

Democratic Politics and Economic Reform in India

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1 Introduction

'India has fundamentally altered its development strategy', the World Bank announced in 1996. Government initiatives since 1991 to restructure the basis of the Indian economy 'ended four decades of planning and have initiated a quiet economic revolution'.¹ Whether this will produce the economic results hoped for by Indian and foreign advocates of liberal reform remains to be seen. But the wide-ranging reorientation of economic policy has already demonstrated a quality which has surprised many observers – staying power. As this book goes to press in mid-1999, the liberalisation process has not been reversed. New reforms continue to be unveiled on a regular basis, while with each passing day the early policy breakthroughs become further entrenched, as people and organisations operate in accordance with them. New approaches to policy on trade, foreign exchange, anti-trust regulation, banking, industry, foreign investment, and many others are now a familiar part of economic life. Because liberalisation is an open-ended process, the policy landscape continues to evolve. But many of the old landmarks have faded from view. Even two changes of government – towards the left in 1996, and then rightwards in 1998 – did not lead to retreat. In many ways economic reform was strengthened after each of these elections.

This is a transformation that requires explanation. The objective of this study is to account for the capacity of the Indian political system to sustain policy reform over an extended period of time in the face of formidable political obstacles. Dismantling a system of state control is a notoriously difficult task. Witness the on-again-off-again reform programmes throughout the developing world.² While most developing

¹ World Bank, Country Operations, Industry and Finance Division, Country Department II, South Asia Region, *India: Country Economic Memorandum – Five Years of Stabilization and Reform: The Challenges Ahead* (8 August 1996), p. i.

² Among the more recent reversals was the Tanzanian government's decision to re-launch its market-oriented reform programme, after many false starts. See 'Tanzania Returns to the IMF Fold', *African Business* (London), no. 218, January 1997. Another classic case of on-again-off-again reform has been Kenya. See 'Survey: Kenya' (special supplement), *Financial Times*, 10 May 1994, p. 3. The governments of Kenya and Ghana abandoned

countries, including India, fail to fulfil all of the obligations stipulated in the conditionality-based lending programmes of multilateral institutions,³ many countries fail even to remain nominally committed to reform. By this standard, India's reforms have shown remarkable durability.

In India, as in most state-dominated economies, there are powerful groups and individuals with a strong interest in maintaining the status quo. Not least among the opponents of change are the bureaucratic and political elites who have prospered as gatekeepers. Their accomplices in the private sector are not only well off financially, largely as a result of the privileged positions they have occupied within the controlled economy, but extremely well organised. When any president or prime minister embarks on a programme of far-reaching reform, he will face resistance from opponents who are well positioned to thwart fundamental change. The groups that might stand to benefit from liberalisation tend to be poorly organised and lacking in influence. They are of little use to reformers seeking a constituency with which to counter the inevitable resistance.

Theoretically, democracy should add to the difficulties of bringing about sustainable policy reform. In democratic settings, powerful opponents of reform – farmers fearing the loss of subsidies, protected industrialists fearing foreign competition, party leaders fearing the loss of the illicit spoils of office – have usually forged strong vertical linkages with electoral constituencies which can be mobilised in opposition to policy reform. Powerful interests, and their junior partners, have many weapons at their disposal. Particularly effective are attacks on a reforming government's 'capitulation' to multinational corporations and western-dominated multilateral banks, and its 'betrayal' of the 'socialist' commitment to economic justice. Elected politicians are not known for their far-sightedness. Indeed, their vision rarely extends beyond the next election. They are disinclined to foment unrest among the powerful interests that fund their political activities and, often, their personal bank accounts. They do not relish conflict with public-sector unions over privatisation, or petty traders over tax reforms. Even when a particularly powerful politician launches a reform programme, it is difficult to sustain.

Like many other developing-country leaders, former Indian Prime Minister Rajiv Gandhi learned this lesson during the second half of the

economic reform in order to win their first multi-party elections in 1992. As the *Economist* put it, 'They threw money around like confetti, were duly re-elected and have never been able to get . . . back on track'. See 'The Rulers, the Ruled, and the African Reality', 20 September 1997, p. 85.

³ See Paul Mosely, J. Harrigan, and J. Toye, *Aid and Power: The World Bank and Policy-Based Lending in the 1980s* (London: Routledge, 1991), two volumes.

1980s. His high-profile efforts to 'modernise' and 'liberalise' the Indian economy lasted less than three years before they were effectively abandoned in favour of the more comfortable path of state-led development. Powerful interests, both inside and outside the state, were credited with forcing Rajiv's retreat from liberalisation. Democracy's theoretical aversion to change seemed confirmed. That liberalisation eventually returned to India in a much more dramatic and lasting form under Prime Minister P. V. Narasimha Rao and Finance Minister Manmohan Singh is thus a puzzle worth untangling. The political durability of India's reform programme runs counter not only to much of the experience in the rest of the developing world, but also to India's own lacklustre track record.

How can we explain the ability of liberal reform to become rooted in India despite the daunting array of political obstacles placed in its path? India is not only a democracy; it has been one continuously for the past fifty years: unlike newly democratising countries in the developing world, or in the former Eastern Bloc, there are no discredited authoritarian regimes on which past failures can be blamed. The lasting ills of colonialism notwithstanding, the Raj has lost much of its usefulness as a scapegoat. Narasimha Rao's Congress Party, unlike so many other reforming governments, was never likely to be granted an extended 'honeymoon' with the electorate. Both had been married before, to each other, and not that long ago. By 1991, Congress had ruled India for all but four years since it attained independence in 1947. It had been out of power for less than two years before Rao and Singh took office. There was no national euphoria to distract people from the unpleasant economic tasks at hand, as there was in the countries emerging from authoritarian rule. Indian voters and powerful interests remained as cynical as ever. The two coalition governments which succeeded Congress – brought in by general elections in 1996 and 1998 – faced even more formidable odds. Both the centre-left United Front government and the coalition led by the Hindu nationalist Bharatiya Janata Party (BJP) had campaigned on anti-liberalisation platforms. That both ultimately pressed on with reform – substantially deepening its content – makes reform's political durability all the more intriguing.

In explaining the political sustainability of economic reform in India, we must address not only the deeply ingrained notion that democracy, particularly under developing-country conditions, constrains politicians from ushering in far-reaching reforms, but also a more recent set of thoughts on the matter. These hold that some variants of democracy may be conducive to sustainable policy reform because open competitive politics provides a forum within which governing elites can 'sell' the benefits of reform to individual constituencies and to the public at large.

This argument is popular among aid agencies, and has had its greatest impact as part of the 'good government' agenda, which seeks to establish links between democracy and market orientation. The good government agenda has been furthered by the findings of mainstream academic research on the politics of economic reform, which is more subtle than the good government literature, but suffers from many of the same shortcomings. Most importantly, both perspectives neglect the capacity of democratic governments to usher in policy reform by engaging in underhanded tactics, one of the salient features of the Indian case.

The unseemly underside of democracy is wished away by the architects of the good government agenda largely because foreign aid must be justified in highly moral terms. Such practical considerations are not the reason why democracy's unwholesome aspect is neglected by academic political economists. In this case the cause is a combination of methodological preoccupations and sample bias. A fixation upon a rather rigid form of rational-choice analysis leads much of the comparative literature to a conception of democratic institutions that is divorced from their actual functioning. Rational-choice political economists have become hostages to models and the model-building process. Concerned with cross-national comparability, the institutional variables selected in this portion of the literature are schematic, bland, and unenlightening. The result is an unfortunate blind spot when it comes to apprehending the complex calculus of survival – particularly its adaptive quality – by which political and socio-economic elites operate in times of change. The relative autonomy of democratically accountable governing elites in India, both today and in general over the past fifty years, is greater than many had expected, and for reasons that standard rational-choice models are unable to comprehend.

As for sample bias, India's status as a long-established democracy goes a long way towards explaining why the new-political-economy approach would have been unable to reveal the underlying reasons for its ability to sustain adjustment. Much of the literature is based on case studies of newly democratising countries. Few studies have examined the politics of economic reform in a long-established developing-country democracy, like India, largely because they are so rare. While democracies clearly can sustain reform (perhaps as well as authoritarian regimes), the sample's bias towards fledgling democracies has led theorists to emphasise the *wrong reasons why* they are able to do so. Preoccupied with the contrasts between new democracies and their authoritarian predecessors, the literature over-emphasises democracy's wholesome aspect – particularly the role of 'accountability', but also democratic governments' skill at selling reform to open-minded electorates. In an effort to assess the

creation of political institutions in the new democracies, they have neglected to look elsewhere to determine how they might function in practice. 'Actually existing' democratic governments are often more 'accountable' to the powerful than to the powerless, a fact which affects their operation in times of reform no less than it does in times of stasis.

In short, there are two variants of conventional wisdom about the relationship between democracy and the promotion of policy reform, and both are wrong. Democracies are less constrained by unholy interest-group coalitions than was previously thought, but neither are they paragons of consensus-building. Democratically elected governments operate in a complicated world in which obfuscation and betrayal are routinely used to achieve political ends. Arguably democracy makes such tactics both necessary and possible. Advanced capitalist democracies rely on them all the time. Nevertheless, the explanation advanced in this book is not simply that India's reformers were Machiavellian enough to outwit opponents of liberalisation. Our concern is with the system within which reform was sustained. We identify three aspects of that system, around which the case material is structured: political incentives, political institutions, and political skills.

Two types of incentives are identified. First, governing elites at many levels of the Indian polity were attracted by the potential of liberalisation to provide new sources of patronage to substitute for some of those forfeited by the shrinkage of the state's regulatory role. Once it became clear to powerful political elites that economic reform did not have to conform to a rigid recipe, but that they themselves could write the rules of the transition as they went along, they were less inclined to press hard for a reversal of reform. They were also able to see the value of a second incentive: the inherent fluidity of India's interest-group structure. Interest groups themselves respond to new policy-derived incentives, and are vulnerable to divide-and-rule tactics. The ability to compensate narrowly defined groups, often clandestinely, and thus to magnify the 'feedback effects' that the new policy environment itself has on the fortunes and lobbying potential of various economic sectors, served to lessen the perceived political cost to governing elites of continuing with reform.

They were aided in this process by two types of political institutions – formal and informal. Many formal institutions were important in absorbing the political strain on reformers at the apex of the political system, but one institutional feature stands out, and is treated in detail – the federal political system. For a variety of reasons, the division of power between the central government and state governments tended to quarantine political resistance to reform within the confines of state-level political systems. Because the impacts of reform varied from state to state, politi-

cians from states that did well economically were less inclined actively to oppose reform, while those from states that were not as fortunate had fewer allies and less clout with which to mount a campaign of resistance. Moreover, the responsibilities of governance forced state-level governing elites to adapt to liberalisation by competing with each other for private investment. Once reluctantly engaged in liberalising activities in their own right – even if not fully committed to reform – governing elites at the state level proved invaluable in tackling resistance among powerful interest groups, who were also subjected to the divisive impacts of the federal system.

Governing elites at the state level were also able to rely upon *informal* political institutions, particularly the regularised networks of influence, encompassing party and non-party organisational arenas, which are constructed around individual party leaders. These are a crucial feature of India's institutional environment, but one which most of the comparative and theoretical literature is ill-equipped to treat seriously. Because of the far-reaching scope of these informal political networks, politicians were able to arrange accommodations between a vast array of groups concerned with the effects of the new policy dispensation. Not all could be adequately compensated. But the openness of the democratic system allowed governing elites at the centre and in the states to use the intelligence-gathering capacities of their informal networks to gauge both the mood and the relative political worth of various constituencies, and to distribute whatever advantages were at their disposal with impressive *political* efficiency. The impacts on *economic* efficiency are less certain, but to the extent this political mechanism facilitated the transition to an ostensibly more efficient policy framework, it can be presumed to have had an indirect effect.

Sustaining adjustment also required political skills. Particularly critical was the tactical skill of governing elites at disarming opponents of reform. On some occasions this relied on the capacity to cloak policy change in the guise of continuity, while at others continuity with earlier liberal reforms was effectively disguised as a return to the status quo ante. Contrary to the conventional wisdom, the projection of an economic 'vision' for India played virtually no role in this process. By using informal political networks to negotiate compensation for powerful allies, and orchestrating the sequencing of reforms in ways that benefited themselves and their parties, governing elites contributed to an image of 'politics as usual', thus concealing the radical implications of reform. All of this bought India's besieged reformers valuable time, the one commodity that any reform programme requires if it is to become politically rooted and have at least a chance of success.

To recapitulate: the Indian state is more capable of producing system-maintaining change than theories of ‘demo-sclerosis’ would have us believe – indeed, less captured by powerful interests than was allowed for by most explanations of why Rajiv Gandhi failed to remain committed to reform in the late 1980s. Nevertheless, the contrary view, most visibly put forward as part of the good government agenda, is marred by inconsistencies, naïvety, and an overly schematic view of democratic institutions. Much of this shortcoming stems from the methodologically constrained analyses found in the theoretical literature on why some democracies have been able to promote reform, from which the good government literature has borrowed highlights. New-political-economy approaches are at times helpful in framing research questions, but tend systematically to discount the incentives facing governing elites to take limited risks, as well as the capacity for interest groups themselves to respond to new incentives, redefine their strategic objectives, and fall prey to the divisive tactics of governing elites. A selective application of the less dogmatic elements of rational-choice analysis can yield a more nuanced approach to both incentives and institutions, which in turn can allow us to appreciate the value of the *informal* institutions and political skills to which formal democracy can give rise. Indian politics, constructed around these institutions, induces socio-economic elites to engage in negotiation and compromise – and governing elites to engage in obfuscatory and manipulative tactics. These tactics include, in addition to outright pilfering: shifting unpleasant responsibilities and blame on to political opponents, surreptitiously compensating selected interests, concealing intentions, reassuring and then abusing the trust of long-time political allies, and obscuring policy change by emphasising essential continuity.

Before proceeding further, a few disclaimers are in order. First, this book is not arguing that India’s reform programme is irreversible. The Indian government could announce a nationalisation of all industries tomorrow, though this or even less drastic forms of backtracking are unlikely. Even if a stark reversal in policy direction were to take place, it would not make the findings from this study any less relevant. The interpretation of events that is put forward is an attempt to explain not the irreversibility of economic reform in India, but its ability to last longer than many had originally predicted. Second, it must be recognised that economic factors are crucial to the sustainability of reform. Without producing at least some economic results, no reform programme, however well managed politically, can hope to retain the political support of state elites or resist the opposition of adversely affected interests. India has been blessed in this area. But positive economic results, while necessary, are not sufficient to ensure the continuation of reform. Third, and

finally, what we are discussing in this book is *Indian* democracy, not democracy in the abstract. Lessons from one country cannot be translated to another. History matters. While the findings from the Indian case may allow us to take issue with generalisations in the existing literature, and to formulate questions about other democracies, they do not constitute a model with general applicability.

Methods and case-study regions

The questions that have arisen from the evolution of economic policy in India do not lend themselves to quantitative analysis. They are intimately bound up with the changing perceptions of interest groups, with back-room deal-making, and with the complex motivations underlying political decisions. It is therefore difficult, if not impossible, to subject such material to rigorous hypothesis-testing. What follows is an interpretive account of events in India. The goal has been to make sense of seemingly contradictory forces, and to do so by probing the actual functioning of political institutions. This, in turn, will allow us to transcend what have become sterile debates surrounding the relative capacities of authoritarian and democratic systems, and the impact of such institutional variables as party and electoral systems.

To achieve these objectives it has been necessary to rely on first-hand information provided in interviews with key informants – that is, with actors involved in the process of bargaining, protest, policy formulation, and other forms of political activity. The research included field visits in every year between 1992 and 1999, inclusive. Field research consisted primarily of close to 300 interviews with senior bureaucrats, elected officials, party functionaries, lawyers, and representatives of business associations, trade unions, and non-governmental organisations. Also contributing to the base of knowledge on which these key-informant interviews were conducted were conversations with local journalists, academics, retired bureaucrats, representatives of international organisations, and long-time observers of the political scene. One of the major sources of background and supporting information has been press reports. These have been combined with reviews of the academic literature and documentation provided by interviewees. The result is not political ‘science’. But it is hoped that the insights provided by this approach will assist us in understanding the complex realities underlying the trends identified by other social scientists, particularly economists, which are often presented with little attention to the context of power relations.

This study has placed considerable emphasis on the state level of

India's federal system. The reasons for doing so are outlined in the analysis of the case material in Chapters 4, 5, and 6. In brief, the justification is as follows: though the decision to initiate economic reform was made by the national government, state governments must cope with many of its implications; they provide the first line of political defence. They play a large – perhaps decisive – role in defusing resistance to reform among socio-economic interests. The existence of well-institutionalised competitive political arenas below the national level is one of the defining characteristics of Indian democracy. The sustainability of adjustment has also been aided immensely by the ability of reformers in the central government to rely on the dynamics of inter-state competition to fragment opposition to reform from within the political elite.

Though evidence to support the propositions advanced in this study is drawn from a number of states, four states receive particular attention. Most of the case material concerns Maharashtra and Rajasthan, largely because the longest periods of field research were spent there. Developments in Karnataka and West Bengal are also featured prominently. Though any two (or even four) states are bound to be unrepresentative of a country as diverse as India, these four provide a relatively good cross-section of political and economic life. They cover the north, south, east, and west of India. This selection also includes a range of points along the spectrum of economic development, from industrially advanced Maharashtra to severely underdeveloped Rajasthan, with Karnataka and West Bengal fitting somewhere in between. While West Bengal's once formidable industrial base went into a period of decline in the 1970s and 1980s, as a combination of trade union militancy and government focus on rural areas took effect, Karnataka's economy, particularly around the capital of Bangalore, made significant strides towards diversification.

India's range of political parties is also well represented, with their fluctuating fortunes adding to the mix. The Hindu nationalist Bharatiya Janata Party (BJP) was the only elected ruling party in Rajasthan between 1991 and 1998.⁴ Rajasthan has been the strongest bastion of the Indian right. The citadel of India's left, West Bengal, is also represented. The Communist Party of India-Marxist (CPI-M) heads a coalition government that has ruled for more than twenty years under the same chief

⁴ The BJP government in Rajasthan was dismissed by the President of India, acting with the advice of the central government, in the wake of the destruction of a disputed religious structure in Uttar Pradesh in December 1992. President's Rule, in which the central-government-appointed governor heads the state administration, lasted until November 1993, when fresh elections were held. The BJP, though it did not win a majority of the state's assembly seats in those elections, managed to form a government with the support of independents and members of small parties.

minister, Jyoti Basu. Maharashtra had until recently been the most consistently Congress-dominated state in India. Its chief minister, Sharad Pawar, championed liberalisation in the state even before it became official party policy under Narasimha Rao. The Congress lost power in Maharashtra in the March 1995 assembly elections. A regional party, the Shiv Sena, took power in coalition with the BJP. The significant degree of policy continuity between the Congress and Shiv Sena–BJP governments in Maharashtra provided a useful context for analysing the political management of economic reform. In Karnataka, the shift from Congress rule to a government led by the centre-left Janata Dal, following elections in November 1994, furnished similar opportunities. These four states thus cover bastions of the left and right, as well as regions in which Congress was superseded by the right and the left, respectively.

Even if we could have chosen only one state, Maharashtra would have been a sensible choice. Because its economy, both agricultural and industrial, is among the most advanced and diversified in India, it faces some of the most difficult political challenges associated with liberalisation, such as mediating between powerful and well-organised interests in both urban and rural areas. It also affords us a bit of a glimpse into the future. As liberalisation of the state's economy began three years before the national trend (roughly in 1988), it has experienced many more of the economic and political implications.

Finally, it is worth noting that the explanation for India's ability to sustain adjustment has borrowed some of the conceptual tools of rational-choice analysis. It takes seriously the role of incentives and the way in which these are affected by the behaviour-shaping role of institutions. Moreover, tactical skill in politics is assessed largely in terms of the ability to influence the expectations of economic agents. And by focusing on the role of informal institutions in expanding the quantity and diversity of political transactions that are possible in a democratic setting, the types of concerns that preoccupy rational-choice political economists are never far from centre-stage. Rational-choice approaches can be useful, but they have their limits.

The next chapter provides an overview of reform since 1991, explaining what has happened and why it is significant. Chapter 3 situates the findings from the Indian case within the comparative and theoretical literature on the politics of economic reform. Chapters 4 to 6 detail the contribution of political incentives, institutions, and skills, respectively. Though for analytical reasons these are treated distinctly, they are part of a functioning system, and an attempt is made throughout to identify points of convergence and processes of interaction among them. Chapter 7 assesses some of the further implications of this interpretation of the

Indian case. It is meant to highlight the types of issues which the Indian experience with adjustment has raised for the study of Indian politics, comparative political economy, and development policy, as well as how the findings from this study might help to frame future research questions.