

## **The Economic Consequences of India's Institutions of Governance**

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### **Abstract**

This paper examines the functioning of India's institutions of governance, namely, the legislative and executive branches of government, the judiciary, and the bureaucracy. An economist's view of the role of government is adopted, i.e., as a provider of public goods and corrector of externalities. Governance is analyzed along three dimensions: (1) the degree of commitment or durability of laws and rules, (2) the degree of enforcement of these laws, and (3) the degree of decentralization of jurisdictions with respect to local public goods. It is suggested that India's experience of governance reflects insufficiencies in all three dimensions: of durability, enforcement, and decentralization, with adverse consequences for economic efficiency. The paper concludes with a normative discussion, including a consideration of the possible roles of nongovernmental action and of civil society, as well as alternative structures of institutions of governance.

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## 1 Introduction

Two recent historical developments seem to have brought issues of governance into prominence. One is the economic failure and collapse of the Soviet-style regimes, the other is the unprecedented rapid economic growth witnessed in East Asia. India, while not a direct participant in either change, has been affected by both, and debates that have gone on since the 1960's about India's economic and political direction have been taken up with renewed vigor. The perceived triumph of the market has helped lead to the sharpest changes in Indian economic policies since independence, and focused attention, as in the rest of the world, on the actual as well as the proper role and functioning of government.

This paper, therefore, examines the functioning of India's institutions of governance. I shall use the term "governance" somewhat broadly, since it seems hard to pin down. Williamson (1994), following Davis and North (1971), for example, distinguishes between the institutional environment ("the set of fundamental political, social, and legal ground rules") and institutions of governance ("arrangements between economic units that govern the ways in which these units can cooperate and/or compete")<sup>1</sup>. I think this distinction is hard to draw in practice. In fact, it seems that the institutional environment in India deserves scrutiny, as it affects governance in practice. Therefore, I focus attention on some aspects of the legislative and executive branches of government, the judiciary, and the bureaucracy. Thus my use of "governance" is close to that of Lewis (1995): "the politics, but, even more, the texture and machinery of government, the bureaucracy, and its interactions with politicians and interests". At the same time, my investigation is somewhat narrower than Williamson's, in that I will have less to say directly about aspects such as corporate governance or forms of what Williamson calls "private ordering"<sup>2</sup>.

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<sup>1</sup>Putnam (1994), in commenting on Williamson, gives the following, slightly more concise definition of governance in this sense: "the organizational relations among economic actors". He emphasizes the role of "social capital", a term that seems to be due to Coleman (1987), and has been defined as "the aspects of the structure of relationships between individuals that enable them to create new values", through facilitating action. See Ostrom (1992) for further discussion.

<sup>2</sup>Thus I address the issue of social capital (footnote 1) only implicitly, in my final section.

Furthermore, I adopt very much an economist's view of the role of government, i.e., as a provider of public goods and corrector of externalities. Thus the role of the government as a guarantor of civil and political rights, "valued mainly on noninstrumental grounds" (Elster, 1994, p. 217), or as an implementer of social equity objectives, is kept in the background<sup>3</sup>. As an organizing principle, I analyze governance along three dimensions: (1) the degree of commitment or durability of laws and rules, (2) the degree of enforcement of these laws, and (3) the degree of decentralization of jurisdictions with respect to providing public goods. No doubt this is an arbitrary and incomplete categorization<sup>4</sup>, but I hope it will be a useful one. Therefore, I examine each of these dimensions in turn, in sections 2-4. The normative purpose of the analysis is, of course, to identify, in India's case, aspects of these three dimensions of governance that have had adverse consequences for economic efficiency. The paper concludes in section 5 with an overall assessment, including a consideration of the possible roles of nongovernmental action and of civil society, as well as alternative structures of institutions of governance.

## **2 Durability**

By their nature, laws are meant to be somewhat durable, that is, to last for some time. In practice, of course, informal social norms may have greater durability. Here I focus on codified laws, whether written down in statutes and regulations, or established by formal judicial precedents. Within this category, there may deliberately be different degrees of durability. Constitutions are obviously meant to be more durable than most laws, being made relatively difficult to amend. Within the particular constitutional framework, more specific laws may be changed more easily, by legislative action. Administrative rules and ordinances are the least durable. The durability of judicial precedents is less clear, depending on the actual workings of the judicial system. Ideally, we would expect precedents to make the interpretation of laws more durable than simple administrative procedures. To some extent, also, this issue overlaps with that of enforceability, and I return to it in the next section.

### **Rationale**

The rationale for durability is twofold, involving the usual economist's dichotomy of equity and efficiency. The kind of durability built into constitutions involves both. There are protections of individual and - in the case of India and many other countries - group rights against future attack. This may be justified on ethical grounds, rooted in equity considerations. Provisions to protect property rights, such as requiring government compensation for takings, may be seen as enhancing efficiency by reducing investment-inhibiting uncertainty. In practice, any constitutional aspect can have implications for both

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<sup>3</sup> However, one may also view the provision of rights or of equity as instrumental concerns, and therefore akin to public goods in nature.

<sup>4</sup>For more complete conceptual discussions, see Williamson (1994), Elster (1994) and the references therein.

equity and efficiency. For example, protecting some minority rights may be necessary for their acceptance of the constitution, avoiding either a less efficient country composition without the minority, or the costs of future conflict if minority concerns are ignored. Or, in the case of protections for private property, these may be seen in terms of fairness, and a particular attitude towards the status quo distribution of property. Thus equity and efficiency considerations are not separable in practice.

The efficiency rationale for durability may also be seen in terms of the benefits of precommitment (i.e., the ability to publicly stick to some predetermined course of action) to avoid the problem of "time inconsistency" (Kydland and Prescott, 1977). This term refers to the problem that a government or other economic actor may announce a policy, but then have incentives to modify it once others have responded to the policy<sup>5</sup>. If all eventualities can be anticipated, then, *ex ante*, having precommitment will be better than not having it. If, in some eventualities, there will be *ex post* renegotiation of contracts, laws, rules or agreements, this, too, can be anticipated *ex ante*. In such cases, some degree of flexibility, by allowing renegotiation, may improve *ex post* efficiency in some states of the world at the expense of *ex ante* efficiency<sup>6</sup>. If all eventualities cannot be anticipated, then precommitment is *de facto* incomplete. In practice, therefore, the optimal degree of durability is impossible to prescribe in general. Perhaps the only possible, rough generalization is that there should be a tradeoff in practice between specificity of laws and their durability, as measured by the difficulty of changing them. I will use this idea to examine the durability of laws in Indian experience.

### **Constitutions**

Elsewhere (Singh, 1995), I have argued that India's Constitution, while avoiding the problem of being over-specific (a charge that has been made about recent Brazilian constitution-making efforts), has been insufficiently durable. This is because it is too easily

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<sup>5</sup> A famous literary example of this problem is the case of the Pied Piper of Hamelin: the local government promised him payment to rid the town of rats, but had no incentive (they thought) to carry out the promise once the rats were gone. In the usual economic model, the potential victim of time inconsistency, having no recourse akin to that of the Pied Piper, recognizes the problem, and adjusts behavior accordingly, leading to a less efficient outcome than the one where precommitment is possible. This particular example raises further issues, of just how to precommit, the credibility of threats, and of common knowledge (what if the Pied Piper had announced his threat in the case of nonpayment - would it have been believed?), which are outside the current paper's scope. Another recent example of lack of precommitment, the Enron deal and renegotiation, is somewhat different, since the governmental actors changed. The problem of time inconsistency is present even without such a change: it is the incentives of the same decision maker that change, due to the actions of others.

<sup>6</sup> For a good discussion of renegotiation in the context of contracting, see Rubinstein and Wolinsky (1992).

amended<sup>7</sup>. In my earlier work, I focused on the erosion of Kashmir's special constitutional status and its effects on the development of violent conflict in that region. This is not directly an economic inefficiency, though the economic costs of such conflict are great. If one examines other key amendments to the Indian Constitution, they, too, have tended to have more political than economic consequences, limiting individual rights in some cases, or enhancing the power of the central government vis-a-vis the states. The efficiency consequences of this lack of durability are not clear. The past and present working of the Indian economy have not necessarily been significantly affected by the lack of constitutional durability<sup>8</sup>.

### **Legislation and Administration**

If we turn to ordinary legislation and administrative regulations, the issue of durability seems more important. However, the problem in the Indian case seems not to have been the one that would be suggested by theory. Much of the legislation and administrative rules which have governed India's economy have been remarkably durable. Despite concerns raised as far back as the 1960's about the basic regime of controls, it was only in the 1990's that any significant changes have been made. In terms of the theoretical framework discussed above, investment or other economic actions in India have not been inefficiently inhibited by the lack of durability of the day-to-day laws and rules governing such actions. Indeed, one could argue that economic actors in India have operated very efficiently in this context: knowing that the domestic market was protected and regulated, firms, bureaucrats and politicians behaved accordingly, often making long-term investments in things that mattered, such as relationships with politicians, or political careers. The inefficiency has been, of course, in the particular laws themselves, not in their lack of durability<sup>9</sup>. However, this inefficiency raises the question of its origins, and its persistence.

Suppose that we adopt the position, suggested by an optimal contracting view of legislation, that particular laws or administrative regulations were *ex ante* efficient when introduced. Why were they not reversed or modified when *ex post* inefficiencies became apparent? The general answer, which I attribute to Bardhan (1984), is that enough groups with sufficient political influence were deriving benefits from the current system to block changes in legislation (a "multiple veto system"). This view suggests that durability of laws is not just dependent on formal legislative rules, such as majority voting to pass legislation, but also the microeconomics of the organization of the legislature. Inman and Rubinfeld

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<sup>7</sup> For a summary of amendment procedures, see Siwach (1985) Chapter 32.

<sup>8</sup> However, note that the durability of a constitution that limits the power of governments to abrogate private property rights has been stressed as important for efficiency by Brennan and Buchanan (1980), North and Weingast (1989), and Weingast (1993).

<sup>9</sup> This point is forcefully made, and illustrated with examples such as The Delhi Rent Control Act of 1958 and the Monopolies and Restrictive Trade Practices Act of 1969, in Basu (1992). See also the chapters on specific laws in Menon and Debroy (1995).

(1994), for example, distinguish between two types of legislatures: minimum winning coalition (MWC) and universalistic (U). Policies chosen in the MWC legislature would reflect the preferences of the winning majority. With multi-dimensional policies, this would, in turn, depend on factors such as agenda rules, to overcome preference-cycle problems. In U legislatures, such problems are overcome by adherence to an informal norm of deference (mutual back-scratching). Empirical research for the United States (Weingast and Marshall, 1988; Hall and Grofman, 1990), suggests that U legislatures lead to higher allocations of public goods. I would conjecture that the Indian context seems to fit the U legislature model, and the proliferation and persistence of interest group subsidies in India, including indirect or in-kind subsidies involved in the protections provided by legislation such as the Industrial Disputes Act (see Datta Chaudhuri, 1994 and Menon and Debroy, 1995, Chapters 1 and 2), can be explained by this reinterpretation of Bardhan's analysis. Note that in this application of the idea to India, geographically based local public goods, the focus of Inman and Rubinfeld, are replaced or supplemented by interest group benefits.

A further point also needs to be made. Inman and Rubinfeld's discussion assumes that legislators are acting on behalf of their median constituents. In practice, especially in the Indian case (and no doubt in other countries also), legislators are substantially influenced by direct and indirect payments from beneficiaries of legislation. If rent creation leads to such rewards for legislators, then legislation that creates rents is likely to come about, and endure due to the sharing of legislators in those rents. This is, of course, a well-known observation in the Indian context. This point, unlike the one about the organization of the legislature, also applies to bureaucrats, and the implementation and durability of rules and regulations that create rents is likely to be biased by this process<sup>10</sup>.

### **Conclusion**

The issue of the optimal degree of durability of laws (how hard are they to change?) is not simple, in that there is no single answer. For protecting individual rights and freedoms, the Indian Constitution seems to have been too easy to amend. But the efficiency consequences of that lack of durability are only indirect, through the effects of conflict. In other contexts, everyday laws and regulations, things have been often too hard to change, owing to the creation of rents, and interests in protecting those rents. Starting from a discussion of durability, we have thus come to the well-known public choice position of James Buchanan, Gordon Tullock, and many others. Their answer to the problem of Leviathan is political competition, both through decentralization, and through effective democracy<sup>11</sup>. Before I turn to the degree of decentralization, my third dimension of

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<sup>10</sup> A recent, opposing viewpoint, that stresses the efficiency of bureaucratic and legislative institutions in the context of a democratic system, is in Wittman (1995).

<sup>11</sup> A complementary prescription would be constitutional restraints on the scope of government to restrict private actors in the economic sphere without compensation. See the references in footnote 8.

governance, we shall see that rent-seeking crops up again in the discussion of enforcement of laws in the next section.

### **3 Enforceability**

Laws do not make sense without enforcement. While classical economic models took the enforcement of property rights and other laws affecting economic exchange as given and exogenous, much recent work has focused on endogenizing this aspect, and analyzing different enforcement mechanisms and institutions. Ultimately, enforcement is the responsibility of the police and judiciary, acting in complementary fashion. The police monitors, investigates and prevents immediate violation where possible. The judiciary examines evidence and it rules on innocence, guilt and punishments. It is this possibility of punishment that acts as a deterrent to violating the law. Again, social norms and even psychological conditioning matter, in addition to legal institutions, but here I focus on formal institutions.

#### **The Judiciary**

In practice, in many cases, the police and judiciary do not directly control or enter into the above process. Several examples of alternative enforcement structures exist in India. The most important of these has been the bureaucracy, which has enforced myriad regulations in the realm of industry and trade, simply by its power to say "no". The police and judiciary remain important, of course, as a back-up, if decisions of administrators are not respected. There has also been a significant overlap between the bureaucracy and the judiciary, in the magistrate's role accorded to members of the Indian Administrative Service. This has been particularly important in rural areas. Also in rural areas, traditional local councils (*panchayats*) have had effective judicial authority over a range of matters. The existence of multiple layers and levels of judicial authority is not unique to India, nor may be the problems associated with its particular structures.

The judicial role of panchayats has been given some policy attention in the past. Since Article 50 of the Constitution requires separation of the judiciary and the executive, an attempt was made, especially after 1959, to create separate *nyaya* or *adalati panchayats* (NPs) to handle judicial matters. This would also serve to avoid overburdening panchayat institutions, since they now were expected to perform a wider range of developmental functions. In practice, the NPs saw a decline in their activity, at the same time state courts' workload was rising. Despite the informality and flexibility of procedures in the NPs, there were considerable delays and arrears at that level. This can be attributed to the lack of training of personnel, of institution building in general, and ultimately to a lack of adequate funding of the NPs. Overall, then the NP system came to be seen as a failure, and became effectively moribund<sup>12</sup>.

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<sup>12</sup> See Galanter (1989), Chapter 4, which, while written in 1978, seems to be the only detailed analysis of the NP system.



The use of local councils and rural magistrates for handling a wide range of legal violations continues to make sense, however, in terms of efficiency and decentralization. In particular, it economizes on the scarce resource of the formal judiciary. This scarcity is, in fact, one of the fundamental problems for India, because by creating lengthy delays, it severely undermines enforceability of laws. One of the most striking features of the state of India's judiciary is the degree of delay. For example, Siwach (1985) notes that by 1980 there were approximately 30,000 cases pending with the Supreme Court, up from about 2,000 twenty years previously. Mookherjee (1993), using data from the Malimath Committee Report (1990), provides more recent evidence at the level of India's High Courts, the next level below the Supreme Court. For the country as a whole, there were a staggering 1,421,589 pending cases in 1989. This figure represented a quadrupling since 1971. Mookherjee notes the failure of the number of judges to grow sufficiently quickly over this period, both in terms of total positions and their rate of being filled<sup>13</sup>. According to his calculations, the number of judges would have had to be doubled in 1989 to deal with existing pendency at the High Court level over five years.

The problem of insufficient judicial strength has several causes: "insufficient financial outlays of State governments, lack of proper manpower planning in response to workload increases, and undue exercise of influence by the Executive (i.e., the Home Ministry, the Chief Minister of the concerned state, or the Law Ministry)."<sup>14</sup> The influence is, of course, for the purpose of distributing patronage. Mookherjee notes the cumbersome procedure for appointment of judges, which permits this influence to be exercised, and which delays appointments. A further negative consequence of this is the erosion of quality of appointed judges.

Given the number of judges, what also matters for delay is the rate of disposal. Here Mookherjee notes the variation in effective management of case loads among different High Court Chief Justices. He also lists other factors mentioned by the Malimath Committee, as influencing disposal rates: the length of the work day, lax codes of conduct for lawyers (leading to frequent lawyers' strikes), and norms for classification and allocation of cases among judges. Reductions in delays could also be achieved by reducing the number of cases that have to be considered at this level. Measures to do this include reassigning jurisdictions between lower level and High Courts, better scrutiny of appeal petitions, and the development of alternative dispute resolution mechanisms. Siwach (1985), in the context of the Supreme Court, provides some additional factors behind the crush of court cases. He notes that judicial

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<sup>13</sup> Mookherjee observes that insufficient judicial strength was noted as a problem in India as far back as 1924.

<sup>14</sup>Mookherjee (1993), p. 18.

procedures such as long oral arguments, or the method of writing judgements, are often antiquated<sup>15</sup>. He also suggests that ill-drafted legislation is a cause of some of the cases filed.

The effects of delays in the judicial system are manifold. A major one is that they can increase uncertainty as to final resolution, and discourage investment. Delays also mean that dispute resolution may become a question of "might is right": using extralegal force to settle a dispute that is stuck in the judicial system becomes attractive since the use of force itself may not be punished swiftly. This further undermines the credibility of the judicial system. In practice, what seems to have substituted for the judicial system in practice is the workings of the political system. Those in political power may not only influence the working of the judicial system through patronage appointments, but also take over its functions. Disputes may be resolved by each side appealing to different politicians or political factions. Resolution of disputes is then a function of the relative political influence of the disputants and the relative political strength of the politicians. While the judicial system may also be subject to these effects, and litigation is costly, resolution of ordinary legal disputes by political means sacrifices fairness, transparency and certainty, since there are no rules, only discretion. A particularly pernicious side effect is that politicians become above the law, since they control its enforcement. Not only are they free to engage in illegal activities without deterrent, but those who are already lawbreakers have a strong incentive to enter politics. All the anecdotal evidence points to the pervasiveness of these developments in India<sup>16</sup>. Note that these effects are self-reinforcing: politicians self-selected by a system which protects them from punishment have an incentive to weaken the judicial system, and the pervasiveness of a norm may affect the number who adhere to it.

### **The Bureaucracy**

Since, as noted above, the Indian bureaucracy has been an important enforcer of laws at some levels, the same process has been at work in the relations of the bureaucracy and politicians. B. Sivaraman, a member of the British-period Indian Civil Service, which continued its role after independence, provides many examples of the distortion of supposedly impartial administrative decision-making by political pressures in his (1991) memoirs<sup>17</sup>. In one case, in Orissa in 1959, a village *panchayat* refused permission to construct a temple in a

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<sup>15</sup> For a discussion of these and other organizational aspects of India's legal system, see Galanter (1978).

<sup>16</sup> See, for several examples of how politicians in India have become above the law, Dwivedy and Bhargava (1967) and Sivaraman (1991). *The Economist*, in a recent article (July 15, 1995, p. 26, "Rascals Rule"), makes very explicit the argument that criminals have thronged to Indian politics because it affords safety from punishment for crimes. For example, it quotes the chief election commissioner as noting that 180 of 425 legislators in Uttar Pradesh have criminal records.

<sup>17</sup> Other works on public administration in India are numerous. Examples of these are Barthwal (1993), Mukherjee (1994) and Tummala (1994).

particular location. The thwarted group petitioned the state government to overrule the *panchayat*. Sivaraman, as chief secretary (the highest administrative post in the state) made a recommendation upholding the *panchayat's* decision, supported by the relevant state minister. The Chief Minister, from a different party in the coalition government in the state, was forced to accept this advice, because of prior agreement among the coalition members to govern such situations, despite a direct appeal to him by the pro-temple group. A victory for rules and transparency and checks and balances? Not quite: shortly thereafter, Sivaraman reports, he was transferred by the Chief Minister<sup>18</sup>! In his concluding chapters, Sivaraman notes the spread of this use of transfers of administrators and other bureaucrats, as a means of exercising political control, especially in the last two decades. Wade (1989), in his studies of South Indian irrigation systems, has detailed similar phenomena. A result of this entire process is that, just as politics becomes more attractive for some types of people than others, so does the bureaucracy.

To some extent, the problem for the bureaucracy is unavoidable, since it must be subordinate to the elected representatives of the people in a democracy. As long as the incentives of politicians are not addressed, there is not much that can be done about providing appropriate incentives to the bureaucracy. This suggests that too much judicial power should not be vested in the bureaucracy, either in cases such as rural magistrates, or in those who implement and enforce administrative rules and regulations. Such power will always be susceptible to distortion by political influence. On the other hand, there is no reason for the regular judiciary to be as subordinate to the political system as it has become in India. Politicians have come to use their powers of appointment and transfer over the judiciary in heavy-handed ways as well, but this can be changed by appropriate legal reforms and new laws. While politicians will always control the purse strings, within this constraint, the Indian judiciary can be strengthened in ways that enhance its ability to enforce the law.

The above argument for constraining the bureaucracy, lest it become corrupted, is worth further analysis. Sivaraman - not surprisingly - emphasizes the positive role in Indian development played by the bureaucracy of which he was a part, especially when it was not subject to arbitrary political control. He, in fact, did play an important role in initiating the Indian "Green Revolution"<sup>19</sup>. Case studies and discussions of the experience of Punjab, the state that was on the leading edge of this revolution, buttress this view with accounts of the positive part played by state-level bureaucrats and technocrats<sup>20</sup>. Bureaucratic governance has also been suggested as a positive factor in East Asian growth<sup>21</sup>. In both these cases,

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<sup>18</sup> This story is on pp. 249-252 of Sivaraman (1991).

<sup>19</sup> See also Lewis (1995) on the Indian government's successful pursuit of agricultural advances.

<sup>20</sup> For example, see Hamid (1981) and Leaf (1984).

<sup>21</sup> See, for example, Wade (1990), and the references therein.

politicians and bureaucrats seem to have collaborated effectively. In both Punjab and East Asia, one can explain this as a case of politicians having appropriate incentives flowing from their constituents (e.g. middle peasants in Punjab), though, in the East Asian case, this would require an indirect argument, appealing to factors beyond electoral pressures.

In contrast to these successful bureaucratic interventions, I have noted the relative failure of bureaucratic governance in Indian industry and trade. The ex-Soviet Union and its former satellites provide other examples of bureaucratic inefficiency. Shleifer (1994), in discussing these cases, and their difficulties of transition from central planning, provides a thoughtful analysis that points to where the differences may lie, in addition to the discipline of the electorate. Shleifer's argument is based on inefficient control structures or property rights, and is as follows. According to Grossman and Hart (1986), property rights are residual control rights over assets. Shleifer further distinguishes between physical and legal rights, the latter being protected by the courts. If there is a divergence between the two types of rights, so that bureaucrats or politicians have extensive physical control rights, final allocations after Coasian<sup>22</sup> bargaining are not enforceable by the courts, so Coasian bargains, and hence efficiency, cannot necessarily be achieved<sup>23</sup>. This is a more explicit version of the argument I presented earlier in this section. The focus on property rights does, however, point out how to resolve the puzzle of different qualities of bureaucratic interventions.

The answer I would give is a very conventional one. If the scope of bureaucratic control extends too heavily to physical property rights, rent-seeking, corruption, and inefficiency are a likely result, as discussed by Shleifer and others. However, where bureaucratic interventions are limited to providing public goods, such as information on new technologies or seed varieties; or correcting externalities, such as by subsidizing credit or inputs; or doing both, such as by creating appropriate institutional forms, there is a greater likelihood of positive effects. This seems to fit well with the Indian case, where farmers did not have to get permission to sow more land, or switch crops, whereas industrialists needed bureaucratic approval to expand capacity or switch product lines<sup>24</sup>.

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<sup>22</sup> Here I am referring to the idea, due to Coase (1960), that in the absence of transaction costs, bargaining among self-interested parties can resolve disputes and lead to efficient outcomes, even in the absence of external intervention. For a modern evaluation of the implications and scope of Coase's argument, see Farrell (1987).

<sup>23</sup> Note that this enforceability issue is another aspect of the "rules vs. discretion" issue raised in the context of the durability of laws.

<sup>24</sup> Bardhan (1994) suggests a complementary explanation for the difference between East Asia and India, based on his conversation with an Indian businessman, this difference being that "in India, unlike in the East Asian economies, you are never sure that the job will get done even *after* the bribe." Bardhan goes on to relate this to Shleifer and Vishny's (1993) model of independent monopolists in bribe collection. He also characterizes the uncertainty in India as due to the "elaborately structured system of multiple veto powers built into the

## **The Police**

The role of the police is worth considering separately, because it involves the bureaucracy and the judicial system. Ideally, the police are impartial investigators and monitors, preventing violations of law where possible. Their role complements that of the judiciary in enforcement. However, the police are also organized as a bureaucracy which is under the control of politicians, just as other branches of administration. The actual functioning of the police in India therefore becomes subject to the kinds of influences discussed above in the context of relations between bureaucrats and politicians. One important aspect of this politicization has been the encroachment of the central government into law and order, constitutionally a state subject<sup>25</sup>.

The solution to the resultant problems of enforcement - inconsistency, corruption, uncertainty, delays - may be to strengthen the organizational independence of the police vis-a-vis politicians, but allow greater control by a stronger judiciary. This line of reasoning may seem naive - after all, why should the judiciary provide an effective monitor of the police, especially since judges do not have to be responsive to electorates? One answer might be that a strengthened judiciary, at least at the local level, might be made subject to election, somewhat along the lines of the United States model. Another possibility is that power and prestige may lead to the opposite of short term self-interested behavior. The persistence of the Indian armed forces as an institution with relatively high integrity and efficiency, without obvious abuses of power, yet without direct control by the electorate, is worth considering in this respect. Of course, the interests of the armed forces may be less in conflict with those of politicians than would be the interests of a strengthened judiciary.

An alternative is suggested by trends in countries such as the United States and Britain: a greater role for citizens' organizations, in the form of police review commissions, as a direct democratic check on police behavior. However, this may be more effective in dealing with sins of commission, rather than of omission. It should be noted that in the United States in particular, much policing is handled at the local level, and local elected officials provide a fairly direct check on the operation of police, ensuring some measure of responsibility and accountability. Some of the pitfalls in local policing in India are similar to those of decentralization in general: lack of resources, training and equity<sup>26</sup>. However, there is no reason that a carefully planned and executed decentralization cannot overcome some of the current problems created by divergence between the interests of citizens and of individuals engaged in law enforcement. Such decentralization would, of course, have to include

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internal organization of the Indian state."

<sup>25</sup> See, for example, Mukherjee (1994), pp. 56-57.

<sup>26</sup> See, for example, the classic treatment of Bayley (1969), particularly Chapter 15.

attention to the organizational structures within which the police operate<sup>27</sup>. Decentralization is discussed more broadly in section 4.

### **Checks and Balances versus Multiple Vetoes**

In discussing durability, I referred to India's "multiple veto" legislature as preventing changes in inefficient existing laws. This concept also was referred to in the context of the inefficiency of India's bureaucracy (footnote 24). This kind of reasoning seems to suggest that the idea of checks and balances that I am suggesting in the context of the judiciary and the legislative and executive branches is misplaced. One possible reconciliation of these positions is to say that there is some optimal degree of checks and balances, and it has been too great within different components of the governance structure in India, but not sufficient across these components. Within the bureaucracy or legislature, it has often proved hard to get anything done, because it would hurt some group relative to the status quo. On the other hand, the executive branch of government in India has come to dominate governance in practice when it is able to overcome these internal constraints and to act. There is, however, another difference between the two cases. Multiple veto powers have mattered particularly for specific decisions in specific circumstances. The idea of checks and balances applies more at the level of rules rather than specific decisions.

### **Conclusion**

I think that the conclusion on enforceability is clear: if enforcement of laws in India were improved by being more consistent and swifter, this would have favorable economic consequences. This is in contrast to my less straightforward conclusion regarding durability. However, the dimension of enforcement complements that of durability. In a sense, they are closely related, since nonenforcement amounts to nondurable laws, with every new situation requiring a new negotiation. In both cases, two prominent conceptual threads were the issue of rules versus discretion and the nature of rent-seeking activity. The final dimension in my schema, that of the degree of decentralization, is somewhat different, in bringing in questions of geographic scope, or span of control, to use a managerial economics phrase. I turn to this next.

## **4 Decentralization**

The issue of the optimal degree or nature of decentralization is crucial in a country the size of India. This section begins with a review of a recent theoretical framework for looking at decentralization in the context of federal governmental structures. This is followed by a summary of the principles of assignment of tax and expenditure functions. Thereafter, I turn to the Indian case, to examine its institutions in the light of the theoretical discussion.

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<sup>27</sup> On organizational aspects, in addition to Bayley (1969), see, for example, Chaturvedi (1985), Mehra (1985) and Mishra and Mohanty (1992).

### **The Design of Federal Political Institutions<sup>28</sup>**

Inman and Rubinfeld (1994) provide a conceptual paradigm for evaluating institutions of federal republics. Since the debate at the time of the framing of the United States Constitution in 1787, one can distinguish between the decentralized "confederate" republic of Baron de Montesquieu and the "compound" republic of James Madison, the latter form having an overarching central government capable of acting against local interests. Similar issues were addressed in the framing of the Indian Constitution, with the final structure being very much one with a powerful role for the center. For either type of republic, Inman and Rubinfeld identify two federalist dimensions of its constitution: representation of the constituent states (or other subordinate units) to the central government, and the assignment of governmental tasks to either the central or the lower level governments. For compound republics, in particular, they suggest that the efficient federal institutions involve a preferred combination of representation and assignment.

Representation in Inman and Rubinfeld's framework is measured simply by the number and size of the constituent units of the federation. For example, a greater number of smaller units, all of equal size, say, will increase the degree of representation at the center, since there is greater potential for diversity of choices across units. This idea of representation is clearest in a country like Britain, where there is no layer of state or provincial government. We can think of the primary constituent units as being the parliamentary constituencies for the House of Commons. When there are multiple layers of government<sup>29</sup>, the interpretation is less straightforward, since there is representation at different levels of government, with different assignments of responsibilities. However, comparisons can often be clearly made. For example, in the United States, the lower house has one representative for about every 600,000 people, while in India the figure is closer to two million. Therefore, we might say that the U.S. has a greater degree of representation at the level of the central legislature. In these terms, the level of representation in India has declined since the constitution was written, since population growth has far outweighed increases in the size of the *Lok Sabha*. An alternative interpretation is to think of the constituent units as being the next lower tier of government where decisions are made. For example, Indian states would be the constituent units in this interpretation. In this case, splitting up states would increase representation at the center, without increasing the number of parliamentary constituencies. I think the true point is that representation is a multi-dimensional concept, and reducing it to one dimension involves some simplification and abstraction<sup>30</sup>.

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<sup>28</sup> This subsection and the next are partly based on Kletzer and Singh (1995).

<sup>29</sup> This is true in Britain to some extent also, since local governments and regional governing bodies do exist, and do not necessarily coincide with individual or groups of parliamentary constituencies.

<sup>30</sup> Another, more difficult issue is that the effective degree of representation - interpreted as the ability to choose different policies - is, to some extent, intertwined with the nature of the assignment of tasks. If policies are effectively decided at the central level, increasing the

With either interpretation, whether the potential for greater diversity of choices is realized depends, of course, on the assignment of fiscal functions. For a confederate republic, where constituent units have veto powers, an increase in representation through having smaller constituent units can be quite powerful in its impact, since the possibility of a veto goes up. In the case of a compound republic, the impact of representation also depends on the institutions that govern the central legislature, since this is where much business will be transacted. I discussed the MWC and U legislatures in section 2, in the context of interest group subsidies. Here the point is that the choice of legislative form affects the outcome of any particular combination of representation and assignment, in terms of efficiency of public good provision.

Which form of republic is preferable? The traditional case for a confederate republic is made primarily on political grounds, in terms of protecting democratic rights and encouraging political participation, debate and accommodation. There is also an economic case, based on the efficiency of Coasian bargaining, but this requires a set of very special assumptions. Since the Indian situation is clearly that of a more centralized compound republic, I shall not go further into these issues here. Within the compound republic, the constituent units such as cities, states or provinces must have a role to play, else no federal structure at all would be required. Madison's case for local governments was economic not political: it can be related to the Tiebout (1956) theory of local government, wherein, under some conditions, interjurisdictional competition leads to the efficient supply of local public goods. The required conditions include a perfectly elastic supply of jurisdictions, costless mobility of households, full information, and no externalities across jurisdictions. These clearly constitute an idealized case, and not one that is easily applied to the Indian economy. However, one can explore the consequences of the failure of one or more assumptions to hold. For example, the lack of free competition among local governments can create rents and rent-seeking, while the presence of externalities or spillovers provides one rationale for an encompassing central government.

One can examine the issue of representation as the choice of the size of the constituent units that send representatives to the central legislature. As noted, the effects of changes in representation depend on how a legislature chooses to do business. In section 2, I suggested that the Indian case corresponds to that of a universalistic legislature (with mutual back-scratching), with the result that there are higher levels of public good provision, or of the provision of interest group subsidies. In majority-winning-coalition legislatures, the effect of increased representation is uncertain. For national public goods, what matters is how the location of the decisive representative in the legislature is altered. For state or local public goods, increases in representation mean larger supporting coalitions are required, which increases the costs of coalition formation, but also raises the spending associated with successful coalitions. Inman and Rubinfeld hypothesize that the latter effect dominates.

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number of parliamentary constituencies will not have much impact on representation.



Therefore, in this conceptual framework, with either legislative form there is a trade-off between increased representation, with its democratic advantages, and economic efficiency, which is impaired by the overspending that accompanies more extensive political representation. The other institutional dimension, of the assignment of economic tasks to the different levels of government, may provide a way of resolving or softening the trade-off.

How should tasks be assigned? Based on economic efficiency considerations, the brief answer is that where spillovers are significant and/or the goods provided are national, the central government should decide, otherwise lower level governments should be assigned the task of provision. However, the extent of spillovers has been contentious in practice. In particular, as Inman and Rubinfeld point out, "If the central legislature assumes responsibility for deciding assignment, then assignment no longer stands as a feasible control to limit legislative inefficiencies."<sup>31</sup> They discuss alternative institutions that have been suggested to deal with this problem: a strong executive, locally-run political parties, and public hearings. I will discuss some of these issues later in this section.

Given a clear assignment of tasks, a level of representation, and legislative institutions<sup>32</sup> one can compare the economic efficiency of different combinations of these three institutional variables. Building on the work of Breton and Scott (1978), Inman and Rubinfeld make this comparison based on an assessment of different types of transactions costs. They conclude that, on grounds of economic efficiency, national public goods should be assigned to the center, with a legislature operating with majority-winning coalitions, while lower level public goods should be provided by state or other lower level governments. This seems a straightforward conclusion. However, like the concept of representation, that of assignment is not as straightforward as it might seem. In particular, the existence of intergovernment transfers, particularly with conditions attached, can make *de facto* assignment different from its ostensible manifestation in the constitution or other law. Therefore, I turn next to a closer look at issues of assignment.

### **Fiscal Assignment**

The classic treatment of the assignment of expenditure functions was provided by Musgrave (1959), who based his principles for such assignment on his threefold division of the public sector, into allocation, distribution and stabilization branches. He argued that the latter two were the primary responsibility of the center. These arguments, and more recent qualifications that have been provided by various writers, are summarized in Oates (1991). The "heart of fiscal federalism", according to Musgrave, lies in the allocation branch. The Tiebout model, mentioned in the previous section, is a good illustration of this: individuals

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<sup>31</sup>Inman and Rubinfeld (1994), p. 29.

<sup>32</sup>Alternatively, as noted by Inman and Rubinfeld, the legislative rules may be undefined by the constitution, in which case they become endogenous functions of the level of representation and nature of assignment.

shop among different jurisdictions that are themselves optimally created. Inman and Rubinfeld and others have discussed how the Tiebout assumptions may fail, and to the extent that they do so, the case for decentralized expenditure is weakened. However, Oates quotes empirical studies to suggest that the efficiency losses from centralized provision of state or local public goods may be quite high in some practical cases.

The assignment of responsibilities for taxes poses a somewhat different set of issues from the case of expenditure functions. Again, Musgrave (1983) provides a systematic treatment. He suggests that highly progressive taxes (especially for redistribution) and taxes on highly mobile tax bases should be centralized. The logic of this is clear, in terms of incentives and efficiency. The central government is also better suited to having authority over those tax bases that are distributed unequally across jurisdictions, for equity as well as efficiency reasons. Finally, benefit taxes such as user charges and fees are very suitable for lower levels of government.

In the context of efficiency and incentives, there is a clear connection between the vertical structure of the revenue system and the assignment of fiscal functions. Taxes which distort prices will affect public expenditures. These connections have been explored by Arnott and Grieson (1981) and Gordon (1983), among others<sup>33</sup>. In practice, Musgrave's prescriptions are most clear-cut in comparing national with local governments. This is reflected in empirical experience, cited in Oates (1991). Large, intermediate units such as states and provinces, on the other hand, have features in common with both extreme levels, and tax assignment is also more complex.

The optimal assignment of expenditure functions and tax instruments does not imply that each government at each level must be in balance. Even if we abstract from intertemporal issues in government finance by requiring balance for the public sector as a whole in each time period, individual government units do not have to be in balance. In fact, it is typical for lower level governments to receive transfers from higher level ones. For example, transfers from the center to the state governments are a strong feature of Indian fiscal federalism. A vertical imbalance may arise simply from differing abilities or efficiencies in tax collection. For example, till recently, the central government in China relied almost entirely on provinces and other lower level units to collect taxes, because it lacked institutional mechanisms to do so directly. One may distinguish this case somewhat from true intergovernmental transfers, in that the revenues collected by one level are *a priori* earmarked for another level, with no official discretion for the revenue collecting government. In practice, some discretion does creep in when the form and level of a tax is decided by one level, and collection effort by another level of government. Similar issues arise in the Indian context as well, in that it has been suggested that the central government is less interested in raising tax revenue from sources where the proceeds largely go to the states. In such cases, the practical assignment of tax instruments is not clear-cut.

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<sup>33</sup>Wildasin (1986) provides a detailed summary and evaluation of this literature.

More generally, intergovernmental grants may be rationalized as serving three main objectives<sup>34</sup>: subsidization of specific programs where there are spillovers across jurisdictions; greater equity in tax incidence; and equalization of fiscal capacity across subcentral jurisdictions. Conceptually, a designer of a fiscal constitution could optimize social welfare by simultaneously assigning revenue instruments, and expenditure functions, taking account of how individual governments, given this assignment, would maximize the social welfare of their constituents by picking levels of expenditure and taxation and of intergovernmental grants. An example of such a conceptual exercise is provided by Gordon (1983). In practice, the determination of intergovernmental grants, in particular, is often the result of political considerations. Inman (1988) provides evidence for this conclusion for the United States, and Kletzer and Singh (1995) suggest that this is true in India as well. Furthermore, the ability of the central government to make significant categorical grants allows it to substantially affect the direction of lower level government expenditures. Thus, *de facto* assignment on the expenditure side becomes endogenous, since it is influenced by central government decisions. This is a slightly different problem than the one noted by Inman and Rubinfeld (see footnote 32). These conceptual issues, I believe, can help us understand the Indian experience, to which I turn next.

### **Indian Federalism and Governance**

The theories discussed in the first two parts of this section provide some guidelines for fiscal federal structures, in terms of representation, and assignment of tax and expenditure functions. The Indian case is one where these guidelines are not well followed. Tax assignments are not clear-cut in India, even without considering the issues of intergovernment tax sharing. The central, state and local governments have overlapping tax assignments which are uncoordinated. Tax rates across commodities are not set at economically rational levels. There are multiple taxes on commodities with cascading effects. Some taxes act as internal tariffs, reducing the advantages of size in India's internal market. These issues have been recognized and analyzed in detail and will not be further examined here<sup>35</sup>.

The assignment of expenditure functions has not been subject to criticisms as severe as those on tax assignment, but the vertical fiscal imbalance, where states rely considerably on central transfers, either statutory or discretionary, has been a source of problems. Kletzer and Singh (1995) have emphasized the political economy of central-state fiscal relations, and suggested that the increased use of discretionary transfers permits greater rent-seeking, or, in the terminology of Milgrom and Roberts (1988, 1990a, 1990b), increases influence costs within the system. Another effect of the ascendancy of discretion over rules in intergovernment transfers has been the failure to advance equity goals through such transfers<sup>36</sup>, with discretionary transfers counteracting the equalizing effects of formulaic ones

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<sup>34</sup>See, for example, Oates (1991), p. 17, and King (1984), Chapters 3-5.

<sup>35</sup> See Kletzer and Singh (1995) and the references therein.

<sup>36</sup> See Rao (1994) for empirical evidence on this point.

made through the Finance Commission<sup>37</sup>. Since equity is a major reason for centralization (internalizing externalities being the other), this is an undesirable aspect of the Indian federal fiscal system. Strengthening the Finance Commission, as suggested by Rao (1995) in his conclusion, would be one possibility. This is in the spirit of the "checks and balances" approach taken in sections 2 and 3 above. More specifically, it can reduce the problem of assignment becoming endogenously determined by the center.

While most discussion of Indian fiscal federalism has been at the level of center-state relations, similar issues arise, and to some extent are worse, at the level of state-local interactions. Local government institutions are quite varied. Each state is divided into districts, with further subdivisions (*tehsils* or *talukas*), for administrative purposes. Each subdivision contains a varying number of villages, which form the base of the *panchayat* system: village, "block", and district, each with representative councils at that level. Urban municipalities form a separate system, with four grades, based primarily on size<sup>38</sup>. The creation or extension of representative democracy at these decentralized levels in the 1950 constitution continued a trend begun under the British. However, state governments retained statutory control over all local governments. This changes with the 73rd and 74th amendments to the constitution, which give local government bodies a more independent legal foundation. The recent Tenth Finance Commission recognized that this is not sufficient, and explicitly draws attention to the issue of assignment in its report ( Finance Commission, 1994, para. 15.13): "Panchayats and urban local bodies need to have well-defined sources of income and taxing powers. They must be encouraged to exploit them to the full, relying on transfers from above only at the margin...". I discuss this more specifically below.

It seems that the strengthening of local government can do two things in the direction of greater decentralization, greater responsiveness to local preferences, and, hence, greater efficiency. First, it provides an easier route for channelling central funds directly to the local level. While this may not seem to get away from the "top-down-ism" decried by analysts such as Lewis (1995), it can have two positive effects, from the Kletzer and Singh (1995) perspective. It reduces the possibility of "skimming" of funds as they pass through multiple levels of politicians and bureaucrats. Furthermore, the political influence equation is different

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<sup>37</sup> The Finance Commission is constituted every five years with a charge to make recommendations that cover a period concurrent to the period of a five year plan. Its membership includes academics as well as civil servants and politicians, but the government selects, and therefore to some extent controls, who serves on each commission. Its existence and broad functions are mandated in the Indian Constitution. Such a constitutional body seems to be unique to the Indian brand of fiscal federalism. The rationale for such an institution can be seen in relation to the Inman-Rubinfeld framework, as providing a way of allowing flexibility in assignment, without making assignment questions politically subservient to the legislature. It seems that the commissions have served some of this role in practice.

<sup>38</sup> More details may be found in Humes and Martin (1969), pp. 424-432.

between the center and a locality, versus the center and a medium-sized or large state. Thus two types of rent-seeking might be reduced. One can guess that the previous fear might have been that such bypassing of the state government would be problematic in view of the danger of capture by "traditional rural oligarchs"<sup>39</sup> at the local level, but not only has this danger lessened over the decades since independence<sup>40</sup>, but it has been demonstrated that coalitions of such oligarchs at the state government level are not necessarily better<sup>41</sup>.

The second practical consequence of stronger local government, one that may be more important from the perspective of genuine decentralization and responsiveness, is that such government may be able to raise funds more effectively. While there are always potential economies of scale in raising revenue, the Indian fiscal system has been marked by a greater degree of centralization of revenue relative to expenditure than in other federations. At the center-state level, this has meant that states rely heavily on transfers from the central government. This is less true at the state-local level, with 10-20% of urban local governments' funding coming from grants and other transfers<sup>42</sup>. However, while local governments do not rely heavily on external funding, it does seem true that the level of services that they provide is often abysmally low. Expanding the authority of local governments may help in this regard, and must receive attention, as noted above in quoting the latest Finance Commission..

It is true that expanding fiscal capacity is by itself not sufficient. Fiscal effort also matters. A property tax is theoretically the least distortionary for local government, which

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<sup>39</sup> This term is taken from Lewis (1995), p. 201, but the idea has been quite pervasive, often with justification. A nice literary illustration is the fictionalized account of what happened to land reform in northern India shortly after the constitution took effect, in Seth (1993).

<sup>40</sup> A quote from the floor discussion of Elster (1994) is apposite here: "It is no accident, responded Bardhan, that in India communists - in name, but really social democrats - have, by mobilizing people in an agitational mode, essentially demanded and now installed some systems of accountability. In connection with his village service in India, Bardhan was pleasantly surprised by how the landless poor, disenfranchised all these years, would stand up in a public meeting and say, what did you do with that money from the government? That had been unheard of in India for quite some time."

<sup>41</sup> A *caveat* is in order here: the recent formation of lower caste ruling coalitions in state governments in Bihar and Uttar Pradesh, and the leftist government in West Bengal, illustrate the positive aspects of higher level governments for groups who might otherwise have less clout at the local level.

<sup>42</sup> See Dutta (1984), p. 12. Note that there is a wide variation in the financing and other institutional arrangements of municipal governments in India, particularly across states, so any average figures are only suggestive.

must be especially sensitive to the mobility of factors. However, municipal authorities have been reluctant to use or enforce such taxes effectively (Dutta, 1984, Chapter 3)<sup>43</sup>. Some of the problems seem to be managerial, being the use of outdated procedures for assessment and collection of such taxes<sup>44</sup>. The issue of tax enforcement, and of incentives to restructure taxes, may, however, be looked at in terms of the problems of durability and enforceability discussed in sections 2 and 3. Thus, decentralization alone will not be enough, without attention to the other aspects of governance highlighted here. Decentralization of authority and enforceability of laws are complementary aspects of governance. Therefore, the functioning of the judiciary, bureaucracy and police at the local level particularly deserve attention. One approach is to argue that effective local government in these dimensions will require a strengthening of local democracy, something that the 73rd and 74th amendments should make possible<sup>45</sup>.

### **Conclusion**

The broad conclusion I wish to offer here is that more effective decentralization, with attention paid to the durability and enforceability of laws at the decentralized level, is likely to be extremely beneficial in India. There is more that can be said about decentralization, particularly with regard to issues of efficient implementation of services that have traditionally been undertaken by the government<sup>46</sup>. The trend in many countries is towards privatizing as much as possible to gain efficiency of delivery and pricing of local public goods. However, where basic needs and equity remain concerns, this course may be undertaken hesitantly, or with some regulation. It may be, however, that even regulated competition is better than local government monopoly provision. When one thus becomes involved in considering the scope of government, a related issue that deserves attention is the role of nongovernmental collective action in general: I focus on this in the next, concluding section. Here I wish to note a final point. The public choice perspective on decentralization (e.g., Brennan and Buchanan, 1980) is that it provides a check on government power through competition. But this is not the only rationale: responsiveness and efficiency may be promoted by decentralization even without this aspect. Furthermore, in the discussion of assignment, it was implicit that one will want to restrict the powers of lower level governments to impose

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<sup>43</sup> Municipal governments in some states rely very heavily on octroi and other relatively inefficient trade and transport taxes. Octroi can provide as much as half of municipal tax revenue in some cases.

<sup>44</sup> Paralleling his discussion of the judiciary, Mookherjee (1993) provides an evaluation of India's income tax enforcement procedures, and their current shortcomings. It seems that the problems are as bad at the local level. See Dutta (1984), Chapter 3. Again, it is important to note that there are great regional variations.

<sup>45</sup> See Singh (1997) for further discussion of these issues.

<sup>46</sup> See, for example, Bajaj and Sharma (1995) and Lewis (1995), Chapter 7.

distorting taxes or quantitative barriers to inter-state trade and movements of capital and labor: decentralization must be implemented efficiently.

## 5 Governance versus Government

In this paper, I have focused exclusively, so far, on the structures of government. Yet much is being written on self-governance, nongovernmental organizations (NGOs) and so on. The importance of civil society is often stressed by political scientists, and the idea of social capital, referred to in the introduction, is quite popular. If I interpret civil society to be the entire gamut of nongovernmental organizations (NGOs) and collective institutions, I do not necessarily see any lack in India. Volunteer organizations, interest groups and social welfare associations seem to be multiplying, alongside and overlapping with traditional occupational and religious groupings or organizations. To some extent, these can be substitutes for lack of effective government: in Delhi, middle class neighborhood residents' associations form to finance and carry out the provision of basic local services such as garbage collection, that are supposed to be performed by local government, but are not, or not effectively. One can view this as an improvement over nothing at all. However, it is important to remember that the rationale of government comes from the publicness of public goods, and the suboptimality of voluntary provision due to free rider problems. Voluntary membership in neighborhood associations at rates of 40-50% may be less efficient than more effective taxation and public provision of some services. Issues of economies of scale are also relevant in cases such as these<sup>47</sup>.

A counter argument may be that if government is ineffective, self-governance is better. This also seems to be the tenor of detailed studies of self-governance in areas such as local irrigation institutions (Ostrom, 1992, Tang, 1992 ). However, even here, it is recognized that such institutions are ultimately feasible only in a system where laws and rules at a broader level are enforced clearly and consistently by government. In a wider perspective, any collective action on a large scale will involve some specialization and delegation of functions. Government is just one aspect of this fact. In a democracy, individuals agree to be ruled by laws made by elected representatives, who are themselves subject to those laws. Voting is only one of several ways that constituent preferences can be articulated. While self-help and voluntary collective action to achieve certain ends are extremely important at the micro level, ultimately, government is the main institution of governance. It must be shaped to serve this role effectively.

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<sup>47</sup> It is interesting to note the spread of condominium and homeowner associations in countries such as the United States. Buying a home or apartment in some locations requires membership in such an association, with the compulsory payment of fees used for maintenance. This removes the free rider problem. Services provided by such communities can become quite elaborate, and governance by elected committees of members is complex, requiring the hiring of professional managers.

The last point is made effectively by Lewis. He describes "pluralism", or "delegating sideways" as a "logical companion theme to decentralization"<sup>48</sup>, and supports this strongly. He explains these terms as the delegation of authority to agencies outside the official hierarchy, including private enterprises, cooperatives, development corporations, and voluntary public associations. He notes the boom in recent years of NGOs, and their frequent virtues, but goes on to point out that "NGOs, whether externally based or indigenous, are often incomplete or awkward substitutes for legitimate official bodies"<sup>49</sup>. For Lewis, the danger is one of persistent dependence on external benefactors, whether official or not. This brings him back to the need for local self-government.

Lewis's final point in his discussion of this topic is the need for accountability of local government to its citizenry. I would summarize these issues as follows, by relating them to the discussion in previous sections. Effective rules or laws, with a reasonable degree of durability and enforceability, are essential whatever the degree of decentralization of government. Therefore, decentralization must be accompanied by more efficient organization of the primary institutions that make, interpret and enforce laws. Of these, the judicial system may be the immediate place to start. *Given* a smoothly operating and independent judiciary<sup>50</sup>, democracy - which gives constituents the ability to replace their representatives routinely and easily - will be more effective than if it is only a revolving door for opportunism. Accountability requires the law and democracy to work together.

In this framework, the role of NGOs and other nonofficial institutions is twofold. First, any collective group, whether a firm or a volunteer organization, may be engaged in producing something of value, ranging from purely private to purely public goods. For each such institution there are issues of efficient internal organization. These include taking advantage of any economies of scale or scope, having a system of corporate governance, and providing incentives to individual organization members. The second aspect of any such group (and in some cases the primary, or even only role) is its interaction with government in pursuing its goals. This is typically thought of as lobbying. It can be hidden and corrupt, trying to circumvent laws or rules, or it can be open and righteous, trying to enforce existing laws, or change them to make them better. Society ideally controls and condemns the former, but encourages acceptable forms of the latter. Political action by consumer or other public groups (outside the electoral process) is, therefore, potentially an additional means for achieving accountability of government.

At the same time, issues of accountability and responsiveness arise for nonofficial bodies as well. I think this is what makes government the key aspect of governance, and

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<sup>48</sup> See Lewis (1995), p. 251.

<sup>49</sup> See Lewis (1995), p. 376.

<sup>50</sup> It is important to note that there are many positive examples in India of both these characteristics: here I am arguing for the kind of environment that would make these routine.



resolves the potential "chicken and egg" problem - do we need effective nongovernmental action to ensure a responsive and efficient government? Therefore, the place to start when thinking about institutional reform, to complement recent economic reforms that have partly redefined the role of government, is the rule of law. Creating effective local governmental and judicial structures, with an efficient assignment of tasks, and the power to raise resources and enforce laws at the local level, is likely to pay off handsomely.

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