

# The State in Retreat? Why has India Experienced Such Half-hearted 'Liberalisation' in the 1980s?

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## Developments in India's Economic Policy

The first budget of Rajiv Gandhi's premiership in 1985 was hailed by some as marking the inception of a new economic regime. It reduced income, corporate and wealth taxes, cut import duties on capital goods, provided tax breaks to exporters and largely eliminated licensing restrictions on investments in 25 main industries (including machine tools, industrial machinery, electrical equipment and electronic components). The philosophy of the budget was to help the private sector, and growth in public sector expenditure was to be kept to the lowest level for many years. Allocations for rural employment and related anti-poverty programmes were to be relatively reduced. Nonetheless a record budget deficit was forecast, though it was asserted that this would not be inflationary in view of the favourable positions both of foodstocks and of foreign exchange reserves. Supporters and critics alike saw in these measures a radically new approach in economic policy, which seemed to extend the general tendency of economic 'liberalisation' to India — though the policy changes proposed were in fact foreshadowed in India's negotiations with the IMF for Special Drawing Rights in 1981. *The Economist*, naturally sympathetic to what it saw as a move towards the freeing of markets, said that 'Mr Rajiv Gandhi's first budget tackles the red tapes and draconian taxes introduced by his mother and his grandfather which have hindered growth in the Indian economy . . . The liberalisation is not complete . . . But (the changes) take India a big step away from the days when bureaucrats rather than businessmen decided its investment plans' [March 23, 1985]. The critical *Economic and Political Weekly* (EPW) has argued 'For the first time since Independence we have in New Delhi an administration which has an unabashed allegiance to a specific ideology . . . (which has) . . . three strands: development is best left to private initiative, taxes are evil and the poor are dispensable' [March 7, 1987]. A political scientist, Barnett Rubin, saw even more in the changes in policy announced:

Analysts and critics rightly saw the new budget as an attempt to accelerate growth by freeing the upper sectors of society to consume and invest. What most of them missed, however, was that it

was part of an attempt to reshape the relationship of the Indian state to economic interests. The budget reasserts the autonomy of . . . 'high politics'. It proposes not only to free business from the state (within limits) but to free the state from . . . businesses. The budget is an attempt to move the state away from patronage politics and toward playing a developmental role, in opposition to the tendencies of the last two decades . . . The new developmental role is, however, an openly elitist one [Rubin 1985:942].

These views, postulating the emergence of a new economic regime, have been falsified by subsequent developments in economic policy and of trends in the economy. In presenting his next budget in 1986 the Finance Minister, V. P. Singh, claimed that his priorities were 'to strengthen the public sector', 'to provide a further thrust to anti-poverty programmes' and 'to provide relief to the common man'. The Budget proposed to increase Plan outlays by 20.5 per cent and to increase expenditure for anti-poverty programmes by 65 per cent, though critics pointed out that even after this increase these programmes would represent less than three per cent of all Plan outlays [Kurien 1986]. And even though, as the *Far Eastern Economic Review* reported 'In the main . . . the 1986-87 budget carried on the tax rationalising initiative begun in the previous year . . . (it also) . . . introduced a modified value-added tax scheme, designed to provide a finer-tuned instrument of fiscal control over industrial development' [July 31, 1986]. *The Economist* regretted what it saw as evidence of a failure to carry liberalisation forward, which it thought was due to the government's having given in to political pressures (March 8, 1986). It was claimed in 1985 that the most important part of the purpose of the tax concessions that were introduced was to improve receipts by better compliance, and it is true that there was an increase in receipts from personal income tax of 24.3 per cent in 1985-86 (though the rate fell in the following year, so that it once again lagged behind the growth of money incomes of those liable to income tax [EPW March 7, 1987:387]). In spite of increased receipts from direct taxation in 1985-86, the imbalance between direct and indirect taxation deteriorated further in the 1986 budget, and the estimated deficit increased yet again. A critic wrote:

The government appears to be unable to generate

resources from its own enterprises. It is unwilling or afraid to tax those who are rich and growing richer. It feels compelled to increase outlays on so-called welfare measures. Then it is left with no option but to fall back on indirect taxes and to rely more than ever on borrowings from those who expect interest and tax concessions for temporarily parting with their resources, to enable the government to continue with its so-called 'development programmes' [Kurien 1986:630].

Thus supporters of economic liberalisation were disturbed by what they saw as some back-sliding in the 1986 Budget, while critics of government policy saw a deepening of the fiscal problems inherent in the 1985 policies.

By 1987 the champion of economic liberalisation has moved to a position of scepticism about the extent to which there really has been change in the economic regime in India. *The Economist* has recognised that 'Rajiv Gandhi's liberalisation of the economy has been an inconsistent affair' [January 31, 1987], expressed sympathy for the view that '... a better description of what the government is doing would be half-hearted, ill-thought out tinkering' and conceded that '... there are not yet any telling measures of how much today's respectable 6 per cent industrial growth is due to liberalisation' [May 7, 1987]. The removal of V. P. Singh from the Finance Ministry early in the year and not long before the presentation of the budget was widely seen as the result of the government's having given in to pressures from big business and professional people, threatened by Singh's pursuit of tax evaders [see *Far Eastern Economic Review* July 31, 1986 for a comment anticipating Singh's removal for these reasons]; and it is felt that powerful lobbies are able to reverse the economic reforms of 1985 when it suits them. In other words, the doubts that Rubin expressed about '... whether the political leadership is indeed willing and able to reassert the autonomy of 'high politics' from the variegated elements of the dominant coalition in order to impose on them the costs of change' [1985:956] seem to have been amply justified — and the answer to the question he implies is quite simply 'No'.

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## Economic Trends

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Strong claims are still being made about the buoyancy and confidence of the economic climate in India. The government's *Economic Survey 1986-87* opens with the claim that the Indian economy '... is now on a new growth path', pointing out that the average annual rate of growth in the 1980s has been five per cent, 'much higher' than the historical trend rate of growth. Estimates of the rate of growth in the 1980s are influenced, however, by the fact that the base year, 1979-80, saw a decline in real GNP of 4.7 per cent!

Further, the growth rate in key production sectors — agriculture, mining, manufacturing and electricity generation — taken together, has not reached five per cent in a single year, except in the recovery year of 1980-81: 'The growth rate of these sectors was around 3.2 per cent in 1985-86 and it is likely once again to barely exceed 3 per cent in 1986-87... On the whole, then, agriculture and industrial production... is (sic) keeping ahead of population growth by the most modest of margins. By contrast the contribution of banking and insurance to gross domestic product expanded by 11.5 per cent in 1985-86 and by 11.3 per cent and 9.1 per cent in the two preceding years. Even more impressive has been the performance of public administration and defence which witnessed growth rates of 12.5, 13.4 and 12.4 per cent, respectively, in the same three years' [EPW, editorial, February 20, 1987].

Parts of this argument may be disputed. It is claimed that the recently revised Index of Industrial Production shows growth in the manufacturing sector of 8 per cent in the three years up to 1987. The *Economic Survey 1985-86* commented: '... the Index of Industrial Production, with the year 1970 as the base, suffers from various limitations. Industrial structure in India has undergone major changes since 1970... (and)... the IIP, therefore, tends to understate the rate of growth of industrial production' (p.43). It went on to compare the growth rate for the period 1974-75 to 1982-83 according to the IIP with an estimate based on the *Annual Survey of Industries* and found that whereas the IIP gave a figure of 4.4 per cent per annum, the ASI showed growth of 8 per cent per annum. The IIP has subsequently been revised with 1980-81 as the base year and it is on the basis of this index that the higher rates of growth in manufacturing are claimed. Under the new measure, industrial production showed an increase of 8.7 per cent in 1985-86 whereas the old index would have shown a decline of half a percentage point. But it is argued that: 'The coverage of the revised series, in terms of numbers of industry groups as well as number of items is... rather poor for the new series to be of much use for planners and policy makers, though the growth rates recorded by it are rather encouraging' [Basu 1987:446].

It is also pointed out, not only by critics, that 'The tom-tomming of the spurt in the growth rate of industry as per the new index only emphasises the reliance that is being placed on the market demand of the upper crust of the population' [BM 1987: 440]. And there are signs that the markets for the 'sunrise industries' which have grown fast — industries such as consumer electronics, two-wheelers and passenger cars — are rapidly becoming saturated. The *Far Eastern Economic Review* reported that 'Market analysts see the current spurt of car purchases as no more than a flash-in-the-pan expression of pent-up demand. Once it wears off, the market is expected to

require a 30 per cent rate of used-car attrition per year to support new car sales' [July 31, 1986]. In 1987 there have been reports of capacity outstripping demand for a number of products — including cement, mopeds and television sets, and, partly in consequence, both of expansion in the advertising industry and of increased company failures [*Economist* April 4, 1986].

The Budget of 1987, drawn up by the Prime Minister, who took over the Finance Ministry himself after V. P. Singh was moved to Defence, was thus announced in a climate of increasing uncertainty about the government's purpose (not just in the sphere of economic policy), about the real trends within the economy, and about the political stability of the country — with no signs of a resolution of the Punjab conflict and increasing doubts about the Prime Minister's control over the situation. The Budget statement returned to claims about the construction of socialism: 'The political tensions which have surfaced in the past few months . . . have induced the political masters to revert with remarkable alacrity to radical rhetoric' [BM 1987:873]. It was otherwise remarkable for leaving much the largest uncovered deficit there has ever been, and for proposing a rise of 43 per cent in defence expenditure alongside an increase in the Plan outlay of just 12 per cent. In 1985-86 the actual deficit turned out to be roughly twice the amount budgeted, and in 1986-87 getting on for thrice that estimated. Even the government's *Economic Survey 1986-87* admits that the rapid increase in non-plan expenditure, especially that for defence and administration, has kept the budget on revenue account in deficit throughout the 1980s and that the deficit has increased steadily over the last five years. The EPW concluded: 'The increases in the government's tax collections, which the *Economic Survey* credits to 'far-reaching reforms in fiscal policy', have thus made no contribution whatsoever to financing the Plan. At the same time, the public sector enterprises, too, have failed to provide their mite . . . Clearly, then, it has been possible for the government to finance the Plan only by large-scale resort to deficit financing' [February 28, 1987:345]. The Prime Minister/Finance Minister was unwilling to go for a hard budget in the face of a very stretched budgetary position, and he chose to meet demands on resources for defence and security at the expense of development (the greatest increases in expenditure projected were for defence and the police), to leave a large deficit uncovered and to refrain from any major additional effort to raise resources [see BM 1987:439]. But the Budget was still not well received. Business hopes for major duty relief and investment allowances were disappointed and share prices plunged across the board.

Alongside the mounting budget deficit the government's expectations of a significant improvement in the country's balance of trade position in 1986-87 have been belied — and the situation would have been even

worse but for the extraneous factor of the sharp fall in international oil prices [see *EPW*, June 13, 1987:913]. Export targets are not being met, and the World Bank warned in 1986 that in these circumstances commercial borrowings and concomitant debt-service levels will be prohibitive if the import levels needed to realise Seventh Plan targets are to be maintained [*Far Eastern Economic Review* October 2, 1986].

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### Explanation: What Has Policy Done?

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What are we to make of these developments? Why, in the first place, should a major change in the economic regime have been pronounced in 1985? Then, why should it have gone off at half cock? Was there really an attempt to liberalise the Indian economy in 1985? Or — viewing developments in the light of Schaffer's aphorism that 'Policy is what policy does' — what interests are served by the peculiarly muddled way in which liberalisation has actually been implemented?

What economic and fiscal policy in India seem to have done in the 1980s has been to generate growth, especially in services (where the growth rate has been more than nine per cent on average), and dominantly in defence and public administration. All the time public expenditure has grown. The government's 'Long Term Fiscal Policy' (LTFP) document of December 1985 . . . drew attention to the fact that the total expenditure of the central and state governments together had increased almost 17-fold from 1970-71 to 1983-84 with its share of GDP increasing from 21.1 to 31.1 per cent' [Kurien 1987:641]. This expansion of public expenditure has been associated in the 1980s with a decline in the proportion of revenue amongst the sources of government finance, and accordingly with greater reliance on borrowing (though mainly internal) and deficit financing [see Kurien 1987:Table 3]. As Kurien says ' . . . there is a need to search . . . for the rationale of growing public expenditure *per se*, treating it as a major policy decision of the government, rather than as a sign of the helplessness of the government which is being confronted by growing demands for funds' [Kurien 1987:641].

Kurien's own answer to the question he poses is that in spite of its professed identification with the poor, the government has in its fiscal policy exercised an option in favour of the relatively small affluent class. The share of direct taxes in the total tax revenue of the central government has declined, according to the LTFP, as has the share of income tax, and the government has claimed that the economy has reached its tax ceiling. On the other side, through its public expenditure and increased reliance on internal borrowing, the government has made a direct contribution to the affluent sector. It is of course not true that all of those who are employed in the public sector are 'affluent', but some of those who pay direct

taxes are government employees; and it is known that a part of the direct and indirect effect of government expenditure accrues as incomes to those who are already affluent — like the larger farmers who are in the best position to benefit from fertiliser subsidies, export traders and contractors. The members of the 'affluent class' benefit from lending to the government through the banks. Public expenditure has not been raised because of increased allocations for poverty alleviation, when these programmes claim less than three per cent of Plan expenditure. The deficit is part of an attempt to stimulate economic activity, but not of the type where deficit financing is used to put people to work to produce labour intensive infrastructural items. Here '... the aim has been to stimulate the production of certain kinds of industrial goods (consumer durables) for which the demand could simultaneously be generated by the type of additional incomes created through increased public expenditure ... The essence of the new fiscal strategy is to make the island of affluence, or the upper crust of the economy, a largely self-serving segment' [Kurien 1987:645].

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### **Explanation: A Longer Run View of India's Fiscal Problems**

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If we examine recent trends in the context of the development of the Indian polity over the last 40 years then it is possible to see the move towards economic liberalisation in 1985 as an outcome of India's persistent fiscal problems, which are themselves politically determined. What some would refer to as 'the fiscal crisis of the state' was, at an earlier stage of its development, instrumental in bringing about the retreat from the attempt to plan India's economic development in the mid-1960s (in the period of what was described at the time as 'the crisis of Indian planning'). That 'crisis' and the subsequent (relative) stagnation of the Indian economy can be understood as the outcome of the compromised nature of class power and the weakness of the state in relation to 'civil society'. The continuation and development of the fiscal problems which were already apparent 20 years earlier seems to account for the 1985 Budget. The way out of the fiscal problem was evidently seen as being through the reduction of the state's role in the economy: 'The political pressure for liberalisation has come from the perilous state of the government's finances ...' — the pressure emanating from '... the desire of India's politicians to increase tax revenue so that they can continue to bestow largesse ...' [*The Economist* January 31, 1987]. For *The Economist* the 'new policy' should be seen as simply another twist in the game of winking out resources which can be doled out as benefits in a political system depending on patronage: 'Mr Gandhi has been told repeatedly (by stalwarts of the Congress Party) that the fortunes of his party depend on the patronage it can dispense in

the name of socialism ... Many in his party see economic liberalisation as a galling erosion of their power. But some also realise that the new policy could increase the tax-take and thus their power to spend where and on whom they want ... Mr Gandhi the politician feels that he must keep doling out the cash. Three of his main reforms — fewer import controls, a cut in income tax rates and the introduction of a value-added tax — are designed to pull in more revenue rather than reduce the role of government in the economy'.

Radical Indian economists like C. T. Kurien, cited earlier, or Sanjay Baru [1985] concur with some of this. They see budget deficits as a reflection, as much or more, of the inability of the state to raise resources as of its inability to control expenditure. Baru wrote of the 1985 Budget that '... to the extent that increased expenditure has to be incurred, the inability of the state to raise matching resources to meet even (the truncated expenditure planned in the Budget) represents "the fiscal crisis of the state"'. He too saw this being used as an argument for the rolling back of the role of the state in the economy, but suggested that this approach does not get at the root of the problem, which has been the inability of the state to raise revenues. The fiscal trends of the last two years seem to prove him right.

Let us amplify these arguments. In 1947, and in the years immediately after Independence, the Congress government, because of the role of the Congress in the Freedom Struggle and the prestige of its (at that time) truly national leadership, was relatively strong in relation to society. But the regime was also divided ideologically between those with socialist views, conservatives sympathetic to the big bourgeoisie and to the idea of market regulation of the economy, and Gandhians. Under Nehru's leadership, undisputed after the death of Patel, the regime embarked on an ambitious programme of planned economic development, but in the context of a formally democratic political system in which the need to accommodate a range of different views and pressures was apparent. In the middle 1950s, in the Second Five Year Plan, a programme for autonomous industrialisation was undertaken, aimed at breaking away from the international industrial division of labour inherited from colonialism, and at the expansion of the economic space of Indian capital [Prabhat Patnaik's formulation, 1986]. The undeveloped industrial structure of India was indeed transformed by the middle 1960s, and high industrial growth rates were achieved. The programme was carried through in the face of strong opposition both internally and externally (and it was watered down as a result), and it has subsequently been fashionable to criticise this industry-led, import substituting and 'urban biased' strategy for development [Mellor 1976; Lipton 1977].

The extent of the achievement must not be discounted therefore [see, for example, Balsubramanyam 1985:112], nor the economic logic of the hostility of Western, especially US capital to it, and the favouring of 'liberalisation' [see Patnaik 1986]. Arguments about the limitations of the Mahalanobis model on which the Second Plan was based, should not be confused with the consequences of the political context in which it was introduced [Sutcliffe 1971].

The drive for autonomous industrialisation faltered, however, and the effort to plan economic development foundered in the mid-1960s. Toye [1981] showed that the deceleration of industrial growth from that time was not a general phenomenon but one concentrated in the capital goods industries and to a lesser extent in intermediate goods. The abandonment of the policy of state promoted capital accumulation, which characterised the Second and Third Five Year Plans, caused the slow-down in industrialisation. Why did this shift in policy take place? There is a good degree of consensus amongst economists that it was most crucially the result of the inability of the government to raise resources domestically at the expense of property incomes, in a context in which the Congress party had an increased need for legitimacy. By the middle 1960s the state was unable to sustain increased development expenditure because of a fiscal crisis, arising from increased non-developmental expenditure commitments combined with an inability to raise more resources domestically, and consequent heavy dependence on regressive indirect taxation, on deficit financing, and on foreign aid.

The crisis of the Third Plan in the early 1960s, with stagnation in agriculture, shortages of power and essential raw materials, increasing prices, and — crucially — yawning budgetary deficits, led to increasing pressures for reductions in plan outlays and for greater reliance on the private sector. By-election reverses in 1963 showed how the opposition could harness discontent and continued the undermining of Nehru's prestige, withered by the China War of 1962. A series of ideological and policy battles ensued as Nehru sought to reaffirm the commitment of Congress to democratic transformation. But with his death the change in the means and objectives of public policy which was being actively pursued by Congress conservatives such as Morarji Desai even in the later part of Nehru's lifetime, was soon completed. Shastri lacked an independent power base and, giving in to both domestic critics and to criticisms by international aid-giving agencies '... of overly ambitious industrial plans in the public sector and inefficient methods of development both in agriculture and in industry that ignored incentives to private (domestic and foreign) investment' [Frankel 1978:246], he allowed a reorientation of the approach to the economy. The Planning Commission was effectively displaced as a

policy-making body; there was a shift from controls to incentives as major instruments of development planning; and an enlarged role for private domestic and foreign investment was encouraged. Shortly after Shastri's death, and before Indira Gandhi had fully taken control of the reins of government, the power of international capital and the direct influence of the US government was shown in the 1966 devaluation, which was strongly opposed within India.

After the middle 1960s, what Shetty describes as 'structural retrogression' took place, shown by the facts (amongst others) that services have grown faster than commodity producing sectors; that the growth of basic and capital goods industries has been slower than the meagre average growth in industrial output; and that the production of mass consumption goods has lagged behind that of elite oriented consumer goods. All these tendencies have been accentuated in the 1980s. At the same time there is evidence of a great deal of under-utilised capacity, and there has been no growth in organised sector employment (latterly, indeed, the proportion of the labour force engaged in the organised sector has actually been reduced [EPW, February 28, 1987:346]).

Shetty argues that structural retrogression is the result of the decline of planning — referring to the twin phenomena of the reduction of rigorous industrial controls (which he shows to have given rise to distortions in production and investment patterns in the private sector), and of serious financial mismanagement, which is shown both in the frittering away of a significant proportion of public-sector outlays in non-developmental expenditure, and in the distorted system of resource mobilisation. These result in large measure from the political pressures of federalism and the power of 'bullock capitalists' (the Rudolphs' evocative term) and landlords both to resist taxation and to mulct public sector resources through cancellations or reductions of electricity charges and of debts to formal credit institutions. The increasing significance of transfers to state governments for purposes other than development and capital formation reflects the increasing pressures exerted by states on the centre, already apparent by the early 1960s, as Hanson showed [1966]. Transfers to state governments include allocations for famine relief assistance, for example, of which the Seventh Finance Commission '... implicitly brought out that the relief expenditure encouraged by the centre was largely determined by political patronage extended to a few states' [Shetty 1978:223]. Financial relations between the centre and the states in the early 1980s were in a chaotic state. Why, for example, should Maharashtra, with a population of 55 mn, have been awarded a plan outlay of Rs15,000 mn while Uttar Pradesh, with twice that population, received only Rs12,500 mn, or West Bengal with the same population received only

Rs5,000 mn? Shetty builds up a picture of enormous wastage of financial resources, whilst showing at the same time that the system of resource mobilisation has been distorted because of (i) the government's refusal to touch the richer segments of the farm community; (ii) reductions in the marginal tax rates on personal incomes and wealth in the non-farm sector; (iii) its continued reliance on indirect taxes which are regressive; and (iv) its resort to a disproportionate amount of deficit spending [and see Shetty's summary; 1978:228].

Shetty's analysis of public policy and its impact shows that the same basic constraints that were crucial in the period up to the mid-1960s — the inability of the state to raise sufficient resources domestically through direct taxation of property incomes; the failure of agrarian reforms; and the serious market constraints which have been exacerbated still further by regressive taxation — have persisted in the period since then, and have even been intensified by the relaxation of attempts to control and to plan the economy. His explanation for 'structural retrogression' is that it has come about because of 'the decline of planning', but this only leads us to ask the further question of why planning should have declined. The crisis of planning came about in the 1960s because of resource constraints and failures in the implementation of plans up to that time which resulted, amongst other factors, from the power of the rural rich to resist taxation and to turn measures of agrarian reform to their own advantage, and from the power, especially, of big business similarly to turn industrial controls and to resist taxation. Fundamentally the failure of planning came about because of the dependence of the Congress government, for its control of the state, upon the classes which would have had to sacrifice most for planning to succeed. The failures of planning became self-reinforcing because, as plan targets were not fulfilled, discontents increased and were given political expression in the rise of opposition. Following from these observations, state power may be seen as lying in an uneasy alliance between the big bourgeoisie and the dominant rural class, and it is this compromise of power which finally underlies the structural constraints that have affected Indian economic development, expressed in fiscal weakness.

### **Theories about India's Political Economy and The Explanation of Recent Developments**

The principal alternative to the view of Indian political economy presented thus far is found in the work described as 'the new political economy', within the neo-classical paradigm, which '... has been based on empirical studies of government intervention in trade and industry and the varied effects that such policy actions in India have had' [Toye 1988]. Empirical studies by Bhagwati and his collaborators sought to

show how exchange controls leading to the overvaluation of the rupee, and bureaucratically discretionary methods of restricting imports and sanctioning investments in industry, led to economic distortions and inefficiency. The '... origin of the new political economy was in the implications that were drawn out of their economic analysis of the consequences of bureaucratic controls' [Toye 1988]. Essentially what is argued is that India is a 'rent-seeking society' — or more accurately that India is a society with a rent-seeking government: '... the misguided adoption of certain economic policies, especially import quotas, itself creates a society with certain economic irrationalities such as permanently under-utilised industrial capacity, a corrupt administration and a political structure dominated by interests fed financially by windfall gains (from bureaucratic rents, based on the system of controls). This latter feature is important because, almost by definition, it rules out the possibility of achieving the reforms which the neo-classicals are seeking, at any rate in a democratic polity like India' [Toye 1988].

Recognising the insights in this argument, whilst also being aware of its limitations in terms of the specification of political dynamics, Bardhan [1984] has brought this explanation together with the conception of the Indian state as 'a duopolistic arrangement between the rural oligarchy and the industrial bourgeoisie' [Mitra] which informs the account of India's political economy offered above. Bardhan's argument is that the trends of Indian economic development can be explained as the outcome of conflicts and compromises between three dominant propertied classes: the industrial capitalist class, the class of 'rich farmers' and a class of public sector professionals. An important expression of conflict between the urban industrial and professional classes, and the dominant rurals, is observed in the struggles over farm prices and inputs costs which have become a recurrent feature of Indian politics [most recently in Gujarat and UP; see *EPW* March 28, 1987]. There is a great deal of inconclusive debate over the 'real' trends in the terms of trade between agriculture and non-agriculture. There certainly is evidence for the recent past (late 1970s and early 1980s) of a 'costs squeeze' in agriculture, but at the same time work like that of Shetty's, discussed earlier, shows the extent of the power of rural people to extract resources from state governments — and not only 'dominant rurals', in view of the sizeable proportions of all development expenditure in Maharashtra, for example, being absorbed by the Employment Guarantee Scheme, or in Tamil Nadu by the Chief Minister's Nutritious Noon Meal Scheme. The state has been unable to tax the rural sector directly to any significant extent, though poor rural people have borne the brunt of the cost of indirect taxation — such as the price increases resulting from the customs and tariff impositions on

cement and on petroleum products in the 1985 Budget. There is a complex net of transfers and payments between 'sectors' which no-one has adequately sorted out quantitatively. But what does seem to stand out is that compromises are being made all the time between the interests of different groups of rural people and those of the industrial bourgeoisie and the working class; and that while the government at the centre may favour industrial interests, state governments have used their resources to maintain political support, which has often meant making concessions to rural interests at the expense of those of industrialists (such, perhaps, as is implied in Devi Lal's pledge to cancel outstanding farm loans in the recent state elections in Haryana). At the same time, for Bardhan, public sector professionals constitute another distinct set of proprietorial interests — in conflict over bureaucratic rent creation and distribution with industrial capitalists and to a lesser extent with farmers. So he presents:

... a picture of the Indian government as managing class conflicts by expanding subsidies on food, agricultural inputs, and public-sector produced inputs with little regard for their impact on raising productivity. This expansion is seen as driven by the rising stakes in electoral competitions and the rise of gangs led by a large number of MLAs and MPs, political middlemen who over the years have specialised in the profession of brokerage services ... [Toye's summary; 1988].

The actual trends in public finance in India have seen the expansion of public expenditure associated with increased reliance on deficit financing, on indirect taxation, and latterly on commercial borrowing, and they have involved a divorce between development goals and actual resource allocation, increased decentralisation of public expenditure decisions and a preference for consumption over investment spending [see Shetty]. These trends are the outcome of the government's quest for legitimacy and the compromises that have been made between conflicting interests of the three dominant propertied classes. The Indian political system (the Congress 'dominant party system') worked effectively to accommodate different interests up till the 1970s. The event of the Emergency between 1975 and 1977 shows the breakdown of that system [see Blair 1980], as a result both of the kind of fiscal crisis depicted by Shetty, and the inability of the system to supply sufficient resources to meet divergent demands, and of Indira Gandhi's attempt to centralise power by destroying the local organisation of the Congress. The period of Janata rule saw first, relief of the pressures of managing legitimacy, and then their renewal in a context in which 'bullock capitalists' were more strongly represented at the centre than before. They were relieved again by Indira Gandhi's triumphant return to power in January 1980, and yet

again by the support generated by Rajiv after her assassination in 1984. But the dominant trends of the 1980s have seen the government at the centre increasingly embattled in the face of violent separatist and regionalist movements, especially in Punjab, Assam and elsewhere in the North East, and in Kashmir, and by its 'isolation' as never before, as the non-Hindi speaking states have come under the control of non-Congress governments. There is, in Bardhan's terms, a crisis of political legitimation which has called forth increased expenditure on defence and internal security, so exacerbating yet further India's basic fiscal problems.

In the light of this view of India's political economy the economic liberalisation proposed in the 1985 Budget can be seen as an attempt by the Central government, in a phase in which it was relatively strong in relation to society, given the strength of electoral support for Rajiv, 'to reshape the relation of the Indian state to economic interests' and 'to reassert the autonomy of high politics' [Rubin]. That Budget really did reflect '... an attempt to change at least some of the conditions that the theoretical debate has pointed to as causes of slow industrialisation' [Rubin 1985:948] — inefficiencies resulting from the industrial policy regime, and the problems of inadequate demand. Prabhat Patnaik, from the left, concurs to an extent with this view when he argues that the declaration of a 'new economic policy' was more the result of a strong build-up of internal pressures than a response to external forces — these pressures being the outcome of the crisis that had developed in the earlier regime '... consisting in the fact that the ability of the regime to generate substantial industrial expansion got progressively impaired overtime' [1986:1,015]. Patnaik's argument is that industrial stagnation has substantially been the result of the stagnation in public investment [cf. Toye 1981, cited above], and that this in turn, has been the result of the 'fiscal crisis' we depicted earlier. Internal pressures for liberalisation have come, he thinks, from big business because it has found growth of investment opportunities constricted relative to the growth of its command over capital. It has to do deals with metropolitan capital in order to enter the international arena in any significant way. But metropolitan capital insists on the opening up of domestic markets. It is for this reason, as well as because of interests in expanding into hitherto closed domestic channels for investment that big business has given cautious and qualified support to the liberalisation urged by the World Bank from the early 1980s.

But though there were, and remain, powerful groups with interests in effective liberalisation, it has become clear that others are threatened by the possible removal of the system of controls from which they have benefited by being able to manipulate it, by direct competition from imports, or by indirect competition

mediated by shifts in demand away from old goods to new ones. And events have shown that the regime is unable to resist the political pressures which have created and perpetuated India's basic fiscal problems. So there has been a fudge, and the underlying tendencies, towards increasing public expenditure, increasing imbalance in taxation, and increasing resort to commercial borrowing, have been intensified in practice. The move to 'liberalise' the economy was perhaps even half-hearted in intention. Rubin argued of the Indira period that '... in the area of industrial policy the autonomy of the state in Bardhan's sense (the ability of the class of state officials to define and pursue a distinct set of interests), together with the power of other dominant classes, limits the autonomy of the state in the Marxist sense. Private deals negotiated among politicians, bureaucrats and industrialists ... render difficult the pursuit of policy in the interests of "capital as a whole" or, for India, the dominant coalition as a whole ...' [1985:947]. In this context the attempt under Rajiv 'to reassert the autonomy of high politics' was very shortlived, as Rubin surmised it might be. Both the 'new economic policy' promised in 1985 and the rapid retreat from it in practice, should be seen as outcomes of the compromised nature of class power and the weakness of the state as an organisation. India does not present an instance of 'the developmental state in retreat' in the 1980s. It remains, as it has been, a weak but plastic state, though also one with a sufficiently developed industrial base of its own in capital and intermediate goods, as to be able to resist external pressures in favour of 'liberalisation'. It seems that here a real attempt to liberalise the economy probably would require the establishment of a much more authoritarian regime, able to ride over the powerful interests represented in the dominant coalition.

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