of the field staff. A similar situation exists in the SPCB. If the state is to generate broad based-growth it will need to create greater social support for investment in the economy. This will require improvements in the capacity and ability to mitigate adverse mining impacts by enforcement of existing regulations.

**The key elements of such a strategy would include:**

- ▶ *Strengthening the capacity of the Jharkhand PCB to monitor and enforce compliance with existing regulations:* This include: (i) developing and implementing a plan to upgrade skills; (ii) developing and adopting tools for better and faster evaluation of environmental assessment of investments; (iii) rationalizing consent management based on environmental risks and re-allocating resources towards more effective inspection and monitoring; (iv) decentralizing responsibilities to regional offices with the respective capacity upgradation in staff and equipment; (v) undertaking full computerization and web-based management of application processing and monitoring; and (vi) introducing greater information disclosure and transparency in decision-making, including getting ready to meet the requirements of the new Right to Information Act.
- ▶ *Building knowledge, awareness and capacity of line departments (industry and mining), investors and financial institutions to improve environmental performance:* Good environmental performance is

increasingly seen as good business practice and a way to maintain competitiveness in global and domestic markets. There is a need for the line departments to provide timely information and technical support to investors on appropriate clean technologies.

- ▶ *Improving environmental compliance, performance and risk mitigation, and management in the mining sector*, which is associated with several issues and challenges, including the preparation and operationalization of detailed procedures for: (i) environmental compliance for different categories of mines; (ii) mine closure; and (iii) mining legacy issues. This will facilitate a sustainable development strategy for the mining sector, which is needed for benefits from investor interest in the state's mineral resources.

- ▶ *Strengthening capacity and efficiency of forest management institutions*: Mining-led growth will not gain the necessary public support without substantial improvement in the way that forestry issues are addressed in the state. Greater attention needs to be given to: (i) the complex forest clearance process; (ii) improving mechanisms for the accountability of the forest department in compensatory afforestation; and (iii) policy guidelines on how to economically restore lost ecological and livelihood benefits.
- ▶ *Promoting more effective public participation in environmental management*, including: (i) raising knowledge and awareness; (ii) a more informed and constructive public hearing process; and (iii) the involvement of citizens in monitoring and enforcement.