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M.R.
G.W.

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6

The Developmental Implications of Federal Political Institutions in India

ROB JENKINS

It is widely accepted that a democratic state's developmental performance can be influenced profoundly by the specific configuration of its political institutions. This chapter argues that a particularly important axis of institutional variation is whether state power is constituted as a unitary government or a federal system comprising multiple levels of political contestation and authority. Any attempt to assess the developmental implications of federalism as an independent institutional variable is complicated by the variety of federal systems in existence and the broad range of social and political contexts within which they operate. While we cannot isolate federalism as a distinct and uniform variable for comparative analysis, it *is* possible to examine the ways in which political dynamics created by multi-level systems facilitate or inhibit the achievement of developmental aims within particular countries.

In order to provide further analytical focus, this chapter explores not development generally, but rather the prospects for attaining both efficiency- and equity-related developmental objectives within the specific context of market-oriented economic reform, using India as a case study.

This chapter's argument can be summarized as follows:

1. Several de jure and de facto features of India's federal system do not conform to the institutional arrangements which the theoretical literature considers most likely to increase developmental performance.
2. Nevertheless, other features of India's federal system which are not explicitly addressed in the theoretical literature—particularly

the way in which it shapes party competition—help to offset these shortcomings. In particular, the organization of state power on multiple levels provides opportunities for political elites to overcome the opposition of powerful groups to market-oriented economic reform.

3. Thus, the structure of its federal institutions has helped India to escape from the change-resistant tendencies to which democratic states are prone. In this sense, federalism can be said to have had a beneficial impact on efficiency.
4. However, some of the very same political dynamics which enabled India's federal system to increase efficiency by making reform politically sustainable have simultaneously reduced certain dimensions of equity. (This is not, it must be stressed, the same as arguing that economic reforms themselves—unmediated by political-management tactics—have had negative distributional consequences, or that there has been a *net* decline in equity, measured along all of its dimensions.)

1. *Theoretical Grounding*

By analysing the role of federal institutions in helping to make economic reform in India politically sustainable, this chapter contributes insights to two sets of theoretical literature. The first concerns the developmental implications of various federal arrangements, while the second focuses on the interaction between democracy and policy implementation. The analysis of the Indian case material suggests that theories of federalism and economic performance suffer from an excessive orientation towards explaining static environments. They need to incorporate an understanding of the relationship between federal systems and the political processes underlying policy change. If they did, then their assessments of the developmental impacts of various federal systems might be altered dramatically, given that an ability to adapt to new circumstances may be one of the most important developmental attributes of any institutional environment. On the other hand, the second body of literature on the interaction between democracy and policy implementation is already fundamentally concerned with change. It has, however, been much less sensitive to federalism as an institutional variable that can influence a democratic state's capacity for policy implementation—in some cases, for the better. Before turning to the case-study evidence, it may be useful to consider some of the major propositions in each of these bodies of literature.

(*a*) *Federalism and economic performance*

Academic debate and political discourse in India are filled with heartfelt pleas for a realignment of relations between the centre and the states, usually in the direction of greater 'autonomy' for the latter. These are usually made on grounds of both equity and efficiency. Two strands of the theoretical literature on the economic impacts of federal institutions also lead to a fairly harsh indictment of the inefficiency and (to a lesser extent) inequity of Indian federalism—one relating to 'fiscal federalism', the other, an offshoot of more recent origin, concerned with what has been termed 'market-preserving federalism'.

(*i*) *Fiscal federalism*

The first subset of the literature relates to 'fiscal federalism'. This body of theorizing is concerned with 'the optimal degree of decentralization of public sector decisions of different sorts', particularly regarding taxation, expenditure, and regulation (Boadway et al. 1994: 3). The aim is to create institutions which provide disincentives for citizens to free-ride or for decision-makers at various levels of government to either overgraze the fiscal commons or evade responsibility for citizens whose needs place disproportionate burdens on public expenditure.

The way in which functions are 'assigned' in India's federal system is generally considered sub-optimal, in terms of both equity and efficiency. The central problem is one of practical operation: while its mixture of 'subnational provision and central oversight is consistent with [desirable] theoretical principles . . . the role of the central government is larger than these assignments suggest' (Boadway et al. 1994: 47). Through the extra-constitutional Planning Commission, and the discretionary transfers made by central ministries to state governments, the central government's influence over taxation, spending priorities, and regulatory decisions has become greatly expanded. Moreover, '[m]ost specific purpose transfers are allocated without a formula, allowing the central government considerable discretion' (Boadway et al. 1994: 59).

Other peculiarities of the system of fiscal relations between governing units in India tend to create unhealthy side-effects. For instance, one comparative analysis noted that 'India [perhaps] is the only federation where an inter-state sale is subject to tax by the exporting state in addition to the tax levied by the importing state' (Rao 1995: 290). Not only does this benefit some states more than others, particularly those with large manufacturing capacities; 'the inter-state sales tax has also led to distortions in tax structures, as the states tend to levy higher tax rates on commodities predominantly exported out of the states' (Rao 1995: 291).

According to the principles set forth in the literature on fiscal federalism, India's particular form of federalism does not possess the features most likely to assist in the attainment of efficiency objectives. It is also found wanting in terms of promoting equity—either between regions, or between groups of people classified according to non-geographic characteristics. In some areas, such as intergovernmental transfers, the negative implications for equity and efficiency are closely intertwined:

> the design of general purpose transfer schemes from both the Finance and Planning Commissions do not adequately offset the fiscal disadvantages to enable 'competitive equality'. The designs for transfer schemes also have disincentive effects and tend to promote laxity in fiscal management. In the event, the system of federal transfers evolved in India has not helped to reduce inter-state disparities in the levels of services or incomes. (Rao 1995: 304–5)

(ii) Market-preserving federalism

A second strand of the literature which attempts to theorize the links between multi-level systems and economic outcomes is centred around the notion of 'market-preserving federalism' (Weingast 1995). Its central premiss is that federal institutions can, under certain conditions, provide credibility to government commitments to honour the legal rights and rules which are required to 'maintain the economy' by 'protecting markets'. The purpose of this 'special form of federalism' is largely to constrain the capacity of political actors to encroach upon markets (McKinnon 1994).

Market-preserving federalism can only be said to exist if the system displays five characteristics that govern the allocation of responsibilities among levels of government: (1) a delineated scope of authority; (2) subnational government control over the economy in their jurisdictions; (3) common-market policing functions assigned to the national government; (4) an effective hard budget constraint through strict controls on revenue-sharing and borrowing; and (5) institutional features which make the assignment of responsibilities and powers impervious to political interference (Montinola et al. 1995: 55). According to these criteria, India does not qualify. The authors of a study on China specifically point out that '[m]any de jure federalisms are nothing like market-preserving federalisms, for example, in Argentina, Brazil, and India. In these cases, conditions 2 and 5, and often condition 4, fail' (Montinola et al. 1995: 57).

These two strands of the theoretical literature—on fiscal and market-preserving federalism—are premissed on sound analytical principles. But they do not necessarily tell the whole story. Even granting all of the flaws that are said to mar the economic efficiency of India's federal system—whether stemming from design or practical operation—there remain hidden aspects of its role in shaping political behaviour that must be taken into account when assessing its *net* impact on developmental performance. To apprehend these we must, in some respects, move beyond the fairly narrow concerns which have informed the modelling of fiscal and market-preserving federalism. This does not mean abandoning all of the rational-choice preoccupations of these writers: still very much at the forefront are issues of how the incentives facing various actors are shaped by both uncertainty and behaviour-constraining institutions. But if we shift the emphasis a bit to include the types of political conflict, and techniques for waging it, that are found in the real world of democratic politics, some functional aspects of Indian federalism can be appreciated. These provide a more balanced picture of federalism's developmental impact. The most significant of these is the contribution of the federal structure to the Indian state's capacity to carry out a programme of market-oriented reform which has, on balance, increased economic performance by reducing systemic inefficiencies (World Bank 1996).

(b) Democratic governance and policy implementation

Making the case for federalism's role in the political sustainability of India's economic reform programme brings us into contact with another body of literature, on the politics of economic reform. While this contains a large and varied set of theoretical propositions, for the purposes of this chapter only one relatively small subset need be addressed—that portion which asks why democratic regimes have over the last several years proven less constrained by political factors in implementing far-reaching policy reform than earlier theories had predicted.

Three lines of thinking can be discerned. The first has tended to focus on the nature of political transitions, largely because the main developing-world democracies involved in implementing economic reform have been those which recently emerged from authoritarian rule (Haggard and Kaufman 1995). Issues of political sequencing have been at the forefront of this school of thought. The second set of studies has been concerned with the ways in which political leaders in democratic settings use the tools that a relatively transparent, liberal political system puts at their disposal. These involve 'selling' reform to the electorate (Husain 1994), promoting an inclusive form of policy-making that involves extensive consultation with key interest groups (Harvey and Robinson 1995), and building new coalitions for reform that can give a greater voice to the poor (Graham 1994: 252). The third analytical stream consists of studies which seek to evaluate the impact of various institutional variables on the capacity of democratic states to achieve their reform objectives (Haggard and Webb 1994). The institutions most often studied are electoral systems, party systems, and the structure of relations between politicians and civil servants.

This chapter's analysis of the Indian case material will reveal the extent to which each of these approaches could be strengthened were they to consider how relations between a political system's various levels influence the shape of political conflict and the prospects for political compromise. First, while India is a long-established rather than a fledgeling democracy, the political dynamics produced by its federal setting clearly have some relevance for post-authoritarian federations such as Russia, Brazil, and Argentina. Second, the Indian experience suggests that the operation of a federal system provides avenues for political tactics that rely less on salesmanship and transparency than on blame-shifting between competing parties and collusive arrangements between the state and privileged economic interests. Third, while electoral systems, party systems, and the structure of relations between politicians and civil servants can each have a substantial impact on the prospects for successful policy implementation, the nature of these impacts is likely to vary significantly, depending on whether they occur in a federal or unitary polity.

While this chapter does not argue that federalism is a 'meta'-variable, it does seek to highlight the importance of federalism as a potentially important cross-cutting variable. The central point is that a failure to assess the impact that the existence or absence of a multi-level polity might have on efforts to implement policy reform renders conclusions based on other (admittedly important) institutional variables far less robust. Although it is impossible conceptually to separate the federal system from the many other formal institutions which make up the structure of Indian government, this chapter highlights the mechanisms through which the federal ordering of state power helps to reduce the political pressures facing reformers at the apex of the political system, allowing the reforms to take root, create new economic incentives, and generate efficiency gains.[1]

[1] An analysis which highlights the role played by informal institutions, as well as the formal institution of a federal system, can be found in Jenkins (1999, forthcoming).

2. About Indian Economic Reform and Federalism

Before turning to the ways in which India's federal institutional form has provided the flexibility required to bring about changes that many other countries (including several authoritarian regimes) have found difficult to sustain, it is important to make the case that the policy reforms in question are far-reaching.

Clearly the most substantial reforms have taken place in the area of trade and industrial policy. While it is true that India still has some of the highest tariff levels in the world, when compared to the pre-reform system (which had *the* highest) the current policy environment represents an enormous transformation of the trade regime. Much of the progress in trade reform consisted of doing away with the system of bureaucratic controls which governed various aspects of international commerce. Examples include the drastic scaling back of the import licensing system and the withdrawal of the Cash Compensatory Scheme for exports, which had been a major subsidy item on the federal budget.

On the industrial side, progress has also been gradual, but it began with a big bang. The centrepiece of reform was the drastic scaling back of the industrial licensing system for all but eighteen 'core' sectors, announced at the beginning of the reform process in 1991. By 1992 the system had been effectively dismantled. The government of India also opened up to the private sector industries that had previously been the sole preserve of state-owned enterprises. Combined with substantial relaxation of the Monopolies and Restrictive Trade Practices (MRTP) Act, which had severely restricted the activities of large business houses, industrial delicensing and dereservation resulted in a spurt of private sector investment and corporate restructuring. This increased business activity, in turn, led to further regulatory anomalies that (over time) necessitated additional reforms in policies relating to taxation, share markets, foreign joint ventures, and infrastructure.

The considerable liberalization of foreign direct investment and foreign portfolio investment began in the form of modification to the Foreign Exchange Regulation Act (FERA), 1974. It was subsequently revised on many occasions before a replacement was proposed, in the form of the far more liberal Foreign Exchange Management Act (FEMA). Like most other areas of reform, financial-sector liberalization has also occurred in a phased manner. Very early reforms included substantial lowering of the statutory liquidity ratio and the incremental cash reserve, instruments through which the government has access to the resources of commercial banks. Interest rates have, with important exceptions, been given relative freedom to seek their natural market levels. The government has also taken numerous steps to create the conditions under which deregulated financial markets could operate. For instance, after the post of Controller of Capital Issues was abolished in 1992–3, many reforms were introduced which strengthened the regulatory capacity of its successor, the Securities and Exchange Board of India (SEBI).

To many economists, a government's capacity to meet targets for reducing the fiscal deficit (measured as a percentage of GDP) is the *sine qua non* of true structural adjustment. The rise in India's fiscal deficit to 7.3 per cent of GDP in 1993–4 was often cited as a watershed, the Narasimha Rao government's first step on the slippery slope back to populism. Nevertheless, when measured over the longer term, the fiscal deficit as a percentage of GDP has come down significantly, and has certainly broken free from the escalating trend that was evident in the pre-reform period. When considered alongside the 1990–1 figure of 8.3 per cent (and growing), it is clear that India has made significant progress in the area of fiscal reform. While the government has consistently failed to meet IMF and World Bank targets for fiscal discipline, a fixation upon the fiscal deficit : GDP ratio is misleading, for it obscures many others of importance, such as substantial reductions in net bank credit to the government, the ratio of indirect to direct taxes, and the proportion of the budget devoted to non-interest expenditure.

One of the main scourges of the Indian economy, according to neo-liberal economists, is the prevalence of subsidies. And, indeed, subsidies are still ubiquitous. But while the two largest subsidy items —for food and fertilizer—have continued to rise, the growth in the overall subsidy burden of the central government has been arrested. Moreover, as a percentage of total central government expenditure, subsidies accounted for just 7.5 per cent in 1995–6, as opposed to 11 per cent in 1990–1. The share of subsidies in GDP was reduced from 3.5 per cent in 1990–1 to 2.8 per cent in 1995–6.[2]

Clearly, this type of summary of reforms is vulnerable to a critique of the 'glass-half-empty' variety (Datta-Chaudhuri 1996). This inexhaustive list is provided in the hope that the depth and diversity of reform measures, as well as an appreciation of their considerable secondary effects, will indicate the scope of what has taken place. This is important, because the main reason why such reforms were once considered unthinkable—why development was seen to be arrested, sacrificed at the altar of democracy—was that the Indian state was

[2] The data in this paragraph are drawn from an analysis of government budget documents performed by the Business Standard Research Bureau, with commentary from the EPW Foundation (Bombay). It was reported in the *Business Standard*, 12 Aug. 1996.

systemically averse to growth-enhancing change. It was viewed as a hostage to a coterie of powerful interests capable of preying on the short-termism of elected politicians, who were themselves among the main beneficiaries of the status quo (Bardhan 1984). Indeed, this stranglehold over the state was the predominant explanation given for why earlier attempts at reform in India (particularly in the early and mid-1980s) had come unhinged, before being abandoned by their initiators (Harriss 1987, Kohli 1989). To the extent that a substantial reorientation of economic policy has been achieved in the 1990s—one which has speeded development in terms of many important indicators—the 'enemy of change' vision of India's democratic state has been dispelled. The federal system played a large role in undermining the strength of those groups who had once been considered the system's main hostage-takers.

The federal political structure, which encompasses a range of institutions such as state and national legislatures, national finance and planning commissions, and inter-state co-ordinating bodies, is a defining feature of Indian democracy—one which is a clear response to the regional diversity of Indian civilization. The frequency with which identity-based politics asserts itself at the regional (or 'state') level invests Indian federalism with a substance not found in many putatively federal political systems, and provides an important decentralizing tendency that runs like a thread through politics since independence (Brass 1982).

And yet, the division of political labour between the centre and the states in independent India has been the subject of much political debate and almost as much academic theorizing. As the Congress Party has slowly lost its dominant position in Indian politics, a process which has been underway at least since the 1967 general election, tensions between national and provincial political forces have taken on an increasingly partisan character. Efforts to reverse this trend, such as the increasing abuse of the constitutional provision known as President's Rule to supersede state governments, have not been successful, and have arguably accelerated the deterioration in federal relations. It is also generally accepted that attempts by Congress prime ministers over the past twenty-five years to undercut up-and-coming Congress state chief ministers have, paradoxically, diminished the national party's ability to influence events in the states where Congress held power (Manor 1978, 1983). In recent years, the Congress has been reduced to a marginal force in electoral politics in important states like Uttar Pradesh, Bihar, and Tamil Nadu. Over the past decade it has usually governed fewer than half of India's twenty-five states, though under Prime Minister Narasimha Rao it presided over the national government during the crucial first five years of economic liberalization, from July 1991 until May 1996, after which the electorate replaced it with a coalition of left and regional parties which relied on Congress support to maintain its parliamentary majority. As this volume was going to press, the Hindu nationalist Bharatiya Janata Party (BJP), in alliance with several regional parties, had been in power for three months, following its victory in the general election of February 1998.

Often, state governments are viewed, by both Indians and foreign observers, as obstacles to coherent and effective implementation of policy reforms. The constitution's unclear division of powers in several areas where responsibility is meant to be exercised jointly by state and central governments (the 'concurrent list') leads to ceaseless attempts from both sides to grab power and abdicate responsibility. This is particularly rife when a state is controlled by a party different from the national governing party. It is also clear that the existence of multiple levels within the political system introduces the potential for administrative linkage problems to emerge. Policy directives formulated in New Delhi can become hopelessly distorted by the time they reach a state capital, let alone a district or subdistrict headquarters. Public resources—whether for productive activity or poverty alleviation—are vulnerable to illegal appropriation at the many decision points along the chain of political and bureaucratic command. The inefficiency inherent in this system was one of the stated reasons for reforming the economy by divesting the public sector of some of its responsibilities.

3. *How Federalism Contributes to the Political Sustainability of Economic Reform*

Despite the complications and uncertainties it introduces, India's federal political structure has been an extremely important ingredient in helping to make its economic reform programme politically sustainable—that is, in reducing the pressure on political decision-makers in the central government to abandon reform. This process operates through four stages of causally related action, each of which stems from the altered incentives facing important economic and political actors.

(a) *Inter-state disparities, inter-state rivalries*

The first, and most basic, advantage of a federal system to political managers in New Delhi is that the impact of liberal economic reform varies from state to state. Some states' economies benefit—from, for instance, employment growth, foreign investment, and more buoyant tax bases—while others do not. Politicians from states that benefit have fewer reasons to oppose the centre's reform programme. Those from states that suffer relative declines in economic performance (or autonomy in determining economic policy) have both less clout and fewer allies (among their counterparts in states that perceive themselves as beneficiaries) with which to mount a serious challenge to liberalization. Even among states that can be considered *net* losers—that is, when the balance of gains and losses from various policy changes are assessed—there is often little commonality in the *nature* of their grievances: almost all states have gained in at least some areas, and these small compensations tend to be jealously guarded. As a result, efforts to mount a campaign of resistance to reform from this crucial tier of the Indian political elite—a group that has long been considered hostile to market-oriented reform because of the threat liberalization represents to its powers of patronage (Kohli 1990)—have suffered from collective-action difficulties.

A good illustration of this problem was the reaction of state governments to the central government's approach to the 'freight equalization' scheme, a classic piece of statist industrial regulation which attempted to negate disparities in transport costs between India's regions. The scheme had long worked to the disadvantage of states in the eastern part of India. Successive chief ministers in the three main states in the eastern region—Bihar, West Bengal, and Orissa—had been decrying the unfairness of freight equalization for years. When, as part of its efforts to marketize the economy, the Narasimha Rao government announced the abolition of the scheme, all three states were governed by non-Congress parties who were officially critical of efforts to dismantle the regulatory state.[3] And yet, because of the popularity of the abandonment of the freight equalization scheme among interests within their states, three usually liberalization-bashing chief ministers found themselves politically constrained from opposing it.[4] Their self-interested acceptance of this policy shift not only dulled the edge of their public fulminations against other aspects of the central government's reform programme; it sent a signal to chief ministers in other regions that the prospects for a united front against liberalization would

[3] Orissa's Janata Dal government lost power to the Congress as a result of assembly elections held in late 1994.

[4] Buddhadeb Bhattacharjee, West Bengal's minister for information and cultural affairs, captured the dilemma facing state leaders when he stated: 'While we are opposed to the philosophy and approach of the Centre's New Economic Policy, we must take advantage of the withdrawal of the freight equalisation scheme and delicensing in regard to some major industries.' *Sunday*, 3–9 Apr. 1994: 68.

be fruitless in the face of chief ministers willing to cave in on particular reforms that suited their particular circumstances.

In time, the every-state-for-itself logic became an entrenched feature of political life. For instance, states which were in a position to take control over their natural resources as a result of new central policies had less reason to oppose liberalization in the mining sector, regardless of objections from their colleagues in non-mining states who claimed that such tacit approval lent further political credibility to the reform process as a whole.[5] With each state holding a soft spot for liberalization measures that worked to its advantage, co-ordinated resistance to the overall redirection of economic policy became extremely difficult.

Even in the one area in which virtually all states have fared poorly, the devolution of resources from the central government, the specific sources of forgone income varied from state to state. Moreover, some states were much better equipped than others to regain a part of the lost revenue by adapting to other aspects of the central government's liberalization policies. These sorts of adaptations further delink states' economic fates from one another—contributing to the pattern of provincial Darwinism alluded to above. In short, while discontent could be found among political elites in every state in India, there was no common *basis* for welding that discontent into a unified programme of opposition to reform. This worked (and continues to work) to the advantage of reformers in New Delhi, who would have found it far more difficult to implement efficiency-enhancing economic reforms in the face of co-ordinated resistance from state chief ministers and other subnational political elites.

The most overtly divisive area of reform has been liberalization of industrial policy. Under the 'licence-permit raj', business-location decisions were effectively taken by central planners in New Delhi. With the abolition of this system, both Indian and foreign capital have been freed to seek locations offering the best returns. Given the centre's reduced regulatory role, state governments have become a crucial point of contact for entrepreneurs keen to take advantage of many of the new reforms. State government agencies are where industrialists must go if they want environmental and labour clearances, water and electricity connections, land and zoning permits, and so on. This has set off an intense competition among state governments to attract investment, resulting in a proliferation of tax-incentive schemes and

[5] Among these states was Rajasthan. At a press conference announcing the state's 'New Mineral Policy 1994', Chief Minister Shekhawat openly thanked the Prime Minister for going out of his way to remove bottlenecks relating to environmental regulation so that Rajasthan could make the most of its natural resources. *Hindu*, 17 Aug. 1994.

promises of speedy administrative procedures, the expedition of land acquisition for industrial uses, and efforts to maintain a 'conducive' industrial-relations climate.

This sort of competition exacerbates the collective-action dilemmas facing state-level political elites (particularly non-Congress chief ministers) who would otherwise be inclined to band together in opposition to what, in more militant moments, they unsubtly refer to as the 'anti-people/pro-rich' policies of the central government.[6] The air of resignation surrounding the prospects for reversing the liberalizing tide reinforces the perceived need to get whatever share of the investment pie might be available. Since not every state will be materially better off (nor will every chief minister be politically better off), there is a strong element of confidence-trick politics at work in the political-management strategies of reformers in the central government. Creating a perception of reform's permanence is as important with respect to political actors, who will only take the go-along-to-get-along bait when convinced that resistance is futile, as it is with respect to economic agents, whose investment and consumption decisions are well known to be conditioned upon expectations of future policy scenarios (Rodrik 1990).

(*b*) *Novel opportunities for corruption among state-level political elites*

The new salience given to state governments in the industrial-development process contributed to reducing resistance to reform among state-level political elites (and thus to sustainable reform and, in turn, efficiency-related developmental performance enhancements in the economy as a whole) in a second way as well: through the allure of illicit income. If competition among states in a climate of fiscal retrenchment represented the stick imposed by the new policy dispensation, then the prospect of enhanced opportunities for corruption was the carrot. Given the investment boom, and the newfound demand for their 'investment-facilitation services', leaders of state governments had suddenly increased their earnings potential enormously.

This has taken many forms. One of the most important has been 'dereservation' of core infrastructure sectors. This is distinct from privatization and disinvestment in that it denotes not the selling of Public Sector Enterprises (PSEs), but the opening up to private sector investors of economic activities previously reserved for government

[6] During the early Narasimha Rao years, the discontent among state leaders was reportedly vented regularly at meetings between state-level party presidents and the Prime Minister—for instance on 23 Oct. 1992. This was considered a major threat to the political sustainability of the reform process. *Sunday*, 8–14 Nov. 1992: 14–15.

departments or PSEs. The keen interest expressed in infrastructure industries by well-funded multinational corporations, and the possibility of diverting illicit income to difficult-to-trace foreign currency bank accounts, has made dereservation one of the most important new sources of political funding. As one commentator has argued, 'rent-seeking—relentlessly objected to in the past in respect of the political-bureaucratic nexus of decision-makers by renowned expatriate Indian economists—is now practised more vigorously, more openly, with greater assurance (verging on arrogance) by private foreign capital in India' (Ghosh 1994: 13).

But the most noteworthy example of liberalization enhancing the prospects for deriving illegal funding is the case of land transactions. Over the years, politicians in various states have developed a variety of illegal means for profiting from land speculation. The registering of co-operative housing societies in the names of friends and relatives, for example, has provided privileged access to an extremely rare resource. Politicians have also employed criminal gangs to intimidate residents into abandoning their rights under heavily pro-tenant legislation, allowing them to obtain possession of and sell prime land in city centres. Special exemptions from local land-ceiling acts are another means by which real-estate developers with political connections can derive lucrative economic rents from projects such as suburban shopping centres.[7] These practices continue today,[8] as do others with an even longer tradition, such as tampering with village land records.[9] But they are considered relatively small time by those who have witnessed the scramble to manipulate the process of acquiring land for private sector industrial and infrastructure projects. Indeed, this area has emerged as one of the primary avenues through which state-level politicians have been able to benefit financially from the process of liberalization.[10]

[7] The 'Baldev Plaza affair' in Rajasthan, dating from the early 1980s but still the source of much controversy, involved such a mechanism, allegedly benefiting the son of prominent Congress MP Ram Niwas Mirdha. *Frontline*, 9 Oct. 1992: 133.

[8] An investigatory committee in Madhya Pradesh, for instance, identified several anomalies in land deals in Mandsaur district which allegedly benefited the brother of former BJP chief minister Sunderlal Patwa. *Asian Age*, 27 Feb. 1995.

[9] For instance, several cases involving the nephew of the Rajasthan chief minister have been documented by opposition politicians and have figured prominently in assembly debates. These cases are cited in page 3 of a letter from Surendra Vyas, MLA, to Home Minister S. B. Chavan, dated Oct. 1992, requesting the government of India to withhold its assent to the Rajasthan Tenancy (2nd Amendment) Bill 1992, passed by the Rajasthan Legislature on 26 Sept. 1992. See also *Observer of Business and Politics*, 18 Mar. 1994.

[10] Interviews with a senior IAS officer in the West Bengal government, 27 Apr. 1995, Calcutta; a member of the Rajasthan BJP, 9 Dec. 1993, Jaipur; an opposition MLA from Karnataka, 23 Mar. 1994, Bangalore; and a dissident member of the Maharashtra cabinet, 5 Apr. 1994, Bombay.

The standard practice by which politicians benefit from land transactions for infrastructure projects is to use the state government's official land-acquisition procedures, which commonly involve a tribunal consisting of MLAs elected from the region, local politicians, and district bureaucrats.[11] The tribunal offers landowners either nominal compensation, or if politicians are worried about electoral implications in that constituency, prices above the market rate, with a 'commission' then going to one or more local politicians and bureaucrats. Often, the senior politicians involved arrange for friends or relatives to buy back the land from the state at a later stage when the project finds that it has 'surplus' land. Bought for the same price at which it was sold, this land is then more valuable because of the commercial potential stemming from its proximity to the venture in question.

Delicensing and dereservation has led to a large increase in the number of project proposals, and it is the power that the legal system gives elected officials to deliver land to promoters of private industrial projects that they regard as the biggest benefit of liberalization. One particularly egregious example is Reliance Petroleum's use of 'dubious means and underhanded tactics', with the alleged help of political patrons, to acquire 4,000 acres of land in Gujarat needed for a refinery project (*Indian Express*, 8 Oct. 1993). But virtually any firm contemplating a new facility requires the assistance of the relevant state government. Subsequent to the announcement of the state's industrial policy in 1993, for instance, the Maharashtra Industrial Development Corporation (MIDC) acquired more than 30,000 hectares of land, with plans to acquire an additional 28,000 hectares over the next three years (*Observer of Business and Politics*, 25 Mar. 1994). This was in anticipation of investment flows, and in response to more liberal guidelines. In the name of promoting market-led industrialization, MIDC has been allowed to acquire land for purposes other than setting up its own government-operated industrial estates.[12] As a 'facilitator' in the process of providing the necessary inputs for investors, it has been permitted to acquire land for private entrepreneurs. In at least four cases, the entrepreneurs involved had ties to the ruling Congress Party, which left power when it was defeated at the polls in 1995. Their intention, not to mention capacity, to establish functioning

[11] This process was described to the author in interviews with a middle-ranking bureaucrat in the Rajasthan land-revenue bureaucracy, 19 Nov. 1993, Jaipur; the president of an agro-processing firm in Rajasthan, 12 Nov. 1993, Jaipur; an expert on agro-processing business practices for a major Indian consulting firm, 4 Feb. 1994, Bombay; and by a Congress MLA from Rajasthan, 22 Apr. 1994, Jaipur.

[12] The land acquisition process, especially the issue of compensation to farmers, has been the subject of much discussion in the state legislature. See, for instance, *Observer of Business and Politics*, 31 Mar. 1994.

business ventures was open to serious question.[13] The lucrative possibilities continued to increase as various arms of the Maharashtra government became more active in land-related activities[14]—a process which has continued under the coalition of Hindu nationalist parties which succeeded Congress.

Two additional points need to be made about the new opportunities created by the liberalizing environment. First, the very same inter-state competition which undermined the structural cohesiveness of the anti-reform lobby among state-level political elites should also, in theory, provide a systemic check on the ability of ministers in state governments to derive illegal income from their suddenly pivotal positions. The competition to create an investor-friendly climate should penalize states that impose heavy 'corruption taxes' on businesses. In fact, this has not been the case. Some states, such as the industrial powerhouses of Maharashtra and Gujarat, began the race for investment pre-eminence with such an advantage in terms of human and physical infrastructure that any implicit threats by entrepreneurs to take their projects elsewhere were relatively empty. This may be changing,* but in the early phases of reform, when the perceptions of state-level elites are crucial to political sustainability, this was not the case. Just as a World Bank research report found that competition for investment among Indian states did not lead to a race to lower environmental standards—that is, lowering them did not attract investment, controlling for other factors affecting business decisions (Mani et al. 1997)—levels of corruption among state-level politicians have been similarly unaffected by competitive pressures.

The second point concerns changes in the way in which the corruption pie is shared between the central and state levels of India's political system. One prominent feature of the transition towards a greater reliance on markets has been, paradoxically, the emergence of new means of profiteering and patronage for *national* politicians. In particular, the new sources of corrupt income provided by foreign capital have, as Pranab Bardhan had predicted in the mid-1980s, reduced the reliance of national elites on domestic business interests for funding political activities (1988: 224). This helps to explain why national politicians were willing to relax investment policies in ways which gave *state*

[13] Interviews with two local journalists with intimate knowledge of Congress politics, 31 Mar. 1994 and 11 Apr. 1995, Bombay.

[14] For instance, the development commissioner (industries) announced in early April 1994 the acquisition of 250 hectares for each of three export processing zones in Pune, Aurangabad, and Nagpur; 500 hectares for a software technology park in Pune; and 350 hectares for a hotel-convention centre in Bombay. *Observer of Business and Politics*, 6 Apr. 1994.

* During 1996 until early 1998, Tamil Nadu managed to steal away a number of high-profile proposed investment projects from Maharashtra, including a Ford motor factory.

governments new responsibilities, in the process providing the politicians that run them with access to new resources.

(c) *States as the central government's accomplices in the political management of interest-group resistance to economic reform*

This brings us to the third aspect of federalism which assists the sustainability of economic reform: its tendency to disperse the political energies of economic interests, as opposed to political elites, by forcing them to battle in twenty-six states rather than in just one unitary political authority at the national level. The result is a significant fragmentation among certain interests along regional lines. This often reduces their political potency. Quarantined within individual states, where they are often less effective to begin with (Weiner 1989: 36), many socio-economic interests find it difficult effectively to influence policy. The issues that concern them have tended to get bound up with the day-to-day political mudslinging of state politics, further reducing their potency, and making the maintenance of a co-ordinated national lobbying effort even more difficult.

What needs to be emphasized is that the tendency for central government policy reforms to have different impacts in different states has affected not only the incentives and collective-action prospects facing state-level politicians, but also the way in which socio-economic interests respond to economic reform.

Moreover, liberalization is increasingly implemented in the form of successive micro-reforms in different states, at different times, and under different political circumstances. This combination means that the political impact of economic reform is refracted through the prism of federal India. This results in a slower pace than many proponents of reform would prefer. But it also helps to blunt the edge of opposition. Efforts to mount co-ordinated political resistance to one or another reform tend to become severely dissipated in such a fragmented environment.

One of the main assets of the Indian political system on which reformers in the central government rely is the political-management capacity of state-level governments. The existence of functional competitive arenas at various levels of the political system helps to spread the burden of conflict resolution over a broader institutional base. The political pressure facing reformers at the apex of the political system is reduced in proportion to the capacity of state governments, acting as the first line of political defence, to outmanœuvre and/or reach agreements with interests which might be aggrieved by either central- or state-level policy reforms.

The example of the trade union response to economic reform provides a useful illustration of the way in which the actions of state governments help to sap the political potency of interest groups. With state governments, in the words of one labour activist, 'doing the centre's dirty work', the resources of trade unions have been spread thin.[15] They have been unable to respond to the many trespasses upon labour's collective interests that have occurred in isolated incidents in different states.

These have taken various forms. For instance, invoking the Industrial Disputes Act of 1947, the Maharashtra government declared the products of four companies 'essential' public-utility items, thus making them immune to strike action (*India Today*, 15 Apr. 1994: 97). Chief Minister Sharad Pawar also worked assiduously to effect splits in various powerful unions.[16] And despite laws forbidding firms from dismissing workers, many chronically loss-making companies have simply locked their factory gates as elected state governments looked the other way, preferring to let this practice proceed quietly. Representatives of a workers' rights organization which held a rally in Bombay in January 1994 stated that more than 20,000 workers had lost jobs in the Bombay area alone due to the failure of the Maharashtra government to prevent the closing of factories.[17] Labour disputes were often used as a pretext for effecting an 'indefinite lockout'. By failing to pay water and electricity bills, employers who find their enterprises no longer profitable—or who would like to start up business with a docile workforce made up of contract labourers—thus invite a 'de facto closure, obviating the necessary legal permission from the government under section 25 of the Industrial Disputes Act' (Bidwai 1994).

Union leaders argue that while they have shown flexibility by toning down labour stridency, 'management militancy' has been on the rise, abetted by state governments. This is borne out by the statistics: while the number of person-days lost because of strikes decreased almost by half, from 12.43 million in 1991 to 6.6 million in 1994, the

[15] Interview with a trade union activist and writer, 11 Sept. 1996, Bombay. The involvement of state governments in this process, rather than the central government acting alone, was considered politically effective because it was 'like the police interrogating suspects individually, and working them over one at a time'.

[16] He played a role in the exit of former MLA Sharad Khatu, along with four other central committee members of the Maharashtra General Kamgar Union, controlled by independent trade unionist Datta Samant, in late 1993, as well as the earlier departure of T. S. Bhokade, once a trusted lieutenant. Interview with Datta Samant, 26 Mar. 1994, Bombay, and with an independent labour activist, 29 Jan. 1994. See also *Business India*, 27 Sept.–10 Oct. 1993: 23.

[17] Interview with two organizers of the Bandh Karkhana Samgharsha Samiti, 24 Jan. 1994, Bombay.

number lost due to management lockouts actually increased over the same period (*Business World*, 7–20 Feb. 1996: 114).

Because such tactics have been used only sporadically—under diverse circumstances in different states—and because of the preoccupation of national trade union federations with national labour reform (the much-talked-about 'exit policy'), local unions have had fewer financial and organizational resources with which to oppose state government actions and inactions.[18] The result is that the trade union movement—already fragmented on the basis of party affiliation and the public–private sector divide—is becoming more regionally fragmented as well.[19] The ability of federalism to weaken interest groups by quarantining them within state-level political systems is of immense value to reformers in New Delhi, who would like to see the strength of the trade union movement reduced before embarking on major national legislative reform.[20] Governments in many, though not all, states possess the capacities needed to accomplish this task without fomenting levels of dissent that can threaten their own survival.

(*d*) *Undercutting anti-reform dissidence among national opposition parties*

Many non-Congress state governments, in response to both the pressures of competition and the new sources of rent-seeking thrown up by liberalization, eventually 'fell into line with liberalization'.[21] This complicity not only helps to provide greater depth to the technical aspects of the reform agenda, it also makes the process more politically sustainable.

The reform measures enacted by non-Congress state governments undermine the heated anti-reform rhetoric emanating from their

[18] For instance, the Orissa government's crushing of a strike among workers at the state electricity board, which was backed by the All-India Trade Union Congress (*Frontline*, 14 Jan. 1994: 23). The Maharashtra state police were alleged to have tortured striking workers at automotive manufacturer Mahindra and Mahindra (*Independent* (Bombay), 8 Sept. 1994).

[19] The involvement of state governments as brokers often results in workers in one state reaching agreement with employers, thus undercutting the union's representatives at a location of the same company in a different state. This happened in the case of Philips India. See *Observer of Business and Politics*, 3 Sept. 1996.

[20] Interview with an ILO official who has held extensive consultations with members of government, industry, and labour, 6 Sept. 1996, New Delhi.

[21] This expression is often used in India—for instance, with reference to the actions of the Janata Dal chief minister of Bihar (Laloo Prasad Yadav) and the Shiv Sena chief minister of Maharashtra (Manohar Joshi), *Financial Express*, 27 Apr. 1995.

parties' MPs in the national Parliament.[22] Finance Minister Manmohan Singh was able to deflect opposition parties' criticism of the government's accession to the 1994 GATT agreement, including the creation of the World Trade Organization, by claiming that it was a decision around which consensus had formed in India:

> Economic reforms are no more an object of contention among political parties. This is evident from their manifestos and speeches of various leaders, and more so from the recent industrial policy statement of the left-ruled West Bengal which is virtually an endorsement of the Centre's policy. (*Economic Times*, 22 Nov. 1994)

A year later, in West Bengal, the Communist Party of India (Marxist)-ruled government's embrace of market-oriented reform was even more highly visible. The CPI (M)'s parliamentary leader, Somnath Chatterjee, was greeted with derisive laughter from all sides when he launched a broadside on the floor of Parliament against 'the [central] government's total surrender to the IMF and World Bank' (*Hindustan Times*, 27 Apr. 1995). Parliamentary debates generally have little influence over policy, but when well orchestrated they can help to frame public debates in advantageous ways for groups that are out of power. To the extent that discrepancies between national rhetoric and state-level reality undermine this, they are a blow to opposition efforts on economic policy.

Federalism provides political shelter for politicians operating at all levels of the political system. Reluctant reformers at the state level are able to claim that actions taken by the central government leave them no option but to liberalize. And when state governments liberalize under duress, reformers in the central government (or their party colleagues in state capitals) are then able to declare that consensus has been reached. The chief minister of Rajasthan stated in 1994 that the state's new mining policy, which was significantly more liberal towards the private sector, was a matter of necessity: 'the new economic policies being pursued by the centre had left the states to fend for themselves' (*Hindu*, 17 Aug. 1994). These and other liberalizing moves were rejected as 'sheer hypocrisy' by the Rajasthan Congress president, Paras Ram Maderna: 'It is shocking that while the state BJP leadership charges the Centre with taking loans from world bodies, burdening the nation with debts, it is itself securing huge loans running into thousands of crores [tens of billions] from international agencies.' Maderna's words were picked up by Congress MPs from the state and used to blunt the edge of anti-reform criticism pouring forth on the floor of Parliament from BJP MPs (*Rashtriya Sahara*, Apr. 1994: 47).

[22] A leaked memo from BJP national executive committee member and economic adviser Jay Dubashi to party president L. K. Advani admitted as much. The damage-control efforts of the party's spokeswoman only revealed further divisions within the party. *Economic Times*, 18 Jan. 1994.

4. *Federalism, Political-Management Tactics, and Developmental Equity*

Many of the same dynamics which made federalism a useful institutional form for breaking down resistance to reform—by 'parochializing' the concerns and actions of both political elites and economic agents—possess negative implications for the equity side of the developmental equation. Again, this does not demonstrate, in general, a positive correlation between the extent of federalism and the extent of inequality. The concern here is with a particular, though important, moment within the development process: the effort to sustain market-oriented economic reform in the face of political obstacles. In attempting to achieve this, reformers in India's central government passed much of the burden onto state governments, deriving significant political benefits for themselves in the process. Unloading thankless responsibilities onto others is part of the time-honoured tactic of shifting blame, one not confined to developing countries: it was a successful tactic for both Reagan and Thatcher in the pursuit of their policy objectives (Pierson 1995). An idealized notion of democracy should not blind us to its pervasiveness in the process of promoting policy change in democratic India. The *conflictual* nature of federalism, as we have seen, provided some of the tools with which accomplished buck-passers in the central government were able to generate competition as a way of furthering their preferred agenda.

While the central government's tactics concealed the extent to which, for instance, the costs of fiscal adjustment were passed on to state governments, they also conceal the great variance in the inclination or ability of states to pass these costs on to the poor. In other words, while it is not clear that the poor are worse off nationally as a result of economic reform—i.e. that national income-group inequality has increased—it is nevertheless true that poorer groups have been less cushioned from adjustment's shocks in some states than they have been elsewhere. The existence of federal institutions, therefore, influences the *pattern* of inequality from region to region in so far as state-level political elites pursue customized strategies to cope with the opportunities and constraints furnished by the new policy environment. This is quite distinct from the extent to which states are unequally affected by liberalization in its politically unmediated form, and will form the basis of what follows.

The response of state governments to the centre's approach to containing the food-subsidy bill reveals the extent to which federalism helps to mask expedient but inequitable means for passing the cost of adjustment on to the most vulnerable sections of society. The government has loudly trumpeted its steadfast refusal to comply with World Bank recommendations that it drastically curtail the public distribution system (PDS), through which rice, wheat, sugar, kerosene, and other essential commodities are sold at subsidized prices to 'ration card' holders. National leaders are able to portray this as a determined stand against attempts to undermine its sovereignty.[23] It is held up as proof of their continued commitment to India's poor and downtrodden. Government officials make frequent mention of the fact that the budgetary allocation for the food subsidy has risen steadily in the years since liberalization began.

What this conceals, however, is that even this increased budgetary allocation for the food subsidy has not been sufficient to offset the steep rise in government support prices offered to cultivators of wheat and rice. As a result, poor consumers have been forced to pay far higher prices. The fact is that it would have required *even higher* increases in the level of budgetary support in order to stabilize the price at which grains are sold in the PDS's 'fair-price shops'. While 'increasing the level of budgetary support' for the PDS, the government has nevertheless made essential commodities more expensive for the poorest of the poor. Through a deft display of political legerdemain, it has transferred a substantial portion of the subsidy from consumers to farmers. This was deemed necessary to compensate for the government's failure to take other measures demanded by farmers. It therefore offered massive 'price incentives' to farmers, while recouping as much of this outlay as possible from those who rely on subsidized foodgrains, the poor. While maintaining the appearance of continuity (continued, though slower, growth in food-subsidy outlays), the government effected a dramatic change (massive increases in the prices at which consumers bought them through the PDS). The rise in the prices at which foodgrains are sold through the PDS tended to lessen the distance between the 'subsidized' and market prices, leading to a very large

[23] In order to quell speculation that India was considering the abolition of food subsidies in response to international pressure, Civil Supplies and Public Distribution Minister A. K. Anthony told a press conference: 'Whatever may be the constraints, there is no question of reducing or abandoning the food subsidy because food security is as important as national security, if not more.' *Asian Age*, 9 July 1994.

decline in consumption through the PDS, from 20.8 million tonnes in 1990 to 14 million tonnes in 1994.

But how has the cost of this political sleight-of-hand been apportioned? Would not the large numbers of poor people reliant on the PDS for cheap foodgrains and other essential commodities revolt? The answer is that it depends on how assertive these groups are, which is in turn closely related to the region in which they live. One reason the central government was able to get away with such sins of omission stems from the federal structuring of political authority: it is, after all, state governments, acting as the first line of political defence, that must face the irate public. S. Guhan has argued that, compared to the central government,

> States are much closer to the electorate and also much more vulnerable to instability. . . . The States are responsible for much that affects the daily lives of people. . . . [T]hese several activities that lie at the cutting edge of administration expose State governments more intimately and continually to popular demands, conflicting pressures, and diverse local grievances. (1995: 101)

Electorates vent their frustrations at the most accessible level of government, not necessarily the one most responsible for their problems. The laying of blame is a political process, one that by no means follows strict rationality. Tactics matter, as the Republican-controlled US Congress learned when it lost the battle of public opinion against President Clinton over which arm of government was responsible for shutting down essential services during a prolonged deficit-reduction standoff in 1995. Faced with protests, and the futility of blaming New Delhi, many state governments in India felt compelled to substitute their own food subsidies to compensate for some of what the central government had withdrawn. The most notable example was the highly expensive Rs. 2 per kilogram rice scheme in Andhra Pradesh, which emerged as a result of a campaign promise during the 1994 assembly elections. In that case, not only was the newly installed non-Congress state government forced to clean up the mess created by the central government's PDS price increases, it was also blamed by the Congress for its lack of fiscal prudence when it had done so.

Andhra Pradesh had the most expensive subsidy scheme, but others took similar actions, and for similar reasons. In Karnataka the Congress government of Veerappa Moily in 1994 reduced the prices at which PDS outlets in the state sold rice and wheat. This cost the state's exchequer Rs. 420 million. As a newspaper editorial noted:

> The decision to reduce the end prices of grains also represents the additional financial burden that the States are forced to carry on account of the Centre's fiscal stabilisation programme. While the Centre raised issue prices

to contain food subsidies, Mr. Moily reduced it to ensure demand among the weaker sections. (*Deccan Herald*, 24 Mar. 1994)

As the central government continued its withdrawal from the PDS, Moily's non-Congress successor as chief minister felt compelled to extend the state-level subsidized rice scheme, at a cost of Rs. 2.2 billion per year, more than five times the amount Moily was willing to commit. In 1995, he announced that the scheme would be extended to urban consumers (*Pioneer*, 18 Oct. 1995).

If we recognize that only *some* states found it necessary to cushion the blow of the central government's PDS price rises, it is possible to gain an even greater perspective on the extent to which federalism not only allows state governments to tackle resistance to reform among powerful interests, but also assists in isolating geographically defined sections of the poor in arenas in which they are less capable of defending their interests. The politically unpalatable consequences of the central government's reform-management legerdemain are masked by federal institutions.

In practice, the distribution of public resources thus takes a *politically* more efficient form: it apportions the price rises in accordance with regional, rather than national, thresholds at which such hardships translate into widespread political discontent. After all, poorer groups are not as politically assertive in Rajasthan and Orissa as they are in Karnataka and Andhra Pradesh. In this sense, it is valid to ask, as Mick Moore's study of the politics of adjustment in Sri Lanka did, whether one unintended consequence of how liberalization has been implemented in India has been to 'remedy an historic "weakness" of the . . . political system: the relatively indiscriminate and inefficient distribution of relatively large volumes of material patronage such that they purchase little lasting support for the party in power' (1990: 352).

Inequalities, in so far as they are exacerbated or simply reconstituted, are not the consequence of federalism *per se*, but of the incentives it creates in the context of economic adjustment—that is, for governing elites at the national level to pass to their state-level counterparts a package of carrots (opportunities for corruption) and sticks (responsibility for filling gaps in social spending and tackling interest-group responses to reform); and for state-level governing elites to respond to their newfound dilemmas by, in many instances, passing whatever costs they can to the poorest groups. This is often the result of several interlocking trade-offs.

Some states, for instance, have been able to compensate for losses to centrally devolved revenue by taxing economic activities within their jurisdictions that have been rejuvenated as a result of other aspects

of the central government's reform programme. One example is the government of India's gradual reform of the coffee-marketing system. In 1992, coffee growers were for the first time permitted to sell 30 per cent of their crop in the open market, having previously been required to sell to the government-controlled Coffee Board at what were usually below-market rates. In 1993 the Free Sale Quota was increased to 50 per cent. In April 1995, in a long-anticipated move, all obligations to the Coffee Board were removed for 'small growers' (those with landholdings of less than 10 hectares). In need of new sources of revenue, states with substantial coffee-growing operations began to cast an avaricious eye towards coffee growers who had received 'windfall' profits. The Karnataka government, for instance, was able to raise resources in this way, justifying the new tax by saying that the coffee growers who had benefited should be prepared to contribute resources for the welfare of the poor (*Hindu*, 18 Apr. 1995).

In fact, the true victims of this policy were not the members of the well-organized 'coffee lobby'. The tax increase was just one part of a complex political understanding, arranged through informal networks connecting leaders from three different parties, which resulted in unofficial permission for large-scale coffee growers to encroach on lands nominally designated for extremely poor and vulnerable 'scheduled-caste' (or ex-untouchable) groups.[24] The log-rolling of favours-for-concessions transactions ended with the poor, and at the kind of localized level that only a state government could manage with any degree of effectiveness. When considered alongside the type of unsavoury tactics used by state governments to undercut the resistance of labour unions to economic reform, it becomes apparent that the intervention of state governments in the politics of reform—a form of involvement on which reformers in the central government rely—serves to shift burdens to poorer groups, but (crucially) in ways that vary from region to region.

5. Conclusion

The reliance of national political elites on the ability of federalism to create intra-state rivalries capable of dampening resistance to their policy agenda, and on state-level political systems to reduce interest-group potency, has generated a new set of political forces. The regionalization of Indian politics that the outcome of the 1998 general

[24] Interview with one of the party leaders involved in this process, 19 Apr. 1995, Bangalore.

elections seems to have confirmed cannot be ascribed solely, or even primarily, to political trends associated with liberalization. But it has certainly been reinforced by them (Jenkins 1996: 511–15, Jenkins 1998). This is perhaps the most lasting contribution of federalism to the sustainability of efficiency-enhancing economic reform. It bears a striking resemblance to the dynamic described by the authors of the study on market-preserving federalism in China: 'These changes [in the relations between central and provincial political authority] endow the economic reforms with a degree of political durability. Each serves to raise the costs of a recentralization of political authority and an economic retrenchment' (Montinola et al. 1995: 72–3). Indian federalism, in other words, may have more market-preserving features than theorists, operating within the confines of their self-devised modelling parameters, are capable of recognizing.

This chapter has not claimed that federal politics is the missing institutional link between democracy and positive developmental performance. However, its analysis of the ways in which this particular institutional variant of democracy can affect the evolution of economic policy—and thus development performance in terms of both efficiency and equity—highlights the desperate need for detailed studies of how individual democracies function in practice. These are required in order to aid our understanding of the extent to which institutional differences among democracies can explain variations in the success of achieving what are widely considered desirable policy shifts. There are many additional features of India's social, political, and economic life that influenced the direction of policy change, and indeed shaped the nature and functionality of the federal system itself. This is surely true of other countries as well. But in seeking to understand the factors which inhibit or promote policy change, and those which influence the developmental impact of such changes, analysts must pay careful attention to the way in which the distribution of authority among levels of a political system can alter the terrain upon which political battles are waged.

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7

Democratic Institutions and Development in Post-apartheid South Africa

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In the last years of apartheid South Africa was distinguished not only by a political system based on racial discrimination against the majority of the population, but also by a very high level of economic inequality. Extensive poverty existed amidst considerable wealth. The open, democratic general election of April 1994 marked the achievement of representative democracy—and transferred responsibility for development to the new, democratically elected government. The developmental challenge facing the new democracy is twofold: to bring about sustainable growth and to facilitate redistribution—in part through job creation, and in part through the redirection of state expenditure. Both goals require an efficient and appropriate institutional framework to succeed.

In the 1990s, as White points out, the orthodox view of development is that 'development can best be promoted through a market-friendly state presiding over a predominantly capitalist economy operating within the political "shell" of a liberal democratic polity' (1995: 27). In the 'new' South Africa a commitment to this orthodoxy is widespread among political and economic elites. In practice, however, the political 'shell' of a liberal democratic polity can be filled with a wide range of different institutions, and the precise character of each set of institutions has very important consequences for both growth and redistribution.

A key feature of liberal democratic polities is the dispersion of authority between different state institutions. In South Africa, historical and political considerations have accentuated this dispersion. In this chapter we examine the implications for development of the relationships between key institutions: between different government departments, between parliamentary and corporatist modes of representation, and between central and provincial government (paying