

# LIBERAL DEMOCRACY AND THE POLITICAL MANAGEMENT OF STRUCTURAL ADJUSTMENT IN INDIA: CONCEPTUAL TENSIONS IN THE GOOD GOVERNMENT AGENDA

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## 1 SUSTAINING ECONOMIC REFORM UNDER LIBERAL DEMOCRACY

This article seeks to identify the factors that have contributed to the Indian government's thus-far successful introduction of liberal economic reforms amidst a liberal political system. For the purposes of this analysis, 'success' is not defined in terms of improved macroeconomic or social development indicators. These may well emerge over the long term, and there have been a number of encouraging signs since a newly elected government began its overhaul of economic policy in mid-1991. During 1994-95, for instance, GDP is projected to increase between 4.8 per cent and 5 per cent, comprising growth in both the agricultural and industrial sectors; exports have been increasing in dollar terms at more than 15 per cent per year for the past three years; and wholesale price inflation has mostly remained below 10 per cent.

Success is instead defined as the ability to sustain the forward momentum of liberalization over an extended period of time, and to allow market orientation of economic policy to become politically 'consolidated'. There is a very practical reason for defining success in this way. As the literature on structural adjustment makes plain, significant economic results – beyond basic stabilization – require at least four years of cumulative reform to manifest themselves. Many governments that have initiated IMF/World Bank-sponsored reform programmes have been unable or unwilling to sustain the process for this duration. There is, of course, no guarantee that a longer period of reform would have delivered substantial economic benefits in all, or even most, of these countries. Yet it is fair to say that four years of sustained reform is a necessary though not sufficient precondition for yielding the economic rewards promised by liberalization. As such, it is important to understand the reasons why some countries manage to stay the course, particularly if they are democracies.

A failure to sustain liberal economic reform is often attributed to political factors, such as mobilization

by 'vested interests' who perceive threats to their economic perquisites. Opponents of reform can include not only narrowly defined 'interest groups' or 'lobbies' – such as subsidized farmers, organized labour, and protected domestic industry – but also politicians fearful of losing their ability to use the discretionary power of state office to distribute favours and cultivate a durable political base.

Governments in democratic political systems have generally been thought to face greater obstacles in bringing about economic reform, mainly because their hold on power relies on electoral consent. In genuinely liberal democracies, anti-reform interests have more political space and resources to influence electorates motivated largely by narrowly defined short-term economic considerations.

India's status as one of the developing world's showcases of democracy makes it an important test case for understanding the politics of structural adjustment. Moreover, it is a liberal parliamentary democracy, just the type that donors would like to see flourish throughout the developing world. Liberal traditions of political openness, debate, compromise, and rule-based struggle in the pursuit of interest have struck deep roots amidst India's complex hierarchical social structure. To find this degree of integration between indigenous and imported forms of political organization is extremely rare among newly independent nations. In India, the result has been a unique, culturally adapted political hybrid.

These features are of immense analytical significance. But just as important is the fact that India's political system has acquired many of the destructive tendencies that have tarnished the image of liberal democracy. Donors and international financial institutions (IFIs) would like to believe that democracy need not be an impediment to sustainable adjustment, primarily because it seems the only way to provide the accountability on which the effective use of aid relies. But democracy's tendency to spawn political systems reliant upon

resource-draining alliances of special interests – and above all the extent to which these systems have proven themselves structurally averse to change – places severe limitations on the faith of even the most committed democratic idealist. So if India, which has shown both the promise and the pitfalls of democracy, can demonstrate a penchant for change – a self-correcting adaptive response – then there is hope after all for the future of both democracy and liberal economics.

The pressing analytical puzzle, then, is to explain why the Indian government of Prime Minister P.V. Narasimha Rao has thus far been able to engineer a transition that many doubted was possible due to structural constraints imposed by the nature of the Indian state, its relations with social and economic élites, and the realities of political competition.

## **2 EXPLAINING SUSTAINABILITY: CONCEPTUAL TENSIONS IN THE GOOD GOVERNMENT AGENDA**

The answer to this question reveals a tension between two of the central tenets of the good government agenda, as defined by international financial institutions and donors. On the one hand is what the UK's Overseas Development Administration (ODA) terms 'competence': 'the capacity to formulate policies and strategies; to take timely decisions both on the longer term and on more immediate issues which arise; to implement policy decisions....' (ODA 1993: 2.9) Competence in this usage is often called capacity by other donors. On the other hand is the concept of 'accountability', which among other things requires 'transparency of decision-making and relationships' (ODA 1993: 2.7).

This study attempts to explain the Indian government's 'competence' in allowing policy reforms to take root amidst the political minefield of India's liberal democracy. Yet one of the main explanatory factors cited is the state élite's ability to employ political tactics that have little to do with 'transparency'. These include strategies to soften the edge of political conflict by promoting change amidst the appearance of continuity, and to arrange accommodations among groups who perceive reform as a

threat. In other words, the governance capacity of democracies need not rest solely on the transparency of decision-making or relationships.

In fact, the cross-national literature on the politics of adjustment explicitly recognizes the need for reforming governments to adopt 'Machiavellian' tactics to create the political conditions under which adjustment can be consolidated (Williamson and Haggard 1994: 529). One collection of case studies cites Albert O. Hirschman's analysis of land reform in this connection. Hirschman argued that successful reformers must often resort to the 'use of ambiguity and obfuscation [and] less visibly extractive instruments....'<sup>1</sup> Governments at the central- and state-level of India's federal polity have assiduously pursued such strategies, and have done so with considerable success thus far.

The World Bank's primary policy statement on governance argues that economic reforms tend to generate a parallel effort at restructuring governmental institutions, and goes on to assert that '[t]o nurture a political consensus in support of these reforms, governments require political skill' (World Bank 1992: 5). In a recent assessment of India's structural adjustment programme, the Bank stated that the 'skill with which reforms have been introduced thus far has few parallels elsewhere.' (World Bank 1994: v). Yet the skill referred to in both statements involves the exploitation of mechanisms of elite compromise, the operation of which often involves a decided lack of transparency, and even corruption.

### **2.1 The importance of countervailing transparency**

Further complicating this picture is the unavoidable fact that transparency is indeed a crucial feature of the democratic political system through which these same (non-transparent) tactics are employed. Transparency serves four useful political functions.

First liberal democracy does provide political space and resources for NGOs to pressure governments to avoid the more extreme forms of structural adjustment. Citizen groups, advocacy organizations, local 'social workers', often with links to grassroots

consistency and courage to face attack often turn out to be liabilities to successful redistribution. Progressive redistribution may be more readily effected when regime leaders indulge in improvisation, obfuscation, and even insincere threatening....' (p 18).

<sup>1</sup> This is how his views were summarized by Haggard and Kaufman (1992). A similar conception was put forward in Ascher (1984). His analysis of the politics of redistributive reform could apply equally well to the politics of liberal economic reform. For instance, he writes: 'The virtues of forthrightness, openness, ideological

political networks, and legal-aid societies have been active in safeguarding social welfare and poverty-alleviation initiatives. The Maharashtra Employment Guarantee Scheme workers' associations, for instance, have engaged in intensive local lobbying in an effort to preserve this important, if flawed, programme.

Second, the looming spectre of elections provides a check on the natural tendency of governments to rely excessively on intra-élite bargains that involve modified forms of corruption. A senior civil servant in the Bombay municipal corporation, for instance, caused considerable political embarrassment for Maharashtra chief minister Sharad Pawar by threatening to expose his links to some of the city's most notorious land-grabbing mafias. These allegations came in the wake of Mafia-related violence in elections to union posts in a major Bombay textile mill. Pawar is reportedly closely involved in negotiations to allow the chronically loss-making mill to sell off its prime Bombay real estate, and to arrange an accommodation whereby workers, and more importantly their often corrupt representatives, are compensated. As the state government prepared for legislative assembly elections in early 1995, the allegations against him were seen to have imposed an extra measure of restraint in his approach to this issue.

Third, politicians who determine the content, pace, and sequencing of reforms rely on the relative openness of political competition in India to gauge the strength and coherence of existing interest-group formations, and to assess the potential for constructing alternative coalitions. The dense network of institutions which have developed around the system of competitive politics in India provides a signalling mechanism which is an important resource for 'political entrepreneurs'<sup>2</sup> – élites who attempt to anticipate events in an effort to exploit changes in the policy environment by mobilizing resources in the form of finance or votes.

Fourth, transparency allows reformers to gain political support for further measures when neglected groups demand parity in respect of liberalization. An example would be the increasing demand among Maharashtra's cotton farmers for the abolition of the state's monopoly procurement scheme, under

which it is illegal for cultivators to sell their output across state lines. The leaders of the largest agitations on this issue have evinced keen interest among cotton farmers by highlighting the benefits that liberalization has provided for the cotton textile industry. As the adjustment process continues, it becomes increasingly difficult for democratically elected state and national governments to deny to farmers the liberalizing reforms they have delivered to the industrial sector.

## **2.2 'Irreversibility' and the 'consolidation' of economic reform**

Attempting to understand why Indian economic reform has been successfully sustained in the face of political obstacles presupposes that there is a 'success' to explain. It is natural to ask what constitutes success in terms of sustainability.

A recent study of the politics of adjustment in twelve countries attempted to draw lessons from those countries that had 'consolidated' reform politically. Consolidation was deemed to have taken place when the basic precepts of market economics and the general direction of reform measures had become irreversible. (Williamson and Haggard 1994: 528-29). Among the adjustment programmes considered 'consolidated' was Colombia's, which was at that time only four years old. July 1995 is the fourth anniversary of India's current reform programme, and in terms of its scale and political rootedness it is comparable to the Colombian case. There are no serious signs of backsliding, and only intermittent periods during which the introduction of additional reform measures is sluggish. Nor does an expectation that policy trends in India will continue in a generally liberal direction rest on unduly optimistic assumptions. Since adjustment began in July 1991 India has weathered a number of potentially disruptive events: widespread Hindu-Muslim rioting following the destruction of a disputed religious structure in North India; an unprecedented series of terrorist bombings in the commercial capital of Bombay; a \$2 billion financial-market scandal involving foreign banks; and a growing secessionist battle in Kashmir.

Similar events in other countries have increased general political uncertainty to a level sufficient to weaken the resolve of reforming governments.

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<sup>2</sup> On the varied roles of political entrepreneurs and the circumstances under which they are able to overcome barriers to collective action, see Moe (1980).

Arguably, less dramatic political developments motivated Rajiv Gandhi effectively to abandon his government's far more modest attempt at economic liberalization by late 1987, barely two years after it was launched. That his failure to stay committed to liberalization was attributed to the mobilization of disaffected lobbies makes it all the more necessary to explain the sustainability of the current reform programme (Harriss 1987; Kohli 1989).

Several informed observers within and outside India consider the general trend of policy liberalization irreversible, even if there continue to exist many competing options on any one issue, and therefore a very large set of possible policy combinations. Jaswant Singh, a senior member of the Hindu nationalist Bharatiya Janata Party (BJP), the major parliamentary opposition party, recently stated that regardless of which party comes to power in India, the basic thrust of liberal economic policy was likely to continue. Nor is anti-liberalization sentiment within the Congress Party likely to result in across-the-board reversal of liberal policy reforms. Following the electoral defeat of the Congress Party in four state assembly elections in December 1994, one of the prime minister's principal contenders for power within the party, Minister for Human Resource Development Arjun Singh, stated that the main thrust of adjustment was irreversible. He reportedly went so far as to reassure the US ambassador to India in a private meeting that he was essentially a friend of liberalization.

### 2.3 The status of the reforms

While there are still many reforms that have yet to be initiated, and others that require further work, what has been achieved to date is very substantial.<sup>3</sup>

**Trade and industry reforms** include the following: devaluation of the rupee; abolition of import licensing with the exception of imports of consumer items; replacement of the Cash Compensatory Scheme for exports — a major subsidy item on the federal budget — with convertibility of the rupee on the current account; reduction of maximum and product-specific tariff levels; reduction and rationalization of excise duties; limited reductions and streamlining of direct taxation; abolition of industrial licensing for all but 18 sectors; substantial relaxation of the Monopolies and Restrictive Trade

Practices (MRTP) Act which had severely restricted the activities of large business houses; liberalization of foreign direct and foreign portfolio investment; and the opening up to the private sector of industries previously reserved for state-owned enterprises.

**Financial sector reforms** that have been enacted to date include: enhancement of the capital base of public-sector banks to meet Basle international norms; the lowering of the statutory liquidity ratio and the incremental cash reserve, instruments through which the government has access to the resources of commercial banks; and limited freeing of interest rates.

**Agricultural reforms** have been rather limited, but include: the abolition of restrictions on the movement of agricultural commodities between government-determined zones; the freeing of prices on some types of fertiliser; the substantial abandonment of canalization of agricultural trade through state trading corporations; the dismantling of quantitative restrictions on agricultural trade; and a range of reforms at the state level.

### 2.4 Assets of India's Democratic Political System

India's democratic political system possesses three key assets, the combination of which continues to propel the reform process along a path which may be far from economically optimal, but which buys the precious time needed for reform to become firmly anchored within the prevailing political culture.

#### 2.4.1 Conflict-mediation Mechanisms

The first asset is an interlinked network of well-institutionalized mechanisms for negotiating and arranging the bargains that prevent potentially hostile opponents of reform from translating their grievances into political actions that could convince reformers to abandon reform so as to remain in power. Political bargaining in India takes place through a variety of formal channels, including political parties, state and national legislatures, business-government consultative groups, and bureaucratic organizations that bring together key actors within specific policy arenas.

However, informal channels such as intra-party factions are just as important. Many crucial and

<sup>3</sup> The grouping and listing of reforms in this section has drawn substantially on the compilation set forth in Gaiha (1994: 5-8).

creative compromises, for instance, are brokered through closed-door, one-to-one meetings between government and interest-group élites. The efficacy of the resulting agreements relies on the extent to which leaders can be seen to deliver the support of the constituencies they purport to represent. In this sense, the openness of the Indian political process – ‘transparency’ of a sort – must be regarded as a critical factor in facilitating politically sustainable adjustment. This is because it allows the negotiating parties to evaluate each others’ strength and cohesiveness. The range and depth of these mechanisms, the degree to which they have acquired ‘legitimacy’ among a wide range of élites, and their capacity to adapt to changing political circumstances are the characteristics which make them particularly valuable during this period of transition.

#### 2.4.2 Political Skills

Political skills are important to any political system, democratic or authoritarian. They are an adaptation to the prevailing political context. In India, the dominant reality has been extreme fluidity within the context of intense élite competition. This has taken the form of politicians and other political figures changing positions on policy and transferring party or factional loyalties, with seemingly little cost to the actors’ credibility within the system. In general, a premium has been placed on the ability to blur the distinctions between conflicting interests. Often this has been accomplished by allocating ‘hidden’ subsidies, and holding out the promise of future rewards, particularly in the form of government posts. During this critical first phase of adjustment, however, the manoeuvrability of India’s political actors (including politicians and non-elected élites), a skill honed by means of training in an environment of fluid competitive politics, has proved extremely helpful in taking advantage of the tools which the democratic system puts at their disposal.

#### 2.4.3 Political Incentives

The existence of institutionalized mechanisms for mediating conflict, and the practice-conditioned ability of élites to operate them, do not further the cause of implementing adjustment unless there are incentives to put them into action. Incentives are intimately bound up with perceptions of interest.

Politicians’ decisions on whether to press on with reform depend on assessments of the ability of interest groups to deploy political resources in a way likely to deprive them of power. A credible threat among business groups to withhold vital election finance may, for instance, persuade reforming élites to reverse the direction in one or more policy areas. Intractability among élites who mobilize such groups is a major disincentive for reforming politicians to sustain adjustment. This disincentive effect is magnified in political systems characterized by winner-take-all conflict outcomes, in which élites perceive losses to their privileges to be permanent. Conversely, the expectation among reformers that groups will respond to offers of negotiation and enter into broad-based compromises provides a major incentive to continue with adjustment.

The value of this incentive is further enhanced by the iterative nature of most adjustment programmes, particularly India’s. The most important implication of the gradualism and fluidity inherent in this process is that even modest changes in policy at one stage in the adjustment programme can significantly affect the inclination or capacity of interest groups to effectively oppose later reforms.<sup>4</sup> To the extent that reformers perceive both this declining capacity and the causal role played by incremental reform they become emboldened to initiate the next set of reforms. The net effect is that politicians operating within a liberal democracy become less risk-averse than general theories would suggest.

Significantly, however, this is largely due to the flexibility displayed by interest groups themselves. Were the élites who represent interests intractable rather than pragmatic, reformers would have little incentive to gamble on the prospect of future political realignments. The argument here is that liberal democracy provides the political space for groups not only to defend their interests, but also to re-define and reinterpret their interests based on, among other things, the content and direction of government policy initiatives. Apprehending the malleability of interests, reformers are less likely to feel constrained by the configuration of interest groups at any given moment, and therefore possess the requisite confidence to introduce limited reforms incrementally. Reformers in political systems endowed with the types of mediating

<sup>4</sup> In the theoretical literature, these are referred to as ‘policy feedback loops’, processes in which the impact of one set of policy initiatives on the structure of interests becomes a determining

factor in the decision of policy-makers to press on with subsequent reforms. For a useful elaboration of this concept as it applies to a wide array of policy areas, see Pierson (1993: 595-628).

mechanisms and political skills found in India's democracy are inclined to take limited risks based on a perception that interest groups, the élites and organizations that represent them, and governmental institutions themselves will tend to adapt to the changing policy context.

### 3 CASES OF POLITICAL ADAPTATION

How have these assets of the Indian democratic political system manifested themselves thus far? Reviewing a selection of cases involving politically sensitive policy reforms will help to illustrate the resilience and adaptability of liberal democracy as it is practised in India. They are grouped according to the two techniques of successful reformers cited above: the use of 'less visibly extractive instruments', and the use of 'ambiguity and obfuscation'.

#### 3.1 'Less visibly extractive instruments': federalism and the incentive effects of policy refraction

One of the assets on which reformers in the central government rely is the political-management capacity of state-level governments. The existence of functional competitive arenas at various levels of the political system helps to spread the burden of conflict resolution over a broader institutional base. Though the impetus for reform comes from a relatively small circle of advisors around the finance minister and the prime minister, state governments are forced to cope with its varied consequences.

The tendency for central government policy reforms to have different impacts in different states has in many cases led interest-group responses to vary from state to state. Moreover, liberalization is increasingly implemented in the form of successive micro-reforms in different states, at different times, and under different political circumstances. This combination means that the political impact of economic reform is refracted through the prism of federal India, resulting in a slower pace than many proponents of reform would prefer. But it also helps to blunt the edge of opposition. Efforts to mount coordinated political resistance to one or another reform tend to become severely dissipated in such a fragmented environment.

#### 3.2 Private sector labour

The example of the trade union response to economic reform provides a useful illustration of this process. Despite laws forbidding firms from dismissing workers, many chronically loss-making companies have simply locked their factory gates as elected state governments looked the other way, preferring to let this practice proceed quietly. Because this has occurred only sporadically – under diverse circumstances in different states – and because of the preoccupation of national trade union federations with national labour reform (the much-talked-about 'exit policy'), local unions have had fewer financial and organizational resources with which to oppose state government actions and inactions. The result is that the trade union movement – already fragmented on the basis of party affiliation, the public-private sector divide, and industrial sector – is becoming more regionally fragmented as well. This is likely to impair its ability ultimately to oppose more thoroughgoing reform of national labour legislation. It is an example of the way in which the effect of even modest, incremental policy changes on the structure of an interest group can help to cause reformers to reduce their estimates of the potential political costs of subsequent reform.

However, the advantages that fragmentation provides to reformers in New Delhi, who would like to see the strength of the trade union movement reduced before embarking on major national legislative reform, depends on the ability of state-level political élites to manage this process in ways that conform to the political logic of local contexts. It bears reminding that this capacity can rely substantially on tactics of obfuscation. A good example of this is the communist-controlled government of West Bengal, which prefers 'to privatize quietly, often through under-the table deals'.<sup>5</sup> The West Bengal State Electricity Board's Kasba gas turbine, for instance, was effectively sold to the RP Goenka industrial group in the guise of a leasing arrangement. In this and other instances, Chief Minister Jyoti Basu has used his personal popularity with the electorate as a lever with which to quietly pressure the leaders of his party's affiliated trade union to take a more 'pragmatic' approach to foreign investment, privatization, and tax reform.

<sup>5</sup> 'If Government is frank, PSUs only mean cash', *The Asian Age* (daily newspaper: Bombay, Delhi, London), 8 November 1994.

### 3.3 Public sector labour

Governments in many, though not all, states possess the political mechanisms, skills, and incentives needed to manage reform successfully. Their application is geared towards subsuming labour issues within the larger political dynamics at the state level, thereby diluting the potency of organized labour as an interest group.

In early 1994, for instance, junior doctors of the medical services in the state of Bihar went on strike demanding higher pay and guaranteed employment for all medical graduates. The Bihar chief minister responded by invoking the weapon of caste-based quotas, a major feature of political life in most Indian states. He announced that of the 644 vacancies in the medical services, 333 would be filled by members of the 'backward castes'. This served to sow discord between high- and low-caste members of the Bihar Junior Doctors Association, effectively ending the strike.

This is not an isolated incident. The divisive implications of the rise of caste-based unions was lamented by none other than the president of the Communist Party of India-affiliated All-India Trade Union Congress (AITUC). Moreover, this trend is most evident at the state level, where caste identity is strongest and most clearly articulated. The AITUC president cites as an example the Brahman Employees' Welfare Associations, which have sprung up in a majority of public sector enterprises in Karnataka.<sup>6</sup> Divisions based on religious identity, particularly between Hindus and Muslims, are also rampant within trade unions, providing yet another opportunity for reforming governments to undermine trade-union unity.

There are other ways in which federalism works to the advantage of reformers in New Delhi. The most important has to do with deregulation. The curtailment of the central government's vast discretionary powers over industrial licensing means that state governments are now the crucial point of contact for entrepreneurs. Political 'fundraising' increasingly takes place at the state level.<sup>7</sup> But there is a systemic check on the ability of ministers in state governments to capitalize on their suddenly pivotal positions. Since individual entrepreneurs rather than bureaucrats in New Delhi now decide where a venture will be located, states must compete with

one another to attract investment, foreign and domestic. This involves creating an investor-friendly climate. By driving a wedge between states capable of offering this and those that are less capable, this process has helped to take some of the sting out of reform-related dissidence among state-level political leaders, particularly within the Congress party.

The good government agenda, as delineated by donors, has studiously avoided recognizing the vital importance of these types of tactics in allowing adjustment to become politically 'consolidated'. For that reason, it has failed to make the connection between the capacity to employ these tactics and the extent to which political systems possess the requisite political skills, mediating mechanisms, and systemic incentives. The architects of the good government agenda have instead advanced a vague, sanitized, and ultimately unconvincing version of how transparency (implicitly equated with formal democracy) will assist reformers by facilitating the 'selling' of policy revisions to the public at large. A donor document on good government would not, for instance, feature the Indian government's practice of continually reassuring critics of its official commitment to 'priority-sector lending', under which 40 per cent of commercial bank credit is reserved for vital areas such as agriculture and small-scale industry, while in actuality allowing banks to consistently miss their targets. This sort of policy ambiguity, however, is a much truer representation of the political reality in India. Above all, it is an integral part of the democratic political process wherever liberal democracy is practised successfully, whether in the developed or developing world.

### 3.4 'Ambiguity and obfuscation': reassuring interests, undermining unity, and mediating conflict

Much of the literature on the politics of adjustment presupposes that the components of coalitions are easily interchangeable. The classic case is between 'winners' and 'losers' from trade liberalization. According to a well-known formulation, the export-oriented sector is expected to be brought into the government's support base, while previously protected producer groups grow politically isolated. Yet the gap between theory and practice is enormous. Even in the simplest economies the model's predictive capacity reveals its limitations.

<sup>6</sup> See the editorial by S. Krishnan, AITUC president, in the official CPI journal, *New Age*, March 1994.

<sup>7</sup> This view was expressed by office bearers of influential business associations in Maharashtra, Karnataka, and Rajasthan.

In Ghana, for instance, cultivators of cocoa, the country's main export, are the obvious beneficiaries of 'getting prices right' through exchange-rate and tariff reform. Yet the government of Jerry Rawlings has found it difficult to convert this into political support, largely because of ethnic divisions, but in substantial measure because of Rawlings' reluctance to cut loose some of his older clients. This is not uncommon in systems in which both state élites and their clients have little experience of shifting loyalties, and therefore little confidence that they will somehow land on their feet. This syndrome is alien to Indian politics, because of the fluidity of its democratic system, the gradualism that characterizes its form of policy change, and the near-universal expectation that new circumstances will bring new opportunities.

Because political support bases are not as easily substituted as some economists might think – even in a fluid system like India's – it is often necessary in the early phases of adjustment to mediate conflicts between contending economic interests. The way in which the government of Maharashtra Chief Minister Sharad Pawar has dealt with the state's politically powerful network of sugar cooperatives illustrates the necessity of performing this function. In addition to emphasizing the paradoxical relationship between political transparency and procedural opacity inherent in the tactics involved, an overview of two interrelated episodes will also serve to highlight the importance of state governments in managing economic change because of 'their role as ... inaugurators of new political alliances and as accommodating initiators in the process of incremental reforms' (Neale 1988: 293).

### **3.5 The management of sugar politics in Maharashtra**

During the first two decades following independence, a network of powerful farmer-controlled sugar cooperatives for organizing production, processing, and marketing emerged as a major political force in Maharashtra politics. Politicians play an active part in the fierce battles waged for the leadership of cooperative boards; and during local, state, and national elections cooperative leaders throw the full weight of the cooperative's resources – vehicles, manpower, institutional influence, and often finance – behind their chosen candidates.

This context of inter-penetration has resulted in the cooperatives being viewed, justifiably, as a

'privileged sector'. Leaders of cooperatives, which include a number of senior figures in the ruling Congress Party, are naturally suspicious about the implications of economic reform for the future of the institutions around which they have built their political careers. The fact that Maharashtra has the largest Congress parliamentary delegation of any state invests their perceptions with added significance. Sharad Pawar's response to this potentially serious source of opposition has been to play a two-level game.

On the one hand, he exploits nascent divisions within the sugar lobby. The stagnation in public investment in agricultural infrastructure during the 1980s had substantially exacerbated infighting between the state's 'sugar barons'. A reduction in the rate at which new land came under irrigation led to declining yields of sugarcane. Under pressure to continue processing activities on an economic scale, cooperatives began increasingly to defy the legally mandated zonal system, under which farmers in a geographic region are required to sell their output only to their zone's designated cooperative processing factory. By illegally offering higher prices to farmers whose lands were not assigned to their zones, the more efficient factories were able to poach on the cane supply of other cooperatives. By turning a blind eye to this practice, and by hinting at the eventual abolition of the zonal system, the Pawar government succeeded in pitting the efficient cooperatives against their victims in the battle for scarce cane supplies.

On the other hand, despite his strong ties with industrialists Pawar's political stronghold is the sugar belt of western Maharashtra. Pawar has therefore taken steps to assuage the fears of selected cooperative leaders. His objective is to blur distinctions, particularly to counter the impression that the advance of the private sector must necessarily be at the expense of the cooperative sector.

For instance, in private meetings with individual cooperative leaders, he has given assurances that their factories will benefit from opportunities in other agro-processing activities. This goes beyond the vague public rhetoric about the prospects for the sugar sector in a liberalized India. A number of promoters of recently established or expanded private-sector agro-processing units hail from prominent cooperatives. Regardless of whether the enterprises themselves flourish, or whether the



cooperative itself benefits, the promoters almost always turn a profit. This is reportedly because of the assistance of the state government in helping to arrange the details of share-rights issues, and in obtaining the state-level clearances required for foreign technology tie-ups. Those that have been helped in these and other ways have been conspicuous by their failure to join factional intrigues that have attempted to use the new economic policy as a lightning rod for anti-Pawar dissidence.

The same is true for cooperative leaders who see future benefits accruing from a provision in the revised Maharashtra Industrial Policy of 1993 which proposes to permit various types of units to hold land in excess of existing land-holding ceilings, 'subject to certain safeguards'. By creating a liberalization-induced loophole in land-reform legislation that is open only on a discretionary basis, the state government has created yet another mechanism to reward collaborators. Far from publicly highlighting this provision of the industrial policy statement, the Maharashtra government has gone to great lengths to play down its significance, and it certainly has not publicized the discretionary nature of this provision.

These and other forms of favouritism have served to undermine the unity of the sugar lobby, and overcome resistance to a number of adjustment-related measures. This series of events is another illustration of the skill of Indian politicians at accentuating the divisive impact of first-generation liberalization measures on the structure of interest groups, and then exploiting the lack of unity to pursue further reforms. This again relies on a well-honed appreciation for the inclination of interest groups to adapt to new incentives, whether they involve the desire of efficient cooperatives to gain at the expense of the inefficient, or the willingness of some cooperative leaders to strike individual deals on diversification. Non-transparent tactics – which, paradoxically, are reliant upon the openness of the political system – are crucial to this process.

### **3.6 Sectoral conflict: mediating between winners and losers**

The success of Pawar's two-level game of reassuring the sugar lobby while undermining its capacity to act unitedly permitted him to manage the distributional conflicts that arose as a result of another

central government policy decision. In April 1993 the Government of India removed controls on the price at which molasses, a major by-product of the sugar factories, could be sold. The gain for Maharashtra's sugar cooperatives during the last eight months of 1993 was estimated at Rs. 1.5 billion.<sup>8</sup>

Manufacturers of alcohol-based chemicals, one of the main buyers of the distilled alcohol into which molasses is processed, were hit with massive price increases – from roughly Rs. 240 per tonne before decontrol, to between Rs. 1500 and Rs. 2000 per tonne. Pressure mounted on the chief minister to take action when two major alcohol-based industrial chemical units, one of which is controlled by one of Pawar's associates, closed due to 'economic unviability'.

Pawar's solution was to introduce 'partial recontrol' of molasses pricing. A proportion of molasses could be sold on the open market, while a quota system would ensure that the price rises facing the chemical industry would not be as dramatic as under total decontrol. According to actors close to the negotiations, this compromise would not have been possible without the active participation of representatives from the chemical industry and the sugar cooperatives. Particularly important in facilitating this process was the divided state of the sugar lobby, which had been one of Pawar's objectives. This sequence – national-level reform, followed by mediation and a compromise formula – paralleled the pattern set in other states, including Uttar Pradesh and Punjab.

The tactic of mediating conflicts that arise between winners and losers from specific reforms has been applied to other cases by both the central and state governments. For example, the increased export opportunities that the liberalized trade regime offered to manufacturers of cotton yarn (the primary production input in the cloth-weaving industry) had increased its domestic price. While the large-scale mill sector could absorb the price increase, the small-scale handloom weavers, an important interest group with a presence in a vast number of rural constituencies, were hard hit. Through a combination of threats and incentives, the textiles minister persuaded the yarn producers to siphon some of their windfall profits to a parastatal agency

<sup>8</sup> 'Sugar industry: an investor survey', *Business India*, 3-16 January, 1994.

that would help to subsidize purchases for the beleaguered handloom sector.

These episodes provide a strong indication that the Indian path to adjustment will not mean the end of patronage politics. Much of the old system remains. More importantly, new avenues of profiteering continue to emerge, as do new modes of operation for existing practices. An example is the widespread abuse of an export-promotion programme, the value-based advanced licensing scheme (VABAL). The key to Pawar's ability to manoeuvre around such obstacles as the sugar lobby is the political system's ability credibly to foster hope among a broad cross-section of élites that they will be provided for in the transition, and that there will in any case inevitably be future opportunities brought on by new circumstances. Indian reformers have done this by successfully blurring the edges of their adjustment programmes with the 'use of ambiguity'. Élites believe in the democratic political system's essential adaptability. This 'legitimacy' is an invaluable weapon in the arsenal of Indian reformers.

#### **4 CONCLUSION: LESSONS FOR THE GOOD GOVERNMENT AGENDA**

The interpretative account outlined above contains four main lessons for aid policy in the area good government.

##### **4.1 Liberal democracies can break free of interest-group 'capture'**

The positive message to emerge from the Indian experience with structural adjustment is that it demonstrates the potential for promoting policy change in a liberal democracy. The capture of the state by rigidly defined interests turns out to be something of a myth. But to draw useful lessons from this 'success story' we need to look more closely at the underlying sources of democracy's unexpected resilience.

The reason why liberal democracy is an effective instrument in India is that it has provided a system for negotiating bargains and sharing spoils that is conducive to incremental change because it provides incentives for both political élites and leaders of interests to take risks based on their assessments of dynamism within the political system. The critical factor is widespread confidence in the flexibility of political institutions. With certain

important qualifications, it is justifiable to term this characteristic 'legitimacy'.

##### **4.2 The difficulty of replicating the virtues of India's liberal democracy**

Yet it is crucial to recognize that the three key assets of India's political system which have aided the sustainability of adjustment – political mediating mechanisms, skills, and incentives – are the product of more than 40 years of constitutional democracy. They are also the result of a prolonged nationalist movement that witnessed the creation of a formidable party organization, the Indian National Congress, that took control of state power in an exceedingly gradual manner. Unfortunately, there is no way to ensure that newly democratizing countries will be capable of constructing and nurturing the complex state-society linkages that underlay these assets.

Arguably, the evolution of confidence in India's élite-pluralist democracy itself rested on the creation of a pool of state spoils for which existing and emergent groups could contend, using the means the new political system placed at their disposal. In other words, we are faced with an historical paradox that limits the ability to replicate the virtues of the Indian political system: a highly *dirigiste* policy regime may have been required to nurture a democratic political system capable ultimately of dismantling that very same state-controlled economy without fatally undermining either the reform effort or democracy itself. If this is substantially true, then the role of historically contingent processes are ignored by proponents of democracy and good government at their own peril. The Indian experience should serve to temper the optimism among donors about the prospects for an ill-defined 'civil society' to serve as the foundation for newly constituted democracies in Africa and Latin America. The reasons for the durability of Indian democracy are more complex, as are the reasons why its evolving form of democratic politics has been able to foster and adapt to policy change.

As Richard Jeffries (1993: 20) has argued, 'the tendency of some Africanist scholars to wax optimistic about a new era of hand-in-hand economic and political liberalization, both supported by a re-flowering of civil society ... is wishful thinking on a par with 1960s modernization and 'political development' theory'.

His conclusion is that '[t]here seems little reason to doubt that economic and political development in African states...will have to go through something like the same historical stages' seen in the case of the east Asian NICs (1993: 30). The Indian case contradicts this assertion insofar as it demonstrates that at least one alternative path exists. Nevertheless, it does not negate Jeffries' underlying criticisms of the good government agenda: that outcomes are historically contingent; that the processes involved cannot be readily speeded up; and that attempts to apply the lessons of political and economic systems across space and time are not feasible.

### **4.3 The costs of defining the good government agenda too broadly**

This historical explanation does not, however, mean that India's success in sustaining structural adjustment does not provide useful policy lessons. Perhaps the most important is that defining the good government agenda too broadly or ambitiously entails substantial costs.

First, when put into practice, the various facets of the agenda can come into conflict. This is not without serious consequences. When the political reality and the stated policy rationale are clearly at odds, as in the Indian case, where the 'competent' management of policy reform necessitates the use of decidedly un-'transparent' tactics, the reaction among recipient governments is often withering cynicism. They cannot be faulted for interpreting an unrealistically broad agenda as tacit permission to compromise one governance objective, whether it is transparency or human rights or democratic decentralization, as a means of achieving another. Recipient governments quite naturally conclude that donor policy does not necessarily mean what it says – that all points of principle are negotiable. This inevitably undermines donor credibility, particularly threats to suspend aid unless performance-based conditionalities are complied with. The result can be an increased tendency, in the name of political exigency, to fail to meet agreed-upon targets.

The second cost of defining the good government agenda too broadly is that even modest, highly effective governance measures can become tainted by their association with the less-appealing elements. Given the at best uneven performance of donors and IFIs in implementing even simple governance projects, the wide-ranging goals of the

good government agenda are unduly optimistic. As many analysts have argued, the policy focus should be on more limited objectives, such as 'the rebuilding of effective administrative institutions' (Jeffries 1993: 24). Yet the potential for even this type of targeted intervention is at risk.

Widely accepted project initiatives, like civil service reform and the spread of best-practice in the management of public services, were originally included with more controversial issues like human rights and accountability to provide credibility to the good government agenda. But in an atmosphere of distrust this logic can backfire. The belief among recipient governments that the seemingly innocuous components of the agenda might be a Trojan Horse containing other more nefarious intentions throws the entire good government agenda into disrepute. Indeed, there is a genuine danger that relatively uncontroversial and effective capacity-building reforms are becoming stigmatized because of their association with a policy framework that tends to breed cynicism about donors' sincerity and suspicion about their motives.

### **4.4 The importance of multi level democracy**

The Indian case also demonstrates the importance of developing healthy and adaptable political systems below the national level. State governments have shown themselves to be extremely valuable in containing the interest-group pressures that accompany a complex reform programme. They have also acted as a testing ground for creative ideas on how to structure and sequence difficult reforms, so much so that the World Bank increasingly has directed its attention and resources at state governments.

While donor governments and IFIs have attempted in recent years to promote decentralization, their approach tends, as with the governance agenda generally, to relegate politics and the realities of political competition to the margin. The emphasis instead is on the efficient provision of public services. A larger commitment to understanding how links between national, sub-national, and local political arenas can help to moderate political instability by reducing the burden of conflict resolution on the apex of the system deserves much greater attention. This, however, requires a more explicit recognition of the role of 'politics' and power, concepts which the sterile language of 'governance' has consistently ignored.

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