Minimum Government, Maximum Governance- Evidence from the Indian States

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Abstract:

This paper studies the link between government size, institutions and economic growth for the Indian economy using a panel of 23 states from 2005-06 to 2013-14. This is the first attempt to study the interplay between the public sector, institutions, and growth in the Indian context, especially at a disaggregated level. We have employed different proxies for government size in the form total government expenditure, total development as well as total non-development expenditure as a percentage of state GDP as well as new dataset Social Progress Index to measure institutional quality. Our results state that Indian states suffer from an oversized government i.e. bigger governments tend to hamper the economic growth of states irrespective of different proxies for government size due to higher inefficiencies. The negative effect of government size on GDP is stronger at lower levels of institutional quality. The positive effect of institutional quality on output increases with smaller government sizes.

Keywords: Public Sector,Institutions,GMM

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