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Political Institutions, Fiscal Capacity, and Economic Governance in India: A Political Economy Analysis of Institutional Effectiveness

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Abstract

The effectiveness of economic governance depends not only on policy design but on the institutional capacity through which fiscal authority is exercised. In political science and development economics, political institutions have increasingly been recognised as central determinants of economic outcomes. This paper examines the interaction between political institutions and fiscal capacity in India up to 2018 using a political economy framework. Introducing the Institutional–Fiscal Effectiveness Framework (IFEFF), the study analyses how institutional credibility, fiscal coordination, and accountability mechanisms shape economic governance performance.

The paper argues that sustainable economic governance is best explained by institutional effectiveness rather than policy ambition alone. By integrating political science and economics, the study contributes to international debates on institutions, governance, and development.

Keywords: Political economy; fiscal capacity; political institutions; economic governance; India

JEL Classification: H11, H61, O17, D73

1. Introduction

Economic governance in democratic systems operates at the intersection of political authority and fiscal capacity. While economic policy debates traditionally focus on efficiency, incentives, and market outcomes, political science emphasises the institutional structures that enable or constrain economic decision-making. Political economy scholarship bridges these perspectives by recognising institutions as mediators between political power and economic performance.

By 2018, the institutional approach had become prominent in comparative politics and development economics. In India, discussions on growth, redistribution, and public finance increasingly highlighted governance capacity rather than policy intent. This paper situates India within this broader political-economy discourse.

The central argument is that economic governance effectiveness in India up to 2018 is primarily shaped by institutional effectiveness in managing fiscal authority rather than by policy scope alone.

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2. Political Institutions and Economic Governance: A Review of Literature

Political economy literature identifies institutions as the “rules of the game” that structure economic behaviour (North, 1990). Political institutions influence economic governance by:

- ❖ structuring fiscal authority,
- ❖ coordinating collective decision-making,
- ❖ enforcing compliance and accountability.

From an economic perspective, fiscal capacity—the ability to mobilise and allocate public resources—is essential for development and redistribution (Besley & Persson, 2011). Political science complements this by emphasising legitimacy, credibility, and rule-based governance.

Recent scholarship converges on the view that economic outcomes are institutionally embedded rather than technocratically determined. This paper builds on that consensus.

3. Analytical Framework: Institutional–Fiscal Effectiveness Framework (IFEFF)

To integrate political science and economics, this study introduces the Institutional–Fiscal Effectiveness Framework (IFEFF), consisting of three mutually reinforcing dimensions:

3.1 Institutional Credibility (IC)

The stability, predictability, and rule-bound nature of political institutions that enable long-term fiscal planning and economic coordination.

3.2 Fiscal Coordination Capacity (FCC)

The ability of institutions to mobilise revenue, allocate expenditure efficiently, and coordinate fiscal policy across governance levels.

3.3 Accountability and Compliance (AC)

Oversight, transparency, and corrective mechanisms that ensure fiscal discipline and reduce inefficiency.

The IFEFF posits that economic governance improves only when these dimensions function cohesively.

4. Methodology

The study adopts a qualitative political-economy methodology involving:

- ❖ review of institutional economics and political science literature,
- ❖ analysis of fiscal governance arrangements,
- ❖ examination of accountability and oversight mechanisms,
- ❖ comparative reference to emerging democratic economies.

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The approach aligns with governance-focused international journals and avoids programme-specific or partisan analysis.

5. Institutional Credibility and Economic Decision-Making

Institutional credibility reduces uncertainty in economic governance by enabling predictability and compliance. Credible institutions lower transaction costs, support coordination, and enhance fiscal discipline.

In India, institutional credibility has been shaped by constitutional arrangements, procedural governance, and rule-based fiscal management. From a political-economy perspective, credibility functions as an economic asset.

IFEFF Assessment: Institutional Credibility — Moderate to High

6. Fiscal Coordination and Public Resource Management

Fiscal coordination represents the economic core of governance capacity. Effective coordination improves allocation efficiency and policy coherence, while fragmentation weakens outcomes.

Political-economy research suggests that coordinated fiscal institutions outperform fragmented systems in sustaining economic governance. India's experience up to 2018 reflects incremental institutional consolidation alongside coordination constraints.

IFEFF Assessment: Fiscal Coordination Capacity — Moderate

7. Accountability, Compliance, and Economic Efficiency

Accountability mechanisms align political authority with economic discipline. Audits, oversight institutions, and grievance mechanisms reduce principal-agent problems and improve efficiency.

From an economic standpoint, accountability enhances resource utilisation; politically, it reinforces legitimacy and institutional trust.

IFEFF Assessment: Accountability and Compliance — Moderate

8. Discussion

The IFEFF demonstrates that economic governance outcomes depend on institutional configuration rather than policy intent alone. Political authority enables fiscal action, but institutional effectiveness determines its economic impact.

This integrated political-economy perspective explains variations in economic governance across democratic systems with similar policy objectives.

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9. Conclusion

This paper concludes that economic governance in India up to 2018 is best understood through the interaction of political institutions and fiscal capacity. Institutional credibility, fiscal coordination, and accountability jointly shape economic outcomes.

Strengthening economic governance therefore requires institutional reform alongside fiscal policy innovation.

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