



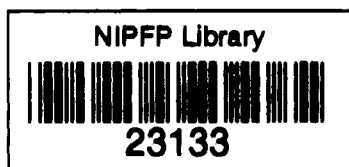
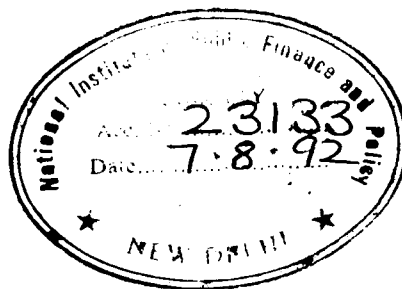
THE POLITICAL ECONOMY OF REFORM

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The Political Economy of Reform*

The spate of quick policy changes which India has experienced during the past two years was triggered by the balance of payments crisis which followed the Iraqi invasion of Kuwait. But the real consideration underlying these reforms is a growing belief that the Nehru-Mahalanobis strategy of development has failed. It is important to recognise here that a critique of this model of development has been formulated at two different levels of discourse. At one level there is a normative critique which can be described as being external to the project of development. This critique, expounded for instance in the recent collection of essays on Dominating Knowledge edited by Marglin and Marglin (1990) addresses not so much the Nehru-Mahalanobis strategy but the very concept of development within which that strategy is embedded. It questions the exclusive validation of a concept which more or less equates development with industrialisation and modernisation of the Western variety. It maintains that alternative patterns of development are possible, which build on the indigenous traditions of different societies and are both less damaging to the environment as well as more fulfilling for human beings. However, such a perspective is not the ideological basis of current reforms towards a more open and market oriented economy with less state intervention.

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The latter are driven by an altogether different internal critique which accepts the goal of industrialisation, more or less of the Western variety, but maintains that the Nehru-Mahalanobis strategy of state led industrialisation within high protective barriers against foreign competition was misconceived. In particular the proponents of this thesis point to the high incidence of poverty that prevails after forty years along the Nehru-Mahalanobis path, 30 per cent of the population as per the latest Planning Commission count (Economic Times, 1992). They ask why India has been left behind by most of its Asian neighbours outside South Asia in terms of all the usual indicators of social and economic development.

The principal answer to this question lies in the domain of political economy rather than the narrow technicalities of economic policy making. There are a number of excellent analyses which do deal with some of the technical problems in the Nehru-Mahalanobis strategy. However, these are really subsidiary to the implicit political-economic and institutional assumptions of the strategy which were flawed, as we can now see from the vantage point of hind sight. This strategy was shaped in the fifties. The Soviet Union was still seen as a great success story which provided much inspiration to India and other post-colonial countries eager to industrialise. Memories of the Great Depression and the New Deal loomed large, while the Marshall Plan was credited with the miraculous recovery of Europe after the terrible war. Conventional wisdom laid much emphasis on market failure but paid little attention to the possibilities of government failure. The Nehru-Mahalanobis strategy of planned industrialisation in India was very much a part of this celebration of the interventionist state.

During the past four decades however we have experienced and learned much about government failure. All this has been widely documented and need not be repeated here. But their cumulative impact has been the exhaustion of possibilities within our chosen path of development. Over the years, various individual and official studies have shown how the machinery of state has been manipulated by certain powerful social groups to their own advantage (Bardhan, 1984). More recent studies have demonstrated how this has led to a crisis of the tax state (Mundle and Rao, 1992), rendering the Nehru-Mahalanobis arrangement unsustainable. In industry, government licensing was used as an effective entry barrier to eliminate domestic competition while restrictions on the import of commodities, capital and even technical know how shut out external competition. Incumbent firms, no matter how inefficient, were therefore guaranteed a profitable existence in this cocooned environment. When losses were incurred despite such protection, huge subsidies were channeled through the budget and the financial sector to keep the large enterprises going. Bleeding a firm of resources to turn it sick became a cheap way of raising more money.

However, in order to enjoy this largesse and protection from government, industrialists in the organised sector had to accommodate the claims of the other players in the dominant political coalition. The powerful lobby of landed interests were able to ensure for themselves the highly subsidised flow of farming inputs such as water, power and fertilizer, along with guaranteed prices for the major farm products. The white collar and burgeoning salariat in government were also able to ensure for themselves a growing number of life time secure jobs with assured upward mobility, inflation indexed salaries and subsidies on

everything from housing to holidays! Their cousins in the public sector enterprises, banks, universities, etc., were no less successful, while 'push me-pull you' competition in compensation claims led to an upward drift of real wages across the board. The upper echelons of blue collar workers in large public and private sector firms also did quite well for themselves under the prevailing industrial labour legislation.

For the coalition of interests which has dominated the apparatus of the state this has been a good arrangement. Everyone in the coalition has prospered while the bulk of the population outside the organised sector have got left behind. But at the end of the day the arrangement has turned out to be unsustainable. The sum of claims for largesse from the state has been larger than the sum of resources available in the kitty. This has done great damage to the long term growth prospects of the economy. The development of essential infrastructure such as power, irrigation, railways, etc., has been retarded while the per capita expenditure on social overheads such as public health and primary education has remained abysmal, even in comparison to the average for low income countries. For a while we continued to live beyond our means by large scale public borrowing, both domestically and abroad. However, the interest burden of galloping public debt only compounded the problem, leading to the double crisis of internal and external deficits which peaked early last year.

The present phase of economic reforms is essentially a response to this exhaustion of public resources and growth potential under the old arrangement. Hence the emphasis on reducing the reach of the state, less protection from foreign competition, etc. However, while this is the stated theme of policy, the underlying reality is that the very same dominant

coalition of interests which prospered under the old arrangement still remains in place. Yet no single interest group, e.g., the industrialists, is powerful enough to force through a programme of development or reform at the expense of the others in the coalition. The process of development thus remains grid-locked politically.

The new government started out quite boldly on a path of reform last year. It took a number of significant measures fairly quickly. But it is important to note that the measures taken so far have not hurt the members of the dominant coalition. Though import restrictions have been substantially removed, the level of protection has actually risen after devaluation, even if we allow for the slight lowering of tariffs. For the farmers, subsidised delivery of water, power and fertilizers remain in place along with price support. Jobs in government have grown, employees have not been retrenched and wages in the organised sector remain indexed.

The two main areas in which public expenditure has been contained are, predictably, areas which have no constituency within the dominant coalition, namely, capital expenditure and the redistributive package, i.e., the employment and anti-poverty programmes, education and health. The same areas of human resource development and capital formation which have been progressively crowded out in the past. However, these soft options will soon be exhausted. Then comes the hard part. Is there any reason to expect that the outcome will be any different from the trajectory of the past?

There is one aspect of the current situation which is worth noting in this context. The present reforms are being driven by considerable external pressure as well as encouragement. Indeed this is the main concern of the critics. But external forces are not necessarily malevolent. On the one hand we have our memories of colonial underdevelopment. On the other, we have the historical antecedents of all our high growth Asian neighbours. In many of these cases, the clearing of an exhausting internal political grid-lock was triggered by external force.

The appearance of Commodore Perry on the shores of Japan was symbolic of great external forces which disrupted the domestic power balance and prised open a society closed to the external world for over two hundred years. In the process it unleashed Japan's dramatic drive for development. Later, it was imperial Japan which, in the pursuit of self-interest, introduced land reforms and other measures in its colonies which established the preconditions for very rapid development in countries like Korea and Taiwan after the colonial haemorrhage was stopped (Brenan and Mundle, 1991). China travelled a different route. But the current phase of breath taking growth along China's Pacific rim is again being driven in large measure by external forces, not least the vast network of expatriate Chinese capital based in Hong Kong, Taiwan, Singapore and elsewhere. It is said that it is this same expatriate Chinese capital, combined with Japanese capital, which is also driving the high growth of countries like Malaysia, Thailand and Indonesia. At the same time, we have in Asia the counter example of the Philippines, not to mention some of the depressing failures under external influence in Africa and Latin America. Besides, in many of the Asian success stories the

invisible hand of the market, even in an externally oriented environment, has often been led by the very visible hand of the state.

None of this is intended to imply that the current reforms in India will either succeed or fail. It would be foolish to pretend that the historical experiences of one country can be mechanically replicated in another. Much depends on the specific circumstances of each particular case. All that the comparison of experiences suggests is that external force is not by definition malevolent. It is possible that this new element in India's present political economic conjuncture may shake up the internal political grid-lock. If, in the process, the reforms succeed, the 600 million Indians outside the dominant coalition will be sacrificing some bread today for jam tomorrow. If the reforms fail, they would have lost altogether.

Thus, it is possible that this new element of external force may shake up the existing dominant coalition. However, its ultimate impact on the development process is indeterminate. Things could go either way, depending on how the other elements of our particular historical conjuncture evolve. Clearly, there is far too much at stake here for the remaining 600 million to adopt a passive attitude of wait and watch. If a healthy process of development is to be restored, then this force of numbers must be deployed to rearrange the political balance between state and civil society in favour of the latter. Decision making processes must be substantially decentralised to levels and institutions where the decision makers are more accountable to the larger public. However, it would be naive to imagine that political power will be so redistributed voluntarily. It must be wrested through active political mobilisation from below. The present

formal consensus, across the entire spectrum of political parties, on the need for decentralisation is a historic opportunity for such mobilisation in a new national movement under the slogan of democratic decentralisation.

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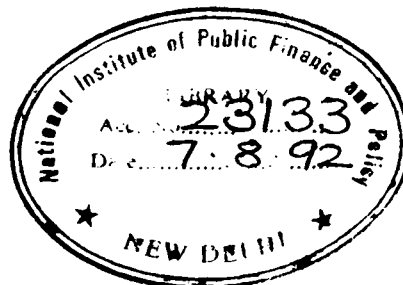
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