

2 Reflections on Indian Political Economy

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On the 1984 book around which this chapter is organized, I have noticed over the years a remarkable asymmetry in its reception among mainstream economists as opposed to others.¹ It has received nothing but benign neglect from the former group. I am pretty sure most of my colleagues in the major economics departments in the United States of America have never heard of this book, even though many of them may be aware of my more technical articles in journals. Looking back, I have sometimes thought that maybe it would have attracted more attention from economists if I published in the book the background theoretical notes I had for a couple of its main messages. One such message was about the difficulty of organizing collective action towards long-term common economic goals such as encouraging public investment in infrastructure, a key ingredient of economic growth, in a country where even the elite is fragmented and finds it difficult

¹ This is a revised version of the text of the opening keynote lecture I gave at a conference at All Souls College, Oxford, United Kingdom, to mark the 30th anniversary of the publication of my book *The Political Economy of Development in India*, which was originally presented as the Radhakrishnan Lectures at that college in 1983. The text was originally published in the *Economic and Political Weekly* on 2 May 2015.

to get its act together in doing something that would have benefited most of its members. With this failure of collective action, the public surplus is often frittered away in short-term subsidies and handouts. Since writing this book, I have elsewhere² elaborated on my theoretical ideas on the adverse effect of social heterogeneity and inequality on collective action, not just on matters of macroeconomic growth but also in the microeconomic issues of management of local commons. The other message (which even non-economists have not paid much attention to) enunciated in the last chapter of the book, for which I had some unpublished theoretical notes, was how the same elite fragmentation that acts as a constraint on economic growth can work as a safeguard for the resilience of democracy in India, where the divided groups may agree on the procedures of democracy as a means of keeping one another within some bounds of moderation in their transactional negotiations.³

In this short chapter, I shall first reflect on how the collective action issue for long-term growth that I had identified more than three decades ago remains acute even today in India. Then I move onto a few of the structural issues, not considered in the 1984 book, that have become prominent in recent years.

I think it is relatively easy to see that the economic growth fundamentals for India are potentially quite strong (stronger than it seemed in 1984):

- Domestic saving and investment rates are relatively high for a poor country.
- After the opening of the Indian economy, the alacrity with which part of hitherto protected Indian business adapted to the demands of global competition and thrived suggests a remarkable adaptability.
- Vigorous entrepreneurial spirit in all corners of the economy has been rejuvenated by the infusion of business entries from hitherto subordinate castes and regional capitalists.

² See, for example, Bardhan (2005).

³ For a recent game-theoretic model of intra-elite conflicts and democracy on broadly related lines, see Ghosal and Eugenio (2009).

- The majority of the population is quite young, thus creating the potential of a large and productive young work force.
- With better transport and communication (particularly with the remarkably fast spread of mobile phones), connectivity is increasing in a way that is likely to speed up enhancement of productivity.

But there are major structural and institutional problems blocking the full realization of these strong growth fundamentals.

- (1) While the business dynamism in the private corporate sector (and the part of the informal economy linked with it in supplier relationships) has been impressive since the reform process started, the physical infrastructure (roads, electricity, ports, railways, and so on) to sustain it remains weak. Particularly in the last few years of stagnant exports and domestic private investment, public investment in infrastructure has again become crucial. But public budgets laden with heavy subsidies, salaries, and debt servicing have very little left for infrastructure investment, leading to increasing frequency of public–private partnerships on infrastructure. But these have often been saddled with problems of mismanagement, too high debt–equity ratios, opportunistic renegotiation, non-transparent regulations, corruption, and now a mountain of bad loans on the books of public banks. In addition, caught in the crossfire between corporate lobbies on the one hand and social activists and the judiciary on the other, official land and environmental clearances for infrastructure projects have become extremely slow, non-transparent, or erratic (lurching from one side to the other in different regimes) in recent years.
- (2) Secondary education is a minimum qualification for many good non-farm jobs, and yet the children from poor families overwhelmingly drop out before entering or completing secondary schools on account of economic and, particularly in the case of girls, also social compulsions.
- (3) The average quality of school and college education is not sufficient for employable skills for many, even for some manual jobs. The provisions for vocational training and skill formation along with connections with potential employers, particularly for rural youths, are extremely deficient. In a so-called ‘labour-surplus’

country, there is now a serious shortage of employable labour in many factories and other enterprises.

- (4) Despite the robust economic growth of recent years, a major social and organizational failure, almost at a disastrous level, over many decades has been in matters of public health and sanitation, where India lags behind even some African countries.⁴ Building more toilets has not yet resolved the problem of why they remain underutilized. Poor public health and sanitation continue to keep the Indian disease burden high and productivity of workers low.
- (5) Environmental degradation has been a major drag on net economic growth. It has been reported in the 2014 United Nations Development Programme (UNDP) *Human Development Report* that the annual depletion in natural resources (depreciation of 'natural' capital) in India as a proportion of national income (conventionally measured) is nearing 5 per cent per year (not very different from the growth rate in national income in recent years), compared to 3.6 per cent for Brazil and 0.1 per cent for Costa Rica.⁵ It has been assessed by the World Health Organization that of the 20 most air-polluted cities in the world, 13 are in India. (Indoor and outdoor) air pollution kills an estimated 1.6 million people every year.

All of the above—infrastructure, education, public health and sanitation, and the environment—involve the governance effectiveness issue with respect to delivery of key public goods and services, which is rather low in India, and, of course, varies a great deal between different states. A recent ranking by Mundle et al. (2012) of 17 major Indian states in terms of a composite score for quality of governance (taking into account delivery of infrastructure, social and judicial services, fiscal performance, law and order, and quality of legislators) suggests,

⁴ According to the *Human Development Report* of the UNDP, the deaths of children under age 5 due to unsafe water, unimproved sanitation, or poor hygiene per hundred thousand children numbered 316 in India in 2004, whereas the number was 255 in Sudan, 256 in Zimbabwe, and 286 in Gambia.

⁵ A recent book edited by Mani (2014) estimates that in 2009 the cost of environmental degradation in India came to 5.7 per cent of gross domestic product (GDP).

unsurprisingly, that the six states that occupy the top ranks, across alternative rules of weighting the different indices, are Andhra Pradesh, Gujarat, Haryana, Kerala, Punjab, and Tamil Nadu; the bottom ranks are largely occupied by seven states: Assam, Bihar, Jharkhand, Madhya Pradesh, Uttar Pradesh, and West Bengal.

Governance ineffectiveness is often regarded as a lack of state capacity, which many point to as India's major failing. While it is true that the bureaucracy is often inept or corrupt or simply truant (apart from the large numbers of continuing vacancies in police, judiciary, and bureaucracy), it is equally important to keep in mind that state capacity is sometimes weak not necessarily because of a dearth of capable people but because of a systemic impasse.

Extraordinary state capacity may be observed in some episodic matters, for example, in organizing the complex logistics of the world's largest election, the world's second-largest census, and some of the world's largest religious festivals. But extraordinarily poor state capacity is displayed in, for example, some regular essential activities like cost-effective pricing and distribution of electricity—the key input for the economy. There exist regular under-recovery of costs, erratic supply, and anaemic investment in electricity caused not so much by an inherent lack of administrative capacity but more by factors relating to complicity in a sinister political nexus of populist pressures and outright theft. Min and Golden (2014) provide evidence that in Uttar Pradesh, the largest state, transmission losses in electricity from public distribution utilities go up sharply before the state assembly elections. Similarly, much of the police and bureaucracy are highly politicized and often deliberately incapacitated to be subservient to the ruling political party. Corruption in India is often more dysfunctional than in, say, the more politically centralized countries of East Asia, primarily because it is fragmented with no encompassing centralizing entity internalizing the distortions ('negative externalities') of each act of corruption.⁶

The apparent lack of state capacity may be more a symptom of the underlying difficulty of organizing collective action (or collectively working out a political or 'social pact') in India, a problem exacerbated by its large heterogeneous population, fragmented polity, and extreme social and economic inequality. In such a context, commitments on the

⁶ For an analytical discussion of this issue, see Bardhan (2005: Chapter 8).

part of the state are often not credible and, anticipating that, different interest and identity groups agitate and settle for short-run patronage and subsidies.

This brings me back to the main theme of the difficulty of collective action emphasized in the 1984 book.

Since 1984, the population has increased considerably both in size and the diversity of now-assertive groups. The polity is more fragmented.⁷ While social inequality may be on a slow decline, economic inequality has almost certainly increased.⁸ Thus, by and large, the consequent problems for collective action may have become more severe, and the rare absolute majority of the ruling party and the apparent centralization of power in the Prime Minister's Office under the new regime has not made much of a difference in the policy implementation stage, despite all the hype. ~~With the possible rise of coalition politics again in the near future,~~ collective action will remain problematic for the Indian polity.

STRUCTURAL ISSUES

Let me now move to the second part of this chapter by pointing briefly to at least four types of structural issues, not considered in the 1984 book, where there are significant unresolved tensions that the Indian political economy will have to grapple with in the coming years.

Changing Pattern of the Regulatory State

In the 1984 volume, I discussed the nature and impact of the dominant public sector and pervasive state regulations over the private sector in the form of fields of operation and various licences and permits. Since economic liberalization the dominance of the public sector has

⁷ Even in the most recent—unusually aggregative and presidential—national election, signs of high political fragmentation remained: there were 36 political parties with at least one seat in Parliament; the vote share of regional parties still remained almost half, and so on.

⁸ Evidence for income inequality rising between 2004–05 and 2011–12 is available from the India Human Development Survey data; evidence for wealth inequality rising between 1991 and 2012 is available from National Sample Survey (NSS) data.

diminished, but unlike in China the commercialization of the public sector enterprises has been rather shallow, and by and large they remain under the thumb of the relevant ministries. As for the private sector, the earlier regime of permits and licences has declined in importance (though this applies more to the central regulations for trade and industry than at the state level), but with the expansion of private domestic and foreign investment in many fields, a whole range of regulatory bodies to oversee them has come up.

The proliferation of these bodies, instead of adding transparency and coherence to the system, has, with few exceptions, made it murkier and more fragmented. Quite often, they have just added another layer to the bureaucracy, with similar hidebound procedures and with post-retirement officers brought in from the ministry at whose behest they work. In the case of some regulatory bodies, like that for telecommunications, they operate only in an advisory capacity and often overruled by the ministry. A landmark Electricity Act of 2003 has been neutered by the state regulatory commissions who obediently follow the state governments in preventing open access to the inter-state grids. Nor do they fail to connive at the state politicians' distribution of electricity to select groups at throwaway prices. In general, the control by politicians is often exerted in the form of selective implementation of the regulations.

In any case, most regulatory bodies have no penal power for non-compliance of their regulations. It looks like the regulatory bodies have mainly expanded the scope for sinecure jobs for professionals (identified as a dominant class in my 1984 book) and cemented state-business relationships between the regulator and the regulated. Prime minister after prime minister has promised at the beginning of their tenure a thorough administrative reform and yet ended up doing very little on that front. This has less to do with lapse of memory and more with the grip of strong vested interests in the class of professionals (including the powerful Indian Administrative Service officers' association), in spite of the various divisions in this class and the frequent need for compromises with their politician bosses. In this sense, there is a remarkable 'resilience' in this class, as noted in Chapter 8 of this volume.

As I have already indicated, the new mode of public-private partnerships has been saddled with problems, and sustainable regulatory protocols governing them are yet to be institutionalized. In this respect,

the private sector has to give up on its tendency in such partnerships to privatize the profits and 'socialize' the losses, if the state-business relationship is to keep some semblance of democratic legitimacy. On the other hand, the state has to work out reasonable modes of long-term risk management and renegotiation as initial conditions unpredictably change, with decisions preferably delegated to an independent body that can avoid the suspicion of indulging in crony capitalism. The history of maintaining the independence of non-elected bodies has been rather poor, and recent years have seen assault on and erosion of even semi-independent institutions.

Accumulation versus Legitimization

For the last few decades, there has been a brewing 'legitimization crisis' of capitalism in India for many sections of the people on account of,

- the rising inequality of wealth;
- the flourishing of 'crony' capitalism;
- the displacements and dispossession of common people from their land and degradation of their environment; and
- deterioration in the supply of basic public services (water, safety, and so on) in the burgeoning cities and towns, while the rich arrange for private access to these services.

In reaction, quite often politicians try to placate with short-run populist measures.

But the legitimization issue has also induced vigorous social movements and pressures for the recognition of various kinds of citizen rights and accountability institutions over the last couple of decades. These movements, however, have occasionally ended up stalling industrial progress—in collaboration with judicial activism they have made mining, infrastructural, and environmental clearances sometimes very difficult to obtain, slowing industrial growth.

The debates all around have become polarized on this matter, and political decisions seem to lurch from one end to the other: under the United Progressive Alliance (UPA) regime (2004–14) in the early years the rights movement flourished, but in the last few years or so the pendulum has swung again in favour of corporate lobbies

and governments that harass and repress activists (compare Chapter 6). Since the social movements have not yet taken the form of mass political organizations, it has been relatively easy for business-friendly governments to bypass or dilute earlier welfarist legislative actions in actual implementation. To negotiate some kind of political balance in this tug of war between competing interests will be complex and time-consuming and the Indian polity will go on vacillating on these issues. And following usual political practice, parties in opposition will agitate against policies they themselves supported while in power.

The mainly elite-led non-governmental organizations and other voluntary organizations often act as strident single-interest lobbies, making compromise difficult. In this respect, they are poor substitutes for large multifarious political parties. But with the decay of inner-party democracy in all the parties, political parties no longer act as a forum for deliberation and transactional negotiations between contending interest groups within the party on controversial policy issues, where there are always trade-offs which could be negotiated.

On the other side, in the arena of organized politics, with the institutional decay of political parties the politics of legitimization has sometimes been usurped by forms of plebiscitary democracy, which depend more on the antics of blustering popular leaders and of the media often driven by crony capital interests, than on liberal procedures of accountability or structured social movements.

Jobs and Reservations

More than citizen rights and welfare, the young people who are the majority of 'aspirational' India seem to be demanding jobs. Over the next decade or so, this may be a major source of political turmoil, particularly because over many decades job growth in India has been very sluggish. It has been estimated on the basis of NSS data—see Ghose (2016)—that nearly 8 million workers are added to the labour force every year, on top of the backlog of over 60 million surplus workers (both openly unemployed and underemployed) in 2015–16 (this does not include those, mostly women, who have dropped out of the labour force but are potentially available with appropriate jobs). Outside the construction sector, growth elasticity of job creation so far has been extremely low. Most recent economic success stories in India

have been in relatively skill-intensive or capital-intensive industries (software, pharmaceuticals, vehicles, auto parts, and so on).

There are several constraints on large-scale labour-intensive industrialization in India—infrastructure, skill formation, credit, regulatory environment, contract enforcement problems, red tape and the ‘inspector raj’, and so on. We do not yet have good statistical decomposition exercises on the net impact of these various factors on job creation or lack of it.

The business press and some liberal economists habitually put much of the blame on trade unions supporting stringent labour laws. But they overlook the fact that, while many of the labour laws do require modification and upgrading, trade unions (particularly of unskilled workers) are now substantially weaker than before, partly on account of technological change and increased capital mobility both across countries and across states in India. Even in the organized sector, more than one-third of workers are now ‘contract labourers’ without security or benefits, sometimes working side by side with regular workers.

Even when jobs are created, there is a major regional discrepancy between job demand and supply, which may turn the so-called demographic dividend from large numbers of young people into a ticking time bomb in parts of the country.⁹ For demographic reasons, these young people are more in the large populous states of North India (where poor governance and infrastructural deficiencies limit job growth as well as delivery of welfare services). But jobs, when created, emerge more in states in western and southern India. Inter-state migration can be a partial relief but, given the staggering numbers, cannot be a solution if one wants to avoid large costs of dislocation and nativist unrest.

The last Finance Commission has encouraged more devolution of finance and responsibility to the states. With large initial differences in state capacity and infrastructural deficit, this is likely to accentuate regional inequality and discontent. With capital being much more

⁹ It is estimated that even if one takes only the males in the 15–29 age group (likely to be socially the most restless young people), currently there are about 14 million unemployed or underemployed among such people, with about 6 million new entrants each year.

mobile across states than unskilled labour, many states are likely to compete in giving concessions to capital while indulging in populist measures for the poor. It also means that states where the dominant caste-coalition is generally pro-business will have advantage in attracting capital. At the same time, there are now some signs that even dominant castes (such as Patidars, Jats, or Marathas) are showing some cracks, as those sections in the same aggregative caste that are not doing well in terms of jobs and general economic conditions (while being pushed out of their traditional occupations by agrarian distress) are getting restive.

General reservations (in public sector jobs, higher education, and political representation), which have long constituted the default redistributive option in much of the public realm in India, are increasingly seen less as a way of fighting the historical legacy of discrimination against marginalized groups, and more as a way of staking a share in the spoils of the system, with even dominant castes demanding more for their share. As the job situation in India's non-agricultural sector becomes more acute, such demands are going to cause a great deal of tension in the political economy of the socio-economic arrangements.

Tension between Rentier and Entrepreneurial Capitalism

While there is vigorous productive capitalism in some sectors of the Indian economy, given the nature of the Indian political-business relationships there are few sectors that are untouched by factors that involve some form of rent (see Chapter 11). Apart from the usual temporary monopoly rent enjoyed by innovating companies in most countries, India has at least three major sources of quite unproductive (and thus socially wasteful) rent:

- Traded natural-resource-intensive goods (like minerals): in the first decade of this century, the mining mafia had its way, but with global recession and slowing down of the Chinese economy this source of rental income is a bit weaker now.
- Non-traded natural-resource-intensive goods and services (like land and real estate).
- Political rent in other activities (following from collusion between politicians or bureaucrats and connected sets of favoured

businessmen).¹⁰ Even after economic liberalization, capital crucially depends on various kinds of regulatory discretion of officials as well as loans from public banks (which have seen many large ‘wilful defaulters’).

- There is hardly any major state or political party in India which has not been corrupted by land and real-estate interests. As the economy grows and land prices in a densely populated country gallop, this is unlikely to diminish in importance. (There is some evidence that land price rise in India in recent years has been one of the highest in the world [Chakraborty, 2013]). While auctions of public resources have now become somewhat cleaner than before and land acquisition and eviction of poor people has been made somewhat more difficult under the new laws, crony capitalism and rent-sharing between business and politicians continue relentlessly in different forms. In fact, politics and business are increasingly intertwined.

On the creation and maintenance of political rent, which is promoted by lack of competition, there are, of course, some built-in checks in economic competition (if scale economies are not large barriers to entry), particularly from abroad, and the political competition of democracy. Though the domestic non-traded sector is large, the Indian economy is now sufficiently globally integrated for the economic check to be quite significant in many sectors. There is, however, not much evidence that the dominance of incumbent firms has declined in the Indian industrial sector even after economic liberalization (Alfaro and Chari, 2012). On political competition, the barriers to political entry are getting stiffer, as elections become inordinately expensive and all campaigning politicians are increasingly dependent on scarce, often illicit, financial and organizational resources. A large part of undocumented election funds from the corporate sector for major political parties is a form of quid pro quo for the political rents enjoyed by business referred to above (although it has been pointed out that the uncertainty in the flow of kickbacks sometimes keeps the businessmen on tenterhooks).

¹⁰ In some sectors (for example, liquor, real estate, construction, transport, private colleges, and so on), politicians themselves are now major business investors.

The impact of rentier capitalism on politics is to encourage oligarchic forces. As Walton argues in Chapter 11 of this volume, in US history the 'robber barons' of the nineteenth century were partially checked by the institutions created by the politics of the 'Progressive Era'. Much will depend on if or how a sufficient number of accountability institutions develop in India. Our elections are vigorous but our democracy is enormously flawed in terms of various kinds of accountability failures. It is this uphill democratic struggle that will shape the future of Indian political economy.