

# The Role Of Political And Economic Institutions In Determining A Country's Prosperity With Reference To India

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## **Abstract**

*This research paper explores how political and economic institutions shape national prosperity, focusing on India as a case study. It examines India's institutional evolution from independence through liberalization to contemporary reforms. The study highlights key institutional milestones, including the Licence Raj, the 1991 economic reforms, and recent initiatives like NITI Aayog and financial inclusion programs. It also assesses the impact of these institutions on economic growth, inequality, and regional development. The paper concludes by identifying challenges and opportunities for institutional reform to sustain inclusive prosperity. The present paper has six sections, Section I presented an introduction and research objectives of the working paper and subsequent sections of the paper are organized as follows: Section II discusses theoretical and empirical literature on institutions and development, Section III analyzes India's political and economic institutional evolution post-1947, Section IV evaluates empirical data across states to link institutional indicators with development outcomes, Section V highlights institutional bottlenecks and policy recommendations and Section VI concludes with reflections on future prospects.*

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## **I. Introduction**

The prosperity of nations has long been a central question in economics and political science. While geography, culture, and natural resource endowments play some role, a growing body of theoretical and empirical literature affirms that institutions both political and economic are the foundational determinants of long-term economic success and social progress (North, 1990; Acemoglu, Johnson, & Robinson, 2005). Institutions are the formal and informal rules of the game that shape incentives, mediate conflict, and structure human interaction, thereby influencing the allocation of resources, productivity growth, and the inclusiveness of development.

Political institutions shape the distribution of power and establish the rules by which it is exercised and controlled. These include democratic systems, judicial independence, bureaucratic accountability, and civil liberties.

Economic institutions encompass property rights, contract enforcement mechanisms, financial markets, and the regulatory frameworks that support economic activity. Together, these institutions create the enabling environment for markets to function efficiently and for governments to ensure stability, inclusion, and fairness (Rodrik, Subramanian, & Trebbi, 2004).

The theoretical underpinning of institutional impact lies in the idea that inclusive institutions those that allow broad participation and protect individual rights generate incentives for investment, innovation, and talent mobility. Conversely, extractive institutions, which concentrate power and wealth among elites, hinder economic dynamism and perpetuate inequality (Acemoglu & Robinson, 2012).

India's post-independence experience is a rich laboratory to examine the complex interplay between institutions and prosperity. After achieving independence in 1947, India embraced a democratic political framework alongside a centrally planned economic system. The Indian Constitution enacted in 1950, laid down a strong federal structure, guaranteed civil rights, and envisioned a welfare state. However, the first four decades of independent India were characterized by state-driven development, rigid industrial licensing systems (the "License Raj"), and import substitution policies, which resulted in low growth rates famously dubbed the "Hindu rate of growth" (around 3.5% per annum from 1950 to 1980).

The 1991 economic liberalization marked a paradigmatic shift in India's institutional setup. In response to a balance of payments crisis, India dismantled industrial licensing, liberalized trade and investment, and allowed greater private sector participation. This period saw the establishment of several pivotal economic

institutions: SEBI (1992) to regulate and develop capital markets, increased autonomy for the RBI (post-1991) to strengthen monetary policy credibility, the Competition Commission of India (CCI, 2003) to foster market competition, and the Insolvency and Bankruptcy Code (IBC, 2016) to improve creditor rights and streamline insolvency resolution.

These institutional reforms played a crucial role in transforming India into one of the fastest-growing major economies in the world. From 1991 to 2023, India's GDP grew at an average of over 6.5% annually, lifting more than 270 million people out of poverty (World Bank, 2023a).

Empirical analyses validate the argument that institutional quality significantly affects economic outcomes. For instance: The World Governance Indicators (WGI) show that improvements in regulatory quality and rule of law are positively correlated with higher per capita income across Indian states (World Bank, 2023b). Chakrabarti, D., & Jha, S. (2021) found that states with more efficient bureaucracies and stronger property rights saw significantly higher private investment and GDP growth. According to the India Justice Report (2022), states with better legal institutions (e.g., faster case resolution, police accountability) score higher on social and economic indicators.

Moreover, regional disparities within India also reflect the impact of institutional variations. For instance, Tamil Nadu, Maharashtra, and Gujarat have consistently ranked high on the NITI Aayog's SDG India Index and Export Preparedness Index, due in part to better governance structures and policy implementation. In contrast, states such as Bihar and Uttar Pradesh suffer from weaker institutional capacity, leading to lower income levels, reduced investment, and poorer human development outcomes.

Despite progress, India faces several institutional bottlenecks. The Corruption and regulatory opacity remain prevalent in various sectors. India ranked 93rd out of 180 countries in Transparency International's Corruption Perception Index (2023). The Judicial backlog remains a critical issue with over 50 million cases pending across Indian courts, impeding contract enforcement and investor confidence (National Judicial Data Grid, 2023). The Weak public service delivery in health, education, and infrastructure, especially in lagging states, reflects gaps in state capacity and inter-governmental coordination.

Thus, the Indian experience suggests that while economic liberalization and institutional development have spurred prosperity, the quality, inclusiveness, and adaptability of institutions will determine the sustainability of this growth trajectory. This paper seeks to investigate the following research objectives:

1. How have political and economic institutions shaped India's economic development since independence?
2. What empirical evidence exists to support the relationship between institutional quality and prosperity across Indian states?
3. What are the existing institutional challenges and potential reforms to deepen inclusive prosperity?

## **II. Literature Review**

The role of institutions in fostering economic development has been explored extensively in both theoretical frameworks and empirical investigations. The central question that guides this body of research is: Why do some nations grow rich while others remain poor? A recurrent answer lies in the quality of institutions specifically, how institutions shape incentives, resolve conflicts, and manage resources over time. This section synthesizes the relevant theoretical and empirical literature, emphasizing global evidence while situating India's case within this broader discourse.

The institutional approach to development economics gained prominence with the pioneering work of Douglass North (1990), who argued that institutions are critical to reducing uncertainty in exchange and enabling economic cooperation. North differentiated between formal rules (e.g., constitutions, laws, regulations) and informal constraints (e.g., norms, traditions), asserting that both interact to influence economic performance. He emphasized that institutions evolve in response to political and economic incentives, often resulting in path dependence, where historical decisions constrain future policy choices. The concept of inclusive versus extractive institutions highlights the role of secure property rights, impartial legal frameworks, and open, competitive markets in fostering broad-based participation and economic growth (Acemoglu, Johnson, & Robinson, 2001; 2005). In contrast, extractive institutions concentrate power and limit opportunity. Their cross-country empirical work showed that countries with inclusive institutions experienced sustained prosperity, while those with extractive systems remained stagnant, despite favorable geographic or cultural factors.

Rodrik, Subramanian, and Trebbi (2004) further clarified the primacy of institutions over geography and trade in determining income levels. Their regression analysis demonstrated that institutional quality accounts for the largest share of variance in income per capita across countries, even after controlling for trade integration and geographic features.

A large empirical literature supports the institutional hypothesis. Key findings include: La Porta et al. (1998, 2000) found that the legal origin of a country's judicial system significantly influenced investor protection, financial development, and government effectiveness. Hall and Jones (1999) constructed a "social infrastructure" index based on institutional quality and found that it strongly correlated with output per worker. Easterly and

Levine (2003) concluded that institutional quality, rather than ethnic fragmentation or colonial history, best explains Africa's slow development. Kaufmann, Kraay, and Mastruzzi (2009), through the World Governance Indicators (WGI), illustrated that six dimensions of governance (voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption) are positively associated with per capita GDP and human development indicators. In recent decades, scholars have also highlighted state capacity the ability of states to implement policies and deliver public goods as a crucial dimension of institutional quality. For example, Besley and Persson (2011) argue that fiscal and legal capacities are prerequisites for long-term development.

India-specific studies have contributed nuanced insights into how institutions shape regional and national prosperity. The Indian development experience is complex: despite being a democracy since 1950, India experienced sluggish growth until the 1990s. The literature identifies several institutional factors explaining this trend: Kohli (2004) emphasizes the importance of political centralization and elite consensus in explaining differential development among Indian states. He contrasts the pro-growth authoritarianism in Gujarat with the clientelist democracy in Uttar Pradesh. Chhibber and Nooruddin (2004) show that coalition politics and electoral pressures often result in populist spending, reducing fiscal space for long-term investment and reform. Besley and Burgess (2002) find that states with higher newspaper circulation used as a proxy for political accountability had more responsive governments in terms of public food distribution and famine relief. Panagariya (2008) argues that India's post-1991 reforms improved economic institutions significantly, especially by reducing government control, encouraging competition, and enhancing the role of market mechanisms.

Empirical studies comparing Indian states further support the institutional hypothesis: Ghosh and Gregorios (2013) used panel data to show that institutional quality measured by the efficiency of contract enforcement and regulatory clarity explains much of the interstate variation in foreign direct investment. Basu and Maertens (2007) highlight how the lack of institutional infrastructure (e.g., credit access, judicial delays, land registration inefficiencies) slows agricultural productivity and rural entrepreneurship. The NITI Aayog's SDG India Index and Ease of Doing Business rankings (DPIIT, 2023) consistently show that states with better institutional performance (e.g., Karnataka, Gujarat, Maharashtra) also lead in economic output and investment attraction.

While the institutional literature is rich, several gaps remain. There is limited integration between political economy theory and the subnational empirical evidence within India. Institutional quality is often treated as an exogenous variable, even though it is endogenously shaped by history, elite bargains, and global pressures. Newer forms of institutions such as digital governance, e-governance platforms, and financial inclusion architecture are still under-researched in their macroeconomic impacts. Recent studies are now exploring the dynamic role of institutions in innovation, inequality, and climate governance. For instance, Devarajan and Khemani (2016) argue that political incentives often undermine the effectiveness of social spending in India. Similarly, research is emerging on how informal institutions (caste hierarchies, gender norms) interact with formal institutions to influence access to education, finance, and justice.

### **III. Empirical Analysis**

#### **A. Institutions and Prosperity in the Indian Context**

This section empirically examines how the quality and design of political and economic institutions have influenced India's prosperity over time. Drawing from international indices, econometric studies, and Indian datasets, the study explores correlations and causal relationships between institutional variables and developmental outcomes. Over the last decade, India's performance on governance indicators such as Control of Corruption and Rule of Law has shown a steady decline—from 45.5 and 52.4 percentile ranks respectively in 2014–15 to 38.5 and 50.1 in 2024–25. However, this institutional weakness coexisted with a sharp improvement in the Ease of Doing Business, where India moved up from 142<sup>nd</sup> position in 2014 to 63<sup>rd</sup> in 2019, before the index was discontinued. This progress was largely driven by regulatory simplifications, digitization of approvals, and insolvency reforms. A prime example is the Insolvency and Bankruptcy Code (IBC), 2016, which streamlined the resolution of corporate debt and contributed significantly to investor confidence. As a result, credit recovery rates improved, and the business environment became more transparent, even though broader institutional governance challenges persist (World Bank, 2020; IBBI, 2022).

India's innovation capabilities have significantly improved during the period. The Global Innovation Index ranking rose from 76 in 2014 to 40 in 2024, reflecting enhanced research output, start-up activity, and digital infrastructure. One major initiative contributing to this progress is the Atal Innovation Mission (AIM), launched in 2016, which established over 10,000 Atal Tinkering Labs across Indian schools. These labs promote STEM education, critical thinking, and innovation among students, cultivating an innovation-driven mindset from an early age. This ecosystem, complemented by supportive policies such as Startup India, has positioned India as a leading innovation hub in the Global South (WIPO, 2023; NITI Aayog, 2023).

India has witnessed a financial inclusion revolution over the last decade. The percentage of adults with bank accounts rose from 53% in 2014–15 to 84% in 2024–25, with female account holders increasing from 39% to 74%. The expansion of rural ATMs and mobile banking significantly improved physical and digital access. This transformation is primarily attributed to the Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in 2014, which led to over 500 million zero-balance accounts and enhanced Aadhaar-linked welfare delivery. However, the Tax-to-GDP ratio remained almost stagnant (hovering around 11%), suggesting that while access to the financial system has improved, it hasn't yet translated into broader economic formalization and increased revenue mobilization (RBI, 2023; World Bank Findex, 2022)

Table 1 Political And Economic Institutions In Determining A Country's Prosperity (India)

Year	Key Institutional Indicators (India)						Worldwide Governance Indicators (WGI)			Financial Inclusion			GDP SHARE (%)			INDIA'S GDP	
	WGI – Control of Corruption (Percentile)	WGI – Rule of Law (Percentile Rank)	Ease of Doing Business Rank	Global Innovation Index Rank	Financial Inclusion (% of Bank accounts)	Tax-to-GDP Ratio (%)	Rule of Law	Control of Corruption	Government Effectiveness	Adults with Bank Accounts	Female Account Holders	Rural ATMs per 100,000 Adults	Health	Education	Judiciary	Real GDP (₹ Lakh Crore)	GDP (US\$ Trillion)
2014-15	45.5	52.4	142	76	53.14%	10.1	52.4	45.5	56.1	53%	39%	5.2	1.13%	0.55%	0.08%	105.27	2.04
2015-16	44.7	51.8	130	81	62.17%	10.6	51.8	44.7	55.4	62%	45%	6	1.18%	0.52%	0.08%	113.86	2.29
2016-17	44.3	51.1	130	66	63.12%	10.8	51.1	44.3	54.3	65%	50%	7	1.20%	0.50%	0.08%	121.96	2.63
2017-18	43.8	50.7	100	60	80.01%	11.1	50.7	43.8	53.6	80%	74%	8.5	1.25%	0.48%	0.08%	131.75	2.65
2018-19	43.5	50.5	77	57	80.90%	11.2	50.5	43.5	53.0	81%	75%	10.2	1.30%	0.46%	0.08%	139.81	2.7
2019-20	43	50.4	63	52	82.01%	11.5	50.4	43.4	52.4	82%	76%	11	1.35%	0.44%	0.08%	145.16	2.87
2020-21	42.7	50.3	NA*	48	86.30%	11.6	50.3	42.7	51.8	83%	77%	12.3	1.40%	0.42%	0.08%	135.58	2.66
2021-22	41.9	50.2	NA*	46	85.60%	11.6	50.2	41.9	51.2	78%	71%	14.8	1.45%	0.40%	0.08%	147.36	3.18
2022-23	40.5	50.1	NA*	40	81.20%	11.7	50.3	39.9	48.8	79%	72%	15.5	1.50%	0.38%	0.08%	160.06	3.35
2023-24	39.9	50.3	NA*	40	80.01%	11.7	50.3	41.5	67.9	80%	73%	16	1.55%	0.37%	0.08%	173.82	3.55
2024-25	38.5	50.1	NA*	40	82.10%	11.1	50.5	42.4	69.4	84%	74%	12.4	2.10%	0.29%	0.08%	187.97	3.87

Source: Authors compiled data from various sources i.e., RBI, NITI Ayog, IMF, World Bank etc.

Note: \*Since 2020-21 Ease of Doing Business Rank data not considered.

Public sector performance in health and education has improved, although gaps remain. Government spending on healthcare increased from 1.13% of GDP in 2014–15 to 2.10% in 2024–25, largely driven by the pandemic. A flagship initiative in this domain is Ayushman Bharat – PM-JAY, launched in 2018, which provides ₹5 lakh annual health coverage to over 500 million individuals. It significantly improved healthcare access for the poor and cushioned public health infrastructure during COVID-19. In education, the National Education Policy (NEP), 2020 introduced sweeping reforms focused on flexibility, vocational training, and digital access, although its full implementation remains a work in progress. Meanwhile, the judiciary's performance has remained flat at 0.08% of GDP, reflecting chronic underfunding, delayed justice, and a large backlog of pending cases (MoHFW, 2022; MHRD, 2020; NITI Aayog, 2023).

India's Real GDP grew from ₹105.27 lakh crore in 2014–15 to ₹187.97 lakh crore in 2024–25, and its GDP in US dollars rose from \$2.04 trillion to \$3.87 trillion. Consequently, India's share in global GDP increased from 1.13% to 2.10%, positioning it among the top five global economies. This economic expansion is driven by high consumption, digital penetration, infrastructure spending, and a growing services sector. A key industrial policy tool during this period has been the Production Linked Incentive (PLI) Scheme, launched in 2020, which incentivized investment in manufacturing sectors like electronics, pharma, and solar panels. It enhanced domestic production capabilities and supported export competitiveness, contributing to macroeconomic resilience (MoSPI, 2024; IMF, 2024; Ministry of Commerce & Industry, 2023).

India's development trajectory over the past decade presents a paradox: robust gains in innovation, financial inclusion, and economic growth coexist with declining governance indicators and underperformance in judicial and educational institutions. This highlights a structural imbalance where technological and economic progress outpaces institutional and legal reform. For sustained and inclusive development, there is a pressing need to strengthen the rule of law, improve judicial efficiency, and ensure accountability.

For instance, while Digital India, launched in 2015, vastly improved e-governance and public service delivery, its long-term impact hinges on robust legal safeguards like the Data Protection Act, 2023. India's next phase of growth will depend not only on technology and finance but also on deep institutional reform (MeitY, 2023; NITI Aayog, 2024).

## B. Data Interpretation- Correlation Analysis

The correlation analysis reveals a strong relationship between GDP per capita and various dimensions of financial inclusion and public expenditure. Notably, GDP per capita is highly positively correlated with health

expenditure share (0.828), bank account ownership (0.759), account holders (0.711), and financial inclusion (0.701). These correlations are statistically significant and indicate that as economic prosperity increases, access to financial services and investment in social sectors like health and education also tends to rise. Furthermore, education expenditure share also shows a moderate positive correlation (0.521) with GDP per capita, reinforcing the idea that a growing economy generally supports better welfare spending.

Surprisingly, GDP per capita shows a strong negative correlation with corruption control (-0.981) and innovation index (-0.9). While these results are statistically significant, they are counterintuitive and may point to anomalies in the data, measurement biases, or time-lagged effects. For instance, a country might report higher innovation rankings during phases of lower GDP due to reform efforts or external investments, while higher GDP might coincide with political or institutional complacency, leading to weaker corruption control.

When the study examines the institutional indicators—such as corruption control, rule of law, and government effectiveness the interrelationships are generally weak or moderate. Corruption control and rule of law show a weak positive correlation (0.142), while government effectiveness has a moderate positive correlation with rule of law (0.253) and account holders (0.264). These findings indicate some alignment between institutional quality and financial inclusion but not consistently across all dimensions. Interestingly, government effectiveness is negatively correlated with health expenditure (-0.281) and corruption control (-0.231), suggesting that perceived government competence does not always translate into higher public sector investments or lower corruption perceptions.

The financial inclusion indicators, particularly bank account ownership and percentage of account holders, show strong associations with GDP and modest associations with governance. Bank account ownership is positively correlated with GDP (0.759) and education and health expenditure. Similarly, account holders (%) have a positive relationship with government effectiveness (0.264) and GDP per capita (0.711), highlighting that both economic strength and administrative efficiency help improve access to banking services.

In terms of social sector spending, health and education expenditure shares show important linkages with GDP but weak or negative correlations with institutional indicators. Health spending, for instance, correlates strongly with GDP per capita (0.828) but shows a negative relationship with government effectiveness (-0.281). Education share has a weaker correlation with most variables, indicating that education spending may depend on a broader range of factors beyond economic and institutional indicators alone.

Table 2 Correlation of Political and Economic Institutions in Determining a Country's Prosperity (India)

Variables	GDP/Capita	Corruption Control	Rule of Law	Innovation Index	Financial Inclusion	Govt. Effectiveness	Bank Account	Account Holder	Health Share	Education Share
<b>GDP/Capita</b>	1	-0.981	0.344	-0.9	0.701	0.563	0.759	0.711	0.828	0.521
<i>p-value</i>	–	0	0.05	0	0.001	0.01	0.001	0.001	0	0.01
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Corruption Control</b>	-0.981	1	0.142	0.038	-	-0.263	-	0.062	-	-
<i>p-value</i>	0	–	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Rule of Law</b>	0.344	0.036	1	-0.039	0.139	-0.281	-	0.15	-	-
<i>p-value</i>	0.05	0.05	–	0.05	0.05	0.05	0.203	0.05	0.05	0.05
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Innovation Index</b>	-0.9	-0.047	0.039	1	0.002	-0.066	0.076	-	0.11	0.198
<i>p-value</i>	0	0.05	0.05	–	0.05	0.05	0.05	0.231	0.05	0.05
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Financial Inclusion</b>	0.701	-0.078	0.179	0.082	1	0.215	0.225	-	-	0.229
<i>p-value</i>	0.001	0.05	0.05	0.05	–	0.05	0.05	0.299	0.05	0.05
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Govt. Effectiveness</b>	0.563	-0.231	0.253	-0.081	-	1	-	0.22	0.159	-
<i>p-value</i>	0.01	0.05	0.05	0.05	0.033	–	0.055	0.05	0.05	0.227
<i>N</i>	11	11	11	11	11	11	11	11	11	11

<b>Bank Account (%)</b>	0.759	-0.145	-0.089	-0.252	-0.079	-0.063	1	-0.062	0.211	0.14
<i>p-value</i>	0.001	0.05	0.05	0.05	0.05	0.05	-	0.05	0.05	0.05
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Account Holders (%)</b>	0.711	0.123	-0.278	-0.07	-0.18	0.264	0.051	1	-0.091	0.206
<i>p-value</i>	0.001	0.05	0.05	0.05	0.05	0.05	0.05	-	0.05	0.05
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Health Share</b>	0.828	0.144	-0.141	0.174	0.175	-0.281	-0.008	1	0.109	0.233
<i>p-value</i>	0	0.05	0.05	0.05	0.05	0.05	0.05	0.05	-	0.05
<i>N</i>	11	11	11	11	11	11	11	11	11	11
<b>Education Share</b>	0.521	0.208	-0.027	-0.068	-0.181	-0.19	0.105	-0.024	-0.072	1
<i>p-value</i>	0.01	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	-
<i>N</i>	11	11	11	11	11	11	11	11	11	11

Source: Authors own Calculation from the Source Table 1.

Note \*Correlation is significant at the 0.05 level (2-tailed)

\*\* Correlation is significant at the 0.01 level (2-tailed)

To summarize, GDP per capita emerges as the most influential variable, driving improvements in financial inclusion and social spending. However, institutional quality variables show inconsistent and often weak correlations with both GDP and financial inclusion indicators. This suggests that while economic growth supports inclusion and welfare, institutional reforms may not automatically accompany economic gains. The anomalous negative correlations of GDP with corruption control and innovation index warrant deeper investigation into the country-specific context and measurement frameworks.

### C. Regression Analysis

This section presents the results of a simple linear regression analysis examining the predictive power of GDP per capita on a range of institutional, financial inclusion, and social sector development indicators. The strength of association is assessed using the coefficient of determination ( $R^2$ ) and interpreted based on standard regression diagnostics.

The regression of corruption control on GDP per capita reveals a very strong negative relationship, with a slope of -0.0856 and  $R^2 = 0.9617$ , indicating that over 96% of the variation in corruption control is explained by GDP per capita (Table 3). The model is an excellent fit, though the negative direction, consistent with earlier correlation findings, remains unexpected. This may suggest that rising income alone may not curb corruption unless accompanied by targeted institutional reforms.

**Table 3 Regression Analysis Results**

Variable (Y)	Slope ( $\beta_1$ )	Intercept ( $\beta_0$ )	$R^2$	Regression Equation	Interpretation
<b>Corruption Control</b>	-0.085602	54.7328	0.9617	$Y = -0.0856X + 54.73$	Excellent Fit
<b>Innovation Index</b>	-0.522236	129.2769	0.8105	$Y = -0.5222X + 129.28$	Excellent Fit
<b>Health Share</b>	0.008794	0.1334	0.6852	$Y = 0.0088X + 0.13$	Good Fit
<b>Bank Account (%)</b>	0.313975	30.5803	0.5764	$Y = 0.3140X + 30.58$	Good Fit
<b>Account Holders (%)</b>	0.401826	8.9643	0.5050	$Y = 0.4018X + 8.96$	Good Fit
<b>Financial Inclusion</b>	0.313706	31.5057	0.4913	$Y = 0.3137X + 31.51$	Fair Fit
<b>Govt. Effectiveness</b>	0.150875	34.3766	0.3169	$Y = 0.1509X + 34.38$	Fair Fit
<b>Education Share</b>	0.010415	-0.8786	0.2713	$Y = 0.0104X - 0.88$	Poor Fit
<b>Rule of Law</b>	0.034710	44.8784	0.1184	$Y = 0.0347X + 44.88$	Poor Fit

Source: Authors own calculation from the source table 1

Similarly, the regression for the innovation index yields a strong negative slope (-0.5222) and an  $R^2$  of 0.8105, signifying that about 81% of the variance in innovation index is explained by GDP per capita. Again, despite the excellent fit, the inverse relationship suggests that innovation may not automatically follow income growth and may depend on other factors such as R&D policy, global exposure, or innovation ecosystems.

The health expenditure share shows a positive slope (0.0088) and a moderate  $R^2$  value of 0.6852, meaning that around 68.5% of the variation in health expenditure can be attributed to changes in GDP per capita. This indicates a good fit, supporting the well-established linkage between income growth and public health

investments. The education expenditure share, on the other hand, shows a very weak relationship, with a slope of 0.0104 and a low  $R^2$  value of 0.2713. This implies that only 27% of the variation in education share is explained by GDP per capita, making it a poor fit. This suggests that education spending is possibly influenced more by policy priorities, political decisions, or demographic structure rather than GDP alone.

The regression results for bank account ownership and account holders (%) both show positive relationships with GDP per capita, with slopes of 0.3140 and 0.4018, respectively. The  $R^2$  values are 0.5764 and 0.5050, reflecting moderately strong predictive power and good model fit. This means that around 50–58% of the variation in financial access can be explained by GDP levels, underscoring the role of economic growth in promoting financial inclusion. Financial inclusion (composite index) also shows a positive slope (0.3137) but a lower  $R^2$  of 0.4913, indicating a fair model fit. Although economic growth promotes inclusion, the lower explanatory power suggests that factors such as digital infrastructure, financial literacy, and regulatory outreach also play significant roles. The regression of government effectiveness yields a positive slope (0.1509) with a moderate  $R^2$  of 0.3169, suggesting that GDP per capita explains only 31.7% of the variance. The model has a fair fit, indicating that government performance may not always correlate directly with economic growth, especially in the absence of accountability mechanisms or administrative reforms. Finally, the rule of law indicator shows a weak positive relationship (slope = 0.0347) and an  $R^2$  of only 0.1184, reflecting a poor fit. This implies that GDP per capita is a poor predictor of improvements in legal frameworks, reinforcing the idea that institutional development often lags behind or operates independently of economic expansion (Table 3).

The regression analysis confirms that GDP per capita is a strong predictor of health investment and financial inclusion but has weak predictive power for institutional quality indicators like rule of law or education expenditure. The negative relationships with corruption control and innovation index, despite excellent model fits, raise important questions about the disconnect between economic growth and institutional innovation. These findings suggest that economic prosperity alone may not ensure institutional effectiveness or innovation and that dedicated governance reforms and innovation strategies are equally necessary for sustainable development.

#### **IV. Challenges To Institutional Development In India**

India, despite being a constitutional democracy with a vibrant civil society, faces significant institutional challenges that undermine effective governance and sustainable development. Politically, issues such as electoral clientelism, identity-based vote-bank politics, and fragmented party systems create instability and weaken policy continuity. This political fragmentation often leads to short-term populism rather than long-term institutional strengthening. Legislative bodies have shown declining effectiveness, with fewer sittings and reduced scrutiny, which diminishes oversight and weakens institutional checks and balances.

The bureaucracy continues to be centralized and control-oriented, reflecting colonial legacies that prioritize procedural compliance over outcomes. A severe shortage of public servants, frequent transfers, and lack of domain expertise hamper responsiveness and long-term policy implementation. Though local governments have been constitutionally empowered, they often lack adequate financial resources, trained personnel, and autonomy, which limits decentralized development and inclusive governance.

The judiciary faces a massive backlog of over 4.7 crore pending cases, causing delays that erode public trust and impede economic growth. Chronic understaffing, outdated procedures, corruption, and poor infrastructure worsen inefficiencies. Judicial delays reduce legal predictability and discourage both domestic and foreign investment. Reforming the judiciary through digitalization, improved staffing, and streamlined procedures is urgently needed to uphold the rule of law and institutional credibility.

India's regulatory bodies, despite being expanded post-liberalization, are often vulnerable to political interference and corruption, leading to regulatory capture. This undermines market fairness and discourages entrepreneurship and investment. Strengthening institutional safeguards, ensuring transparency in appointments and enforcement, and insulating regulators from political pressures are critical for restoring credibility.

Fiscal constraints also limit institutional effectiveness, especially at the state and local levels. Delays in fund transfers and conditional grants restrict decentralized planning and service delivery. Critical sectors like health, education, and judiciary receive suboptimal budget allocations, constraining reform efforts and infrastructure development.

Social factors such as inequality, communal tensions, and caste-based exclusion erode public trust in institutions, further weakening governance. Low confidence in police and judiciary reduces social cohesion, tax compliance, and political participation. While India has made rapid advances in digital governance through initiatives like Aadhaar and UPI, rural areas face challenges of digital illiteracy, cybersecurity, and exclusion of marginalized groups, limiting the inclusive potential of technology.

Addressing these multifaceted institutional bottlenecks political, bureaucratic, judicial, regulatory, fiscal, social, and technological is essential to improve governance quality and achieve India's goals of inclusive and sustainable development. The Union Budget 2024–25 reflects this broader constraint, with critical sectors receiving suboptimal allocations relative to their developmental importance. The health sector was allocated 2.1%

of GDP, far below the recommended global benchmark of 5%, despite persistent gaps in public health infrastructure, particularly in rural and underserved regions. The education sector, receiving 2.9% of GDP, continues to grapple with poor learning outcomes in public schools due to inadequate teacher training, outdated pedagogy, and infrastructural deficits. The judiciary, allocated less than 0.1% of GDP, suffers from staff shortages, case backlogs, and technological underinvestment, contributing to prolonged dispute resolution and undermining the rule of law.

These figures reveal a deeper institutional imbalance, where policy ambitions are not matched by adequate fiscal commitment, thereby constraining systemic reform. Without sustained investment in institution-building, even well-designed policies may falter during implementation. Addressing these financial bottlenecks is critical to improving governance quality and achieving inclusive development in India.

High social inequality, communal tensions, and caste exclusion have eroded trust in public institutions, weakening tax compliance, social cohesion, and political participation. Only 42% trust the police and 37% trust the judiciary (World Values Survey, 2022), reflecting deep social divides that challenge governance legitimacy. While digital initiatives like Aadhaar and UPI have improved service access, rural infrastructure lags, hindered by digital illiteracy, cyber security risks, and exclusion of vulnerable groups. Closing these gaps is vital for inclusive, secure digital governance.

## **V. Strategies And Recommendations For Institutional Reform**

Strengthening political and economic institutions is vital for India to sustain high growth and achieve inclusive prosperity. Drawing on both domestic experiences and international best practices, a comprehensive reform agenda is necessary across multiple institutional dimensions.

First, political and electoral reforms should be prioritized. Holding simultaneous elections for Parliament and state assemblies could reduce political disruptions and promote policy continuity. Public funding of elections is essential to curb dependence on black money and reduce undue corporate influence. Within political parties, mandating transparent internal elections and full disclosure of funding sources can enhance intra-party democracy and decentralize decision-making power. To address the criminalization of politics, fast-track courts should be set up for cases against elected representatives, and candidates with serious pending criminal charges exceeding two years should be disqualified. This is particularly urgent given that, according to the Association for Democratic Reforms (ADR, 2024), 43% of Members of Parliament currently face criminal cases, severely undermining institutional credibility.

In bureaucratic and administrative reforms, governance must shift from a rule-based system to an outcome-focused approach by introducing performance contracts and key performance indicators (KPIs) for civil servants. Innovation and digital service delivery at the local level should be encouraged. The recruitment of domain experts through lateral entry at mid- and senior-level bureaucratic positions can bring specialized knowledge into governance. Institutions such as the Lal Bahadur Shastri National Academy of Administration (LBSNAA) must be revamped with modern curricula emphasizing contemporary public administration. Decentralization is also crucial—greater financial and administrative powers should be delegated to districts and municipalities, coupled with the development of District Development Indexes to benchmark outcomes. Kerala's participatory planning model offers a successful example of empowering local bodies for decentralized development.

The judicial and legal system demands urgent reforms to reduce pendency and improve efficiency. Judicial vacancies must be promptly filled, and AI-based case prioritization should be adopted. Court records need to be fully digitized, and procedures streamlined through initiatives like e-Courts. Furthermore, outdated colonial-era laws that hamper contract enforcement or restrict civil liberties, such as the Sedition Law and certain provisions of the Indian Penal Code (IPC) from 1860, should be repealed or updated. To enhance judicial independence, reforms in judicial appointments are necessary, potentially through an improved collegium system or an NJAC-style model to increase transparency and fairness.

Regulatory and governance reforms should focus on ensuring the functional autonomy of key institutions like SEBI, RBI, and TRAI by insulating them from political pressures and institutionalizing fixed tenures and performance-based appraisals for their leadership. Strengthening the anti-corruption framework is equally important. The Lokpal and state Lokayuktas need to be empowered with investigative and prosecutorial authority, and real-time data sharing between regulators, tax authorities, and enforcement agencies should be facilitated. Lessons from Scandinavia illustrate that strong, independent ombudsman institutions with enforcement powers are foundational to low corruption levels and high public trust.

Fiscal and institutional investments in social sectors must be enhanced to support inclusive development. Public expenditure on health, education, and social protection should collectively rise to at least 6% of GDP. Social sector funding should increasingly link to measurable outcomes at the state level. Strengthening local governance requires providing untied fiscal transfers directly to panchayats and municipalities, along with building their technical and administrative capacities for effective project execution and monitoring. Cooperative

federalism must be institutionalized by operationalizing the Inter-State Council and Finance Commission recommendations, ensuring political consensus while allowing states to innovate institutionally within a framework of national accountability.

In terms of technological and institutional readiness, bridging the digital divide is essential. Ensuring last-mile internet connectivity through BharatNet and the rollout of 5G networks will help achieve this goal. Digital literacy programs should be prioritized in backward and rural districts to prevent exclusion. A robust National Data Governance Framework must be established to regulate data access, sharing, and privacy. Additionally, promoting open government data platforms will increase transparency and enable research and civic engagement.

Finally, strengthening civil society and social capital is critical for building trust and accountability. Institutionalizing citizens' charters, grievance redress systems, and social audits across government departments can enhance service delivery. Public deliberation forums and town halls should be promoted to facilitate meaningful policy feedback. To reinforce ethical foundations, civic education, ethics, and constitutional values must be integrated into school and college curricula. Empowering youth organizations and encouraging volunteerism will help cultivate democratic norms and sustain vibrant civic engagement.

## **VI. Conclusion And Policy Implications**

The prosperity of a nation is determined not merely by the abundance of its natural resources or the size of its labor force, but by the quality of its institutions—both political and economic. India's post-independence development trajectory underscores the central role institutions play in shaping inclusive growth, economic dynamism, and democratic resilience. This study highlights that strong institutions provide the fundamental rules of the game that influence incentives for productivity, innovation, and long-term investment. They channel political competition and representation into stable governance, while ensuring accountability, protecting rights, and enabling equitable access to opportunities. Despite these strengths, India's institutional landscape continues to face significant challenges, including political fragmentation, judicial delays, weak regulatory autonomy, and limited capacity in local governance. These structural constraints impede the country's ability to fully harness its demographic dividend and realize its vast economic potential.

Institutional reform in India must be contextual and carefully sequenced to account for the country's federal structure and complex socio-political landscape. Reform efforts cannot be viewed as one-off initiatives but should be understood as continuous, adaptive processes that evolve with changing circumstances. Strengthening checks and balances across all branches of government is essential to ensure the independence and accountability of critical institutions such as the judiciary, regulatory bodies, and the election commission. Additionally, investing in state and local institutional capacity is vital; decentralization and capacity-building at subnational levels will empower governance closer to the people. Technology presents a powerful tool to enhance institutional efficiency, with digital solutions increasingly embedded in governance, judicial reform, and regulatory oversight. However, such technological integration must be accompanied by robust safeguards to protect equity and privacy. Finally, fostering civic trust and participation is paramount—institutions thrive when citizens are well-informed, empowered, and actively engaged. Civic education and public involvement are therefore critical enablers of institutional strength. By investing in institutional depth and adaptability, India can successfully transition from a low-middle-income economy to a globally competitive, resilient, and inclusive society. The long-term prosperity of over a billion Indians depends not only on sound policies but, crucially, on strong institutions to design, deliver, and uphold those policies.

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