

## 1 Introduction<sup>1</sup>

The new political economy (NPE) - perhaps more accurately called 'economic politics' - has applied to political 'markets' or to political action in economic markets the profit and utility maximizing assumptions which underlie neoclassical economics (Basu 1991) to show the conditions of rent seeking<sup>2</sup> under which individually rational behaviour on the part of bureaucrats<sup>3</sup> impedes the collective economic good, leads to economically irrational outcomes and overwhelms 'good policy advice' (Krueger 1974). While the soft policy options both required by NPE and acquired from it form a lengthy and messy agenda<sup>4</sup>, the hard option is less contested and is entirely consistent with the macroeconomic theoretical background underlying the first decade of structural adjustment. This involves deregulation: - in extreme states the limitation of the state to the protection of private property rights and the enforcement of 'voluntary private contracts'.<sup>5</sup>

While NPE does not **require** the individually rational behaviour of bureaucrats to be corrupt, corruption, when defined as the 'clearing response to the inefficient distribution of free public goods' (Jagganathan 1987: 110), is entirely consistent with this theoretical approach and its policy implications.

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<sup>2</sup> Rent seeking is understood here as the use of resources to obtain politically created rents.

<sup>3</sup> And on occasions a conflated category of 'bureaucrat-politician' which is referred to by either designation.

<sup>4</sup> Increase information to curb rent seeking; use law to restrict the activities of those most prone to rent seeking; raise bureaucrats' salaries; tax rent seeking activities; use rent-seeking status to prioritise deregulation (Jagganathan 1987; Grindle and Thomas 1991).

<sup>5</sup> (Krueger 1974; Buchanan 1980; Basu 1991 and critically discussed in Grindle and Thomas 1991). The sequencing of privatization and liberalization, of inter- and intra- sectoral contraction, the mix of capital and current expenditure in a compressed state sector are contentious policy issues, all of which follow from the deregulation agenda (Cornia and Stewart 1990).

# Liberalization and Corruption:

*Resolving the  
Paradox  
(A Discussion Based  
on South Indian  
Material)*

**Barbara Harriss-White**

Jagganathan (*ibid.*) for instance (acknowledging his debt to Wade 1985) distinguishes three sorts of corruption for 'India' according to location within the bureaucracy. The first and second are very similar: i) the traditional revenue collection/registration functions of the state and ii) the developmental functions of the state. Both face excess demand. Type i) is characterized by chronic institutional scarcity. Corruption is not the only response to such scarcity. Nepotism is also both rational and common as a rationing mechanism. Public officials become discriminating monopolists. In type ii) corruption, privately appropriable benefits are perceived to be provided by public services e.g. the delivery of newly created supposedly common property rights (health, irrigation, roads, control over necessary inputs e.g. fertiliser). The third type is fraud: 'the exploitation of information asymmetries within the bureaucracy to defraud the exchequer'. Type iii) happens when public agencies are not accountable and/or when public opinion is unaware and a feeble regulator. Officials may become private co-owners, or creditors of contracting firms and simultaneously contract awarders. In all three forms of corruption, intangible property rights result and can be purchased.

Here, the bribe is not a transfer with a socially neutral impact. It is distinctly ambivalent. On the one hand, it is an 'efficient' reward to the entrepreneurial drive of the bureaucrat. On the other, it is an incentive for the bureaucratic propagation of corrupt sites (by restricting activity and then accepting a rent preferentially to ration it at price which may be formed under a variety of competitive conditions depending upon assumptions about bureaucratic structure and organization) (Shleifer and Vishny 1993).

Deregulation will then remove the positions where this 'systematic exploitation of illegal income earning opportunities' in the public sector is possible. By contrast, this article is a preliminary attempt to examine the opposite proposition - that a reduction of state controls may be accompanied by increased corruption.

Even within the stylized world of NPE, there are several reasons why its prediction that deregulation will reduce corruption may be confounded. First, partial changes in ownership (as with quango-ization) may multiply sites for corruption by complicating

lines of accountability and by diluting enforcement capacity. Second, there will be no change in corruption under privatization if the state continues to regulate economic conduct directly or indirectly through quasi-state organizations. Then some business interests may use corrupt means to maintain access to resources or exemptions, while other interests will bribe to enforce deregulation and increase the territory of market exchange. Third, officials may seek bribes against promises of future economic rents, given that their tenure outlives that of politicians.

The prediction grounded in NPE can also be discussed with empirical material. It is not surprising that corruption - the 'great black hole of development economics and public policy' (Jagganathan 1987: 116) - is easier to theorize than to analyse empirically. As Leys (1965) pointed out long ago, there is a 'widespread feeling that the facts cannot be discovered or that if they can, they cannot be proved, or that if they can be proved, the proof cannot be published' for reasons either of research diplomacy or of social science conventions about validity. Here we will use empirical material gathered as a by-product of research on the development (despite, or because of, noticeable government neglect) of a small South Indian market town over two decades.

Three propositions will be explored:

- i that the overall process of capital accumulation is as important to corruption as is the bureaucrat;
- ii that bureaucratic corruption is but a subset of its commonly observed forms;
- iii that deregulation may be accompanied by an increase in corruption and by mutations in relations of corruption.

The concept of corruption as it is practised and experienced in the town under study is in line with the definition given in 1964 by the then influential Santhanam Report on the Prevent of Corruption: '**all forms of impropriety or selfish exercise of power and influence attached to a public office or to the special position one occupies in public life**'. This is a broad brush definition, but accords

with my understanding of what local citizens mean when they use the word.

## 2 Primary and Primitive Accumulation as a Motor of Corruption

The maximizing behaviour of bureaucrats in corrupt exchange theorized as 'markets' neglects the social relations by which corrupt transactions are 'demanded' (or funds for corruption are 'supplied') by the non-bureaucratic party to the corrupt contract. Talk of 'market clearing' asserts one form of corrupt exchange and yet obscures the mechanisms by which there might be a 'market' in the first place. My empirical evidence suggests that three types of relation are particularly important in supplying the means whereby the non-bureaucratic party engages in corrupt transactions, and in enabling intangible private property rights to be created over public goods and services in the first place: **tax evasion, exploitative labour relations and fraud and economic crime**. In this article we have room to discuss only the first of these.<sup>6</sup>

### Tax evasion

Widespread, large scale tax evasion is entrenched in India. As long ago as the early 1980s it was estimated that 41-58 per cent of potentially taxable income from all sources escaped taxation and that in specific instances of commercial taxation on agricultural products non-compliance amounted to possibly 80 per cent of potential revenue.<sup>7</sup> There is a trade-off between the costs of, and returns to, tax collection which creates incentives to organize production and commerce in units below the various thresholds. Below the threshold the art of avoidance is practised while above them the craft of evasion prevails. In the business economy of the South Indian market town all but the pettiest of commercial firms had net returns before tax above the income tax threshold of Rs 45,000 p.a. Little tax is paid. Bus companies for instance keep no accounts at all and the income tax of owners is collectively negotiated. Commercial taxation is also avoided by pre-emptive development and evaded with

corruption. The first is instanced by the burgeoning scrap metal sector where commercial taxes are levied on the first purchase. The sector is structured around a sizeable number of independent small wholesalers whose gross output is beneath the commercial tax threshold and who bulk and sell to a small number of large wholesalers (whose 'second purchases' are therefore tax exempt). In practice, all the apparently independent small wholesalers are completely financed by the large wholesalers and are poorly disguised wage labour. The second evasion is instanced by groundnut, subject to cascading taxes at every stage, which are extensively evaded by means of verbal, spot contracts with immediate cash payment. Thus the only commodity whose conditions of transaction remotely resemble those of perfect competition assumes this particular and rare contractual form specifically to escape state intervention.

The failure to pay local municipal taxes has a dire effect on municipal finance and its implications for urban development are far reaching. Over a period of two decades, taxes raised from the very poorest categories (from the bullock- and horse-cart stands and from stalls in the municipal market) contributed nearly as much as those from all inhabitants with taxable property and income. The Municipality appears to tax people earning less than its own employees, but is unable or unwilling to tax the elite. Three interpretations suggest themselves:

- i a class conspiracy (between officials and the commercial elite);
- ii the political weakness of local government in the face of the commercial elite;
- iii the local government's lack of legitimacy, such that tax evasion represents a 'principled protest' by the economic elite at the high spend on salaries and the low spend on infrastructure: a set of circumstances which is likely to be self-perpetuating, if not self-reinforcing.

Tax evasion fuels a black economy characterized by a large black financial sector, by tendencies to invest

<sup>6</sup> See Harriss-White, 1996, for the second and third with reference to agricultural trade elsewhere in South India.

<sup>7</sup> Goswami *et al.* 1991; Harriss 1984. It is estimated that a mere seven million out of a total population of over 1,000 million Indians pay income tax.

in real estate rather than production, by short-term finance and investment, by the privatization of civic services and by pervasive relations of corruption. Avoidance and evasion, while legally distinct activities, are both part of the tactical armoury of private accumulation.

### 3 The Social Locations of Corruption

There are respects in which local-level state institutions are considerably more progressive than are their market counterparts: 40 per cent of municipal employees are from scheduled castes and 43 per cent are women. The structure of wages in state institutions is more egalitarian than that of the commercial workforce (though absolute pay levels are lower). While throughout the Indian state, uncorrupt individuals are to be found, local level corruption is widely experienced to be much more extensive and systematic than it was 20 years ago. It takes a greater variety of mutually intersecting forms:

i Bureaucratic corruption. This includes 'commissions' paid to employees of nationalized banks for loans; expansion of property rights on official posts, promotions and transfers (sometimes - as in the case of entrance to the police sub-inspectorate - using bribery to screen applicants in the wake of open competition); complex modes of purchase of state regulated goods (e.g. liquor) with bribes at every stage (for the permit, transport certificate, and records of payment at the bank and lifting at the store); multiple bribes for the acquisition of a good or service (one for the transaction, another for speed and a third for certification); and discretionary valuation (e.g. under the Stamp Duty Prohibition Act 67 where a registrar undervalues property for stamp duty by an amount which is shared between registrar and transacting parties). This category also includes pre-emptive bribery and extortion. Those sectors of the bureaucracy with the role of vigilance or control are bribed so as not to harass their clients (classically, in the field of industrial audit and income taxation). Technically incompetent officials are bribed so that the 'victim' can gain irregular access to a competent official; vigilance and inspection officials privately appropriate fines so that offenders can avoid penalties for breaches of regulatory law. The practice of official

'sunlighting' is also widely regarded as corrupt since it deviates from bureaucratic norms, intensifies the rationing of their work time, lengthens queues and increases incentives for bribes to gain preferential access.

ii Judicial corruption. This is one aspect of an alleged deterioration of professional conduct. Certain lawyers are said to be corrupt intermediaries between clients and judicial officers so that criminal and civil cases are increasingly selectively prioritized, judgements warped and the implementation of judgements delayed.

iii Political corruption. This is the most commonly reported form. It may take the form of intermediation e.g. the political negotiation of an indefinite delay to a work-force pay rise agreed by employers after a strike; the political invasion of a cooperative board of management, which proceeds to embezzle commodities from the cooperative; or the political appropriation of 'donations' required for entry to Teachers' Training Institutes.

Bureaucratic corruption has been politicized over time, in a trend which can be illustrated through the case of bus transport. Bus routes should be allocated bureaucratically according to closed tender proceedings and bus fares are capped by administrative fiat. However, administrative corruption over time ensured a 'clearing response' type of prioritization of routes according to returns, net of wear and tear, which matched the ranking of bribes. In the next phase, this administrative rent-seeking discretion was subjected to political capture. Politicians have inserted themselves as regulators and fund collectors and routes are doled out periodically in a 'public' meeting of politicians and bus owners according to the latter's **individual** roles in electoral and party political funding. Thus the political executive both commands the administration and captures the formerly private rents they gathered. Even more recently, the **collective** political investments of bus owners themselves have borne fruit in the form of discriminatory policy changes timed to disadvantage the state's own public bus transport and to advantage private owners. This is a more subtle form of corruption (also theorized by Khan and Roy in this issue) wherein the state subverts its popularly mandated or otherwise legitimated development project to

benefit powerful economic interests. Political corruption may bypass the bureaucracy entirely, the implementation of favours from corrupt alignments being administered according to political command in an entirely legal and orthodox manner. Here officials are far from being principals and private sector clients far from being agents.

While bureaucratic earnings are comparatively low, and low-risk, the commercial elite tolerates long and extremely costly waits in order to lodge kin (routinely and corruptly) in the bureaucracy. Administrative positions have high economic and non-economic entry barriers and are in effect investments (made with funds derived from primary accumulation) requiring returns (derived from corruption). Symbiotic economic relations develop between business, the administration and the ruling political party. Furthermore, the underfunding of state institutions as a result of tax evasion results in an understaffing and a resource scarcity which reinforces bureaucratic and political incentives for rent-seeking. Poor quality, easily sabotagable law raises questions about the intentions underlying law and the possibility of corrupt coalitions between legislators, administrators and the judiciary. The impoverished nature of training for political office at state level (due to a history of suppression of democratic local government) favours a verdict of incompetence rather than conspiracy on the part of legislators. But the resultant, apparently widely ramified skeins of corruption satisfies a broad set of interests so effectively that the consequences of incompetent law making are indistinguishable from that of a conspiracy.

Flows of money up and down political networks solidify social relations of tribute and clientelage which run closely parallel to those of state revenue and development. Under a populist regime, funds (originating mainly in the commercial economy) may flow upwards, be centralized and subsequently redistributed to the mass of potential voters in the form of money as pre-election sweeteners.<sup>8</sup> In a predatory state, centralized funds may also be privately appropriated and used for conspicuous

consumption. Under a patrimonial political regime, they may be reallocated into semi-legitimate forms of politicized bureaucratic provision or commercial investment. Thus the distribution of gains from political corruption is central to party politics and to state forms.

#### 4 Regulation, Deregulation, Accumulation and Corruption

Ever since Independence, commercial regulation by state intervention has had a variety of development objectives in which the suppression of open market rent-seeking and equitable public provision of basic goods and services have figured prominently. In suppressing open market rent-seeking, opportunities are created for bureaucratic rent-seeking. Further, the curbing of corruption and black marketing by state regulation not only entails direct bureaucratic costs, and the transaction costs of compliance to the parties involved, but also reproduces and multiplies the very structural conditions it is intended to regulate. This is well illustrated by what are by now the 'classic' commodities, the distribution of which is still widely thought to require state regulation (e.g. grain, cloth, fertiliser, kerosene, liquor), and activities such as moneylending and the private provision of public transport. In every case, corruption is, so far as we can judge, mandatorily and routinely entailed at each stage of the transactions, involving a wide range of parties in consequence (such as store-keepers, check-post guards, police, officials and labourers).

The question is whether, **given** the conditions we have described, deregulation is any better at guaranteeing compliant, unexploitative and orderly economic behaviour. Part of the answer may be sought by examining how minimally regulated market exchange presently obtains order. Despite, or because of, widespread corruption, a strong system of ethics orders and protects the commercial economy<sup>9</sup>. Business contracts are mostly oral and traders respect one another's property. Market exchange is strongly structured not to be open

<sup>8</sup> Wade described similar relations for village councils and the irrigation bureaucracy in his **Village Republics** (1988).

<sup>9</sup> This is no 'generalized morality' of the sort Platteau argues underlies market exchange (1994). On the contrary, the commerce we have researched is underlain by a pluralist ethical system (see Harriss-White 1996).

contract-forming processes but by tight persistent networks of repeated transactions, established hereditarily or through long processes of apprenticeship or induction, i.e. with high non-economic barriers. In such networks, trust and **reputation** are as important structuring principles as is power, and all are simultaneously deployed. Repeated contracts develop normative extra-contractual obligations, the breaking of which (by trading outside them) may affect reputation and even lead to exclusion. With the development over the least two decades of complex and sophisticated long distance trade with non face-to-face contracts, the nature of the reputation - and trust - based networks has changed. Ascribed reputation (on the basis of family, caste or locality) is being replaced by acquired reputation (on the basis of reliability or efficiency). In the town we study, social relations of commerce are still strongly rooted in institutions of ascription. Acquired reputation factors are most evident in long distance networks for new commodities, the products of corporate industry.

Regulation by reputation is as important for some kinds of ultimate client as it is for merchants. In the black financial economy, for caste-insiders, reputation is crucial for creditworthiness, for terms and conditions. It is still inherited. If repayment is delayed, the possibility of future loans elsewhere is jeopardized. People will stay in very oppressive credit and debt relations rather than let reputational failure affect their children and family. With a reported increase in corruption, with the prevalence of adulteration, quackery and incompetence, the importance of reputation as a mechanism of regulating conduct cannot be underestimated.

However, enforcement is also carried out by private security **forces**: '**goondas**'. The locations of these institutions of regulation are very precise. In the black financial economy, social outsiders such as **marwaris** employ a visible coercive squad to enforce repayment. The extra-contractual obligation of paddy producers indebted to paddy **mundy** owners to sell all marketed surplus (not merely that which repays loans) is regulated by collusion and force. Moreover, mercenary forces are amassed by local political bosses to protect returns to their investments. It is the black and the 'political' economy which tends to use extra-legal force.

Formal institutions are more successful in regulating labour relations than commodity exchange. Certain parts of the urban labour force are unionized and strikes over working conditions are regular events. However, organization by competing political parties weakens the work-force by dividing it and works in the favour of management. Much of the working population of the town is collectively regulated: e.g. market-place coolies and cartmen whose associations set entry barriers and unilaterally fix job-rates. The paddy and rice sector is poorly organized, however, and work conditions for casual female labour are the poorest remunerated and most physically oppressive. By and large the regulation of the urban work force is achieved by the strategic use of **family** labour. Such labour is both controllable and trustable. Power and trust run together and structure much of the regulation of the labour force in the commercial economy.

Finally, the market town has a total of 25 professional associations based on occupation, a fledgling chamber of commerce plus two ginger groups for consumer welfare and urban development. These **collective institutions** appear superficially as regulatory bodies to whom disputing parties would be expected to turn. They can establish norms of conduct for transactions and for the adjudication of disputes. But such regulatory activity is rarely put into practice. In fact, these associations i) defend members from threat - from organized labour and from the government; ii) organize collective bribes in the general interest of members; iii) exclude entrants; and iv) perform small acts of redistributive charity. At closer gaze many are tight networks of interest cemented by caste and kin, exemplifying how old institutions such as kinship are being put to new economic roles.

These kinds of regulatory institutions conspicuously fail to control an enormous amount of minor disorder in market exchange which never reaches 'official' notice. Such disorder includes adulteration and tampering with price and brand labels or weights and measures, pervasive agency problems, such as the underdeclaration of turnover to owners by managers; the above-norm appropriation of earnings (e.g. by bus conductors); rogue extra - contractual behaviour; petty theft of public property; evasion of taxation and labour

laws; the active resistance by employers to unionization.

There are thus already many alternatives to state regulatory intervention. Non-legal enforcement is necessary and cheaper; it's not just a market response to a defective state law but possibly pre-dating it and very likely to survive its demise. These alternatives are not to be regarded with starry eyes. Private industry and commerce may be corrupt when regulated by government, but they are not necessarily competitive and efficient when not regulated. It is sometimes forgotten that rent-seeking originated in markets, where it seems to remain a fundamental force. **Norms and thugs** and a penumbra of exclusive associations are the institutions on which local commercial orderliness rests.

'Deregulation' is thus of marginal importance when most regulation is not by law or the state but by reputation, norm and private force. Certain commodities will always have to be state-regulated if only on populist political grounds and in order to ensure the state's capacity to distribute essential commodities in emergencies. Others cannot be left to self-regulation because the collective interest cannot be served by 'the market', because institutions such as micro-monopolies and collusive oligopolies conflict with mass public interests, because social goals (such as gender and social justice) are blatantly not served by non-state regulatory institutions even if they are not well served by the state either.

Deregulation to date has had a contradictory impact on the local economy. A simplification of paddy procurement in 1991 resulted in a textbook reduction in corruption in the Civil Supplies Department, increased the velocity of transactions, formalized the previously seasonally illegal long distance, specialist trade and provoked improvements in quality. However, former strategically sited rent-seekers such as check-post guards, still survive and flourish on rents extracted by means of coercion. To this extent deregulation remains rhetorical. The delicensing of gold, also in 1991, has had a different impact. In the short term, it raised employment for goldsmiths at the margin, but it is lately leading to the domination of a millennia-old skilled artisan industry by mechanized, capitalist firms in Madras and their local agents on tied credit lines. The

displacement of large numbers of highly skilled local craftsmen is expected.

## 5 Conclusions

Policy predictions from the New Political Economy are derived logically from its theoretical analysis which is derived logically from the definition of corruption which is deployed. If the Santhanam Committee's definition of corruption is accepted, as here, then the analysis which flows from it produces radically different conclusions. While 'institutional scarcity' (not only understaffing and under-resourcing - scarcity **in** institutions - but the scarcity **of** appropriate institutions) does indeed encourage corruption, corruption is not always a clearing response and the public distribution of goods is not always inefficient compared with market alternatives. *Pace* Jagganathan, public agencies are unaccountable not (only) through administrative incompetence and institutional scarcity but (also) by dint of being politically captured. Public opinion does not act as a regulator not because it is unaware (because it is extensively aware), but because influential factions of the 'policy elite' regard what they (have been taught by NPE to) believe is the market clearing role of corruption as developmentally efficient.

If the workings of one market town are replicated widely, then primary accumulation may yet still characterize the mass of firms in an economy whose apex is dominated by corporate capital and which is being penetrated by global capital. Open and black markets function in similar ways. Primary accumulation is not only historically and logically necessary, it also takes what Marx called 'primitive' forms. Economic crime is one aspect of this 'primitive' condition. Corruption is another. But tax evasion and black investment are likely to be most important quantitatively. In a society where rent-seeking is generalized, the epicentre of corruption is not necessarily the venal official. A shift in the scope of the state may lead not to the eradication of rent-seeking but to its redistribution between 'state' and 'market'. Not for nothing is the Tamil proverb: 'an honest person is one who does not know how to live'.

We have identified four types of party to corruption, who may act in contradictory ways:

i Officials. Where demand by officials is the origin of corruption, then deregulation would not only reduce the 'supply' of activity amenable to corruption; it will also reduce the 'demand' for it.

ii Politicians. If ministers are at the origin of corruption (with various chains of money collected for them and dispensed by them), then deregulation would simply increase the political competition over state employees and the resources they command. Depending on the political gains from money-collecting corruption, the price of corrupt transactions could increase. There is no reason to assume the quantity of corruption would decline if political corruption is the most prevalent form.

iii Businessmen. Bribes may be supplied without much coercion as an institutionalized transaction cost to influence future events. Then neither officials nor politicians would be the source of corruption, rather it would stem from 'demand' for goods, services and preferential non-compliance. Merchants and business houses fund political parties on a large scale. They lobby systematically to protect business from threats; their kin are placed in politics and in the bureaucracy and they can place pressure on the police and judiciary. Deregulation by itself would not set conditions requiring a significant change in such behaviour. Indeed it could strip the state of its residual capacity to curb it.

iv Lawyers. All the other groups are in positions to bribe the judiciary to decide and implement in their favour. Deregulation would not necessarily reduce such corruption, merely shift its content.

The relations surrounding these four types of 'actor' are complicated by two facts. First, their role in relations of corruption is subject to internal contradictions. For the state does have the capacity to

redistribute resources. Corrupt and uncorrupt activity co-exist. Second, the distinction between types of actor is increasingly blurred.

Liberalization occurs slowly and incrementally. The official process of liberalization was long predated by forms of development which pre-empted state intervention and was exacerbated by a regulatory incapacity stemming from strategic understaffing. When the state does not perform well the minimalist role to which NPE would reduce it, other so-called 'informal' regulating institutions imperfectly fill the breach. Their existence has yet to be acknowledged in policy debate.

That deregulation can be accompanied by an increase in corruption is a proposition sustained because corruption takes much more complex forms than allowed for in NPE. A ganglion of relations of black economy, economic crime and corruption (increasingly political) sets the conditions for its own perpetuation. Corruption is a social phenomenon - part of a broader, institutionalized process of redistribution and accumulation, of new forms of property relation. Decades of tax evasion, black investment and corruption results in relations and institutions which are now serious obstacles to reform in directions predicted by NPE.

New norms, contractual arrangements and institutions have replaced broken laws or plugged gaps where regulatory law is not implemented as formally laid down. Complex contracts where *mafiosi* have the monopoly of force might be expected to lead to the eventual extortion of other parties. This article has not touched on the developmental effects of this ganglion of relations. While these may be ambiguous (Harriss-White 1994), the mafianization of the local political economy is developmentally very unwelcome.

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