

**Some Economic Consequences of India's Institutions of Governance:
A Conceptual Framework***

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Abstract

This paper examines the functioning of some of India's institutions of governance, namely, the legislative and executive branches of government, the judiciary, and the bureaucracy, from an instrumental, economic perspective. 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 brief normative discussion of collective action in general, and 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 1960s 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.

Given this background, this paper examines the functioning of India's institutions of governance. We use the term 'governance' more broadly than some economists. Oliver Williamson, following Davis and North, 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').¹ However, this distinction is hard to draw in practice, and the institutional environment in India is intertwined with governance. Specifically, we focus attention on some aspects of the legislative and executive branches of government, the judiciary,

¹ See Oliver Williamson, "The Institutions and Governance of Economic Development and Reform," *Proceedings of the World Bank Annual Conference on Development Economics* (1994), pp. 171-97, and Lance E. Davis and Douglass C. North, *Institutional Change and American Economic Growth* (Cambridge: Cambridge University Press, 1971). Robert Putnam, in commenting on Williamson, gives a more concise definition of governance in this sense: 'the organizational relations among economic actors.' (Robert D. Putnam, "Comment on 'The Institutions and Governance of Economic Development and Reform' by Williamson," *Proceedings of the World Bank Annual Conference on Development Economics* (1994), pp. 198-200. He emphasizes the role of 'social capital,' (James S. Coleman, "Norms as Social Capital," in Gerard Radnitzky and Peter Bernholz, eds., *Economic Imperialism: The Economic Approach Applied Outside the Field of Economics* (New York: Paragon House, 1987), pp. 133-55), that has been defined in turn as 'the aspects of the structure of relationships between individuals that enable them to create new values,' through facilitating action. See Elinor Ostrom, *Crafting Institutions for Self-Governing Irrigation Systems* (San Francisco: Institute for Contemporary Studies Press, 1992) for further discussion.

and the bureaucracy. Thus, the use of ‘governance’ is close to that of John Lewis: ‘the politics, but, even more, the texture and machinery of government, the bureaucracy, and its interactions with politicians and interests.’²

Most importantly, we take 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, op. cit., p. 217), or as an implementer of social equity objectives, is kept in the background, though one may also view the provision of rights or of equity as instrumental concerns, and therefore akin to public goods in nature.

As an organizing principle, we 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. This is not a perfect or complete categorization,³ but still a useful one. We examine each of these dimensions in turn, in sections 3-5, prefacing this with a review of the literature on governance and economic performance, with particular reference to India. The purpose of the analysis that follows this review is to identify, in India’s case, aspects of particular dimensions of governance that may have had adverse consequences for economic efficiency. Our analysis is meant to suggest a conceptual framework for empirical work, rather than providing definitive empirical answers. The paper concludes in section 6 with an overall assessment, including a consideration of collective action in general, as well as alternative structures of institutions of governance.

Before turning to the analysis, we summarize India’s main institutions of governance. India is a constitutional democracy, comprised of 28 states, six ‘Union Territories’ (UTs), and the

² See John P. Lewis, *India's Political Economy: Governance and Reform* (Delhi: Oxford University Press, 1995). At the same time, this investigation is narrower than Williamson’s, in not dealing with corporate governance or forms of what Williamson calls ‘private ordering.’

³ For more complete conceptual discussions, see Williamson, op. cit., Jon Elster, “The Impact of Constitutions on Economic Performance,” *Proceedings of the World Bank Annual Conference on Development Economics* (1994), pp. 209-26, and the references therein.

National Capital Territory of Delhi. It has a British-style parliamentary system, with universal adult suffrage and first-past the post elections, and a bicameral legislature. Legislative powers rest primarily with the lower house, the *Lok Sabha*. The Prime Minister is the effective executive, though there is also a President, who has some powers of persuasion and guidance.

India's structure is explicitly federal, but with features that emphasize the power of the center over subnational units. Delhi, the UT of Pondicherry and all the states have elected (unicameral) legislatures, with Chief Ministers in the executive role. Each state also has a Governor, nominally appointed by the President, but effectively an agent of the Prime Minister. The constitution also assigns certain statutory powers to the states: the exact nature of this assignment, and how it has played out in practice, determine the extent of centralization within the federation.

The Indian bureaucracy has played a continuing and important role in the country's governance, its main structures having been inherited almost intact from the colonial period. It is provided constitutional recognition. The central and state level tiers of the 'public services' are given shape through the provisions of Part XIV of the Constitution. The key component of the bureaucracy is the Indian Administrative Service (IAS). IAS members are chosen by a centralized process, and trained together. In India's version of indicative central planning, bureaucratic discretion was (and, in many respects, continues to be) extremely important, and the IAS has had tremendous power and prestige for most of independent India's existence.

At the national and state levels, the judiciary constitutes a distinct branch of government, though the legislative branch influences appointments. At the local level, IAS members are vested with some judicial authority. The Supreme Court stands at the top of the Indian judicial hierarchy. Its powers include broad original and appellate jurisdiction and the right to pass on the constitutionality of laws passed by Parliament. In practice, there has been conflict between the Supreme Court and the legislature/executive over the scope of these powers, and their boundaries remain subject to bargaining, though one can generalize that the Court has been

overshadowed by the central legislative/executive branch. The President, in consultation with the Prime Minister, appoints Justices of the Court. At the state level, below the Supreme Court, are the High Courts, whose justices are appointed by the President, in consultation with the Chief Justice of the Supreme Court and the state's Governor. Paralleling the situation at the center, the state's Chief Minister can influence the Governor's advice. High Courts also have both original and appellate jurisdiction, and they superintend the work of all courts within the state.

2 Governance and Growth

The link between governance and economic performance was originally developed by economic historians such as Douglass North. North argues that, "economic history is overwhelmingly a story of economies that failed to produce a set of economic rules of the game (with enforcement) that induce sustained economic growth."⁴ The evidence used by historians is typically broad comparisons of countries over long periods of time. More recently, there have been substantial efforts to develop mathematical models of the link, and to provide empirical tests.

The mathematical models provide greater precision in terms of causal effects. For example, Rivera-Batiz analyzes the impact of democracy on the quality of governance, which is the level of corruption in his model, and how that, in turn, affects growth. Gradstein, in an analysis close to North's arguments, examines the impact of enforceability of property rights on growth. There are many similar models, all of which involve considerable abstraction and simplification.⁵ Note that enforceability, absence of corruption, and so on can be considered to be public (non-rival) goods from an economist's perspective.

⁴ Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990).

⁵ See Francisco L. Rivera-Batiz, "Democracy, Governance, and Economic Growth: Theory and Evidence, *Review of Development Economics*, Vol.6, No. 2 (2002), pp. 225–47; and Mark Gradstein, "Governance and Economic Growth," World Bank Policy Research Working Paper 3098 (July 2003).

Empirical analyses typically look at cross-country data, formalizing, in a sense, historians' case study comparisons. In order to conduct such analyses, various data sets have been constructed, attempting to capture different dimensions of governance. Table 1 summarizes three of these data sets. The first, from Freedom House, is the easiest to understand, since it is a narrow measure of political rights and civil liberties, what one broadly associates with democracy. The second has six different indices of governance, representing different 'clusters.' One interesting point is that these clusters combine structure, conduct and performance of institutions of governance. Most of the indices are self-explanatory, in terms of what they are meant to capture. Government effectiveness, however, may be elucidated further. According to the authors, it combines assessments of the "quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government's commitment to policies." Finally, the third index, GADP, which is used by its authors as one half of an index of social infrastructure, itself combines five measures, of bureaucratic quality, law and order, risk of appropriation, corruption and government repudiation of contracts.

Cross-country regressions, unsurprisingly, tend to find quite strong positive links between governance and growth, with much of these results being driven, perhaps, by differences between developing and developed countries. For example, Table 1 reports India's scores, which are typically much lower than the United States. On the other hand, they are not dissimilar to China's ratings. Comparisons within similar groups of countries are therefore harder to make using such data: for example, China's economic performance in the last 20 years has outstripped India's, but only in stability and effectiveness does its governance seem to rate higher. While this suggests a detailed comparison of India and China would be useful, it is beyond this paper's scope. However, the point that remains valid is that a consideration of a country's governance institutions within a conceptual framework may give pointers toward their impact on economic performance.

Just as India is not the worst country in terms of governance measures, it has also been a reasonable performer in terms of economic growth. From independence in 1947 through the 1970s, India's economic growth was reasonable, averaging 3.75 percent per year, but this was not rapid enough to significantly diminish the number of poor people. Changes in economic policies, starting in the 1980s, but especially in the 1990s, seemed to be associated with India moving to a more satisfactory range of 5 to 7 percent annual growth. One might argue that further economic reform will push this rate still higher. However, there is a case to be made that further economic reform itself is intertwined with improved governance, along the different dimensions indicated in Table 1.

As we noted, the empirical indices attempt to combine many different facets of governance, which may themselves interact (Rivera-Batiz, *op. cit.*). In particular, they combine aspects of governance structures with the conduct and performance of government. Abstract theoretical models are somewhat clearer, focusing on deadweight losses through what Bhagwati has called Directly Unproductive (DUP) activities (including corruption and rent-seeking),⁶ and on uncertainties in governance that inhibit private investment. In subsequent sections of the paper, our focus on durability, enforceability and decentralization examines these aspects of governance structure for India, and how they feed into the conduct and performance of government, and ultimately of the economy as a whole.

3 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 we 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 other laws, being made relatively

⁶ Jagdish N. Bhagwati, "Directly Unproductive Profit-Seeking (DUP) Activities," *Journal of Political Economy*, Vol. 90, No. 4 (October, 1982), pp. 988-1002.

difficult to amend. Within a particular constitutional framework, 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 we return to it in the next section.

Rationale

The rationale for durability is twofold, involving the economist's usual 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.⁷ In practice, any constitutional aspect can have implications for both 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

⁷ In particular, the durability of a constitution that limits the power of governments to abrogate private property rights has been stressed as important for efficiency by Geoffrey Brennan, and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press, 1980); Douglass C. North, and Barry Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England," *Journal of Economic History*, Vol. 49, No. 4 (1989), pp. 803-32; and Barry R. Weingast, "Constitutions as Governance Structures," *Journal of Institutional and Theoretical Economics*, Vol. 149, (1993), pp. 233-61.

avoid the problem of ‘time inconsistency’.⁸ 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.⁹ 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.¹⁰ 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. We use this idea to examine the durability of laws in Indian experience.

Constitutions

One can argue¹¹ that India’s Constitution, while avoiding the problem of being over-specific (a charge that has been made about Brazilian constitution-making efforts), has been

⁸ Finn Kydland and Edward Prescott, “Rules Rather than Discretion: The Inconsistency of Optimal Plans,” *Journal of Political Economy*, Vol. 85, No. 3 (June 1977), pp. 473-91.

⁹ A 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 believed) 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 in India and its 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.

¹⁰ For a discussion of renegotiation in the context of contracting, see Ariel Rubinstein and Asher Wolinsky, “Renegotiation-Proof Implementation and Time Preferences,” *American Economic Review*, Vol. 82, No. 3 (June 1992), pp. 600-14.

¹¹ See, for example, Nirvikar Singh, “Cultural Conflict in India: Punjab and Kashmir,” in Beverly Crawford and Ronnie Lipschutz, eds., *The Myth of “Ethnic Conflict”: Politics, Economics and “Cultural” Violence* (International and Area Studies, University of California, Berkeley, 1998), pp. 320-352.

insufficiently durable, because it is too easily amended.¹² The amendment requirements, requiring two-thirds majorities of both houses of parliament, and a majority of state legislatures,¹³ do not seem much weaker than those of the United States, but the rate of amendment has been over ten times as great (86 in 53 years, versus 27 in 214 years).¹⁴

Before justifying the characterization of the rate of amendment as too high, it is worth looking at its connection to the underlying political situation. For example, it can be hypothesized that in a situation such as prevailed in India's first decade as a republic, when the Indian National Congress controlled the central as well as most state governments with supermajorities, amendment would have been relatively easy, unlike the case of the nineties, with a weak coalition government and divided rule at the level of the states. Table 2 summarizes the time pattern of amendments. Of course, simple enumeration tells one nothing about the relative import of various amendments. Furthermore, decadal aggregates can hide special circumstances (e.g., the 'Emergency' in force from 1975 to 1977) and variations within decades (e.g., 1980-1989, when the Nehru-Gandhi family's Congress exercised strong control, versus 1989-1990, which saw a coalition government). Nevertheless, one can see that, even at the best of times, in terms of diffusion of political power, the structure of the amendment process has allowed for relatively frequent changes.

¹² It is important to add the qualification that, at another level, one that we take for granted, India's Constitution and its other institutions of governance have been very durable, in that their basic character has survived, and even strengthened in some dimensions (e.g., the Election Commission). This point is made by Devesh Kapur, "The Role of India's Institutions in Explaining Democratic Durability and Economic Performance, paper prepared for conference on India's Institutions: Performance and Design, Harvard University (July 2002), who also discusses the links to economic performance. Our focus is more at the level of legal frameworks, their durability, and their marginal effects on the economy.

¹³ For details of amendment procedures, see J. R. Siwach, *Dynamics of Indian Government and Politics* (New Delhi: Sterling Publishers, 1985), Chapter 32.

¹⁴ The United States is a useful standard as an early model of constitutional democracy, but it might be an extreme case, and not the best comparison. For another comparison consider Ireland, which was also used as a model in framing the Indian Constitution. Ireland's Constitution has been amended 22 times in 66 years, a rate one fifth of India's, in a much smaller, more homogeneous nation.

What have been the impacts of easy amendment? Singh (op. cit.) 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 have been great, in the case of Kashmir. If one examines other key amendments to the Indian Constitution, many of them have tended to have more political and distributional, rather than economic efficiency consequences, limiting individual rights in some cases, or enhancing the power of the central government vis-à-vis the states. The efficiency consequences of this lack of durability are not clear. In these cases, the past and present working of the Indian economy may not have been significantly affected by the lack of constitutional durability.

In other cases, the economic impact of amendment has been more dramatic. I provide one striking example. Economic theories such as market-preserving federalism (MPF), which emphasizes having a common internal market, implicitly assume constitutional commitments to maintain such conditions. The framers of the Constitution were aware of the need to ensure a common market, and Article 301 of the Constitution states, “Subject to the other provisions of this part, trade, commerce and intercourse throughout the territory of India shall be free”. Furthermore, according to Article 286 of the Constitution, “No law of a state shall impose, or authorize the imposition of the tax on the sale or purchase of goods where such sale or purchase takes place (a) outside the state, or (b) in the course of import of goods into, or export of goods out of, the territory of India”.

However, based on the recommendations of the Taxation Enquiry Commission (India, 1953), which noted the problems of tax administration in handling intrastate versus interstate sales, the Sixth Amendment added two clauses to Article 286, enabling the central government to levy taxes on inter-state transactions. As argued by Rao,¹⁵ such taxes have been a major source of inefficiency in the Indian economy.

¹⁵ M. Govinda Rao, “Tax Reform in India: Achievements and Challenges”, *Asia-Pacific Development Journal*, Vol. 7, No. 2 (2000), pp. 59-74.

In another respect, also, the Constitution has not provided enough durability in its provisions, through its use of escape clauses. The instrumental rationale for Constitutions, recall, is the presumption that *ex post* incentives for government decision-makers will be different than *ex ante*, and that they would choose to bind themselves *ex ante*. In the Indian case, the escape clauses in the Constitution were more likely to have been motivated by a certain kind of myopia or different perspective on human nature, rather than by any narrow self-interest. Constitution makers such as Jawaharlal Nehru and B.R. Ambedkar saw themselves as benevolent guardians who would continue in that role, or be succeeded by like-minded people – quite far from, for example, James Madison’s views at the time of the framing of the US Constitution, warning that men are not angels.

In the above example, the amendment to Article 286 was possible, in spite of Article 301, because Article 302 empowers Parliament to impose restrictions on internal trade that are in the ‘public interest’. Another extremely important example, where a constitutional escape clause was used to engineer major changes in the conduct of the economy, has been the case of center-state transfers. Despite the elaborate constitutional provisions governing such transfers, including the creation of a Finance Commission, the center used the ‘miscellaneous provisions’ of Article 282 to justify Planning Commission transfers that were the linchpin of the enormous apparatus of central planning that grew to dominate Indian economic management from the 1950s.

Legislation and Administration

While the basis of central planning was in constitutional loopholes, much of the exercise of central government economic control relied on specific laws and administrative regulations. Here the problem was not lack of durability, but the opposite. Despite concerns raised as far back as the 1960s about the basic regime of controls, it was only in the 1990s that any significant changes were made. In terms of the theoretical framework of time inconsistency, investment or other economic actions in India were not inefficiently inhibited by the lack of durability of the

laws and rules governing such actions. Indeed, one could argue that economic actors in India 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 was, of course, in the particular laws themselves.¹⁶ How did this inefficiency originate, and why did it persist?

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? One possible answer¹⁷ is that enough groups with sufficient political influence were deriving benefits from the current system to block changes in legislation (Bardhan's 'multiple veto system'). Since the period of the 1970s and 1980s was one of rapid growth of subsidies, associated with a government-led development policy, for the interest group view to be consistent with the evidence, one would have to hypothesize increasing participation and effectiveness in the 'rent-seeking' process over time.

An alternative view focuses instead on the changing role of political parties. Several researchers¹⁸ have charted the changing position of the once-dominant Indian National Congress, with its organizational decay and reduced political influence throughout the country, as a major factor in explaining political instability in India. Chhibber extended this analysis to explain the deepening of 'rent-seeking' – including the persistence of the laws that make it possible – in

¹⁶ 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 Kaushik Basu, "Markets, Laws and Governments," in B. Jalan, ed., *The Indian Economy: Problems and Prospects*, (Delhi: Viking Publishers, 1992), pp. 338-55. See also the chapters on specific laws in N. R. Madhava Menon and Bibek Debroy, eds., *Legal Dimensions of Economic Reforms* (New Delhi: Allied Publishers, 1995).

¹⁷ See, for example, Pranab Bardhan, *The Political Economy of Development in India* (Oxford: Basil Blackwell, 1984) and Myron Weiner, "The Political Economy of Industrial Growth in India", *World Politics*, Vol. 38, (1986), pp. 596-610.

¹⁸ See, for example, Lloyd I. Rudolph and Susanne H. Rudolph, *In Pursuit of Lakshmi: The Political Economy of the Indian State* (Chicago: University of Chicago Press, 1987); Paul Brass, *The Politics of India Since Independence* (New York: Cambridge University Press, 1990); and Atul Kohli, *Democracy and Discontent: India's Growing Crisis of Governability* (New York: Cambridge University Press, 1990).

terms of the needs of political competition.¹⁹ Essentially, powers of patronage for electoral support became more important in the 1970s and 1980s, overwhelming any concerns about the inefficiency of the system from the perspective of economic growth. Chhibber is able to provide empirical evidence for this proposition, by showing that central loans, food assistance and subsidies to the states were all linked to electoral considerations.

In a similar vein, Kapur and Mehta have argued that large payments were directed by the center in the late 1990s to the states (Andhra Pradesh and Punjab) from which regional parties that were key coalition partners originated.²⁰ In this case, the support mechanism is direct, to build a majority coalition in parliament, whereas in Chhibber's analysis it derives from the *ex ante* need to mobilize state-level political resources for national elections. In any case, both Chhibber and Kapur and Mehta emphasize the role of political parties, and geographical divides, rather than class interests.

Kapur and Mehta also highlight the role played by the details of the organization of the Indian parliament. Briefly, their analysis involves tracing the decline of parliamentary functioning, in ways that reduce oversight for the Executive, increase spending, and make legislation more difficult. Measured by annual number of bills passed, the productivity of parliament declined only in the 1990s, whereas it was relatively stable in the previous four decades (Kapur and Mehta, Table 5). As documented in Kapur and Mehta, parliament meets for fewer days and fewer hours, with more disruptions caused by disorderly conduct, and attendance has declined, with quorum requirements often having to be ignored in order to conduct business.

Individual Members of Parliament act chiefly as recipients and distributors of patronage, either directly or as intermediaries, and not as legislators. Major economic reform bills, introduced by reform-minded governments, have tended to get stuck in parliamentary standing

¹⁹ Pradeep Chhibber, "Political Parties, Electoral Competition, Government Expenditures and Economic Reform in India," *Journal of Development Studies*, Vol. 32, No. 1 (October 1995), pp. 74-96.

²⁰ Devesh Kapur and Pratap Mehta, "The Indian Parliament as an Institution of Accountability," Report prepared for the IPU, Harvard University (May 2002).

committees, where the organizational norm of unanimous approval is almost impossible to achieve. From this perspective, therefore, the distorted microeconomic incentives within the legislature are a significant contributor to the durability of inefficient laws.²¹

Conclusion

The perspective of the optimal degree of durability of laws has led to a two-part answer. First, the Indian Constitution has been relatively easy to amend, and also included various escape clauses, permitting the easy passage of legislation that eroded initial intent. This legislation was biased in the direction of a situation that created ‘vested interests’. The inherent difficulty of reversing such legislation has been compounded by the nature of political competition, as well as the internal organization of the main legislative institutions. The presumed consequence of this situation has been the low growth of India relative to some East Asian countries. While there are clearly many other variables that matter in this comparison, the durability of a particular set of laws and administrative rules has presumably played some role, and may be a factor in India’s inability to accelerate its growth to the level of countries such as China.

²¹ This description, while emphasizing incentives within the legislature, is quite different from standard theories developed for the United States. Robert P. Inman and Daniel L. Rubinfeld, “The Political Economy of Federalism,” in Dennis Mueller, ed., *Perspectives on Public Choice: A Handbook* (Cambridge, Cambridge University Press, 1997), pp. 73-105, for example, distinguish between two types of legislatures: minimum winning coalition (MWC) and universalistic (U). Policies chosen in a MWC legislature reflect the preferences of the winning majority. With multi-dimensional policies, this, in turn, depends 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 (Barry R. Weingast and William J. Marshall, “The Industrial Organization of Congress,” *Journal of Political Economy*, Vol. 96, No. 1 (February 1988), pp. 132-63; Richard L. Hall and Bernard Grofman, “The Committee Assignment Process and the Conditional Nature of Committee Bias,” *American Political Science Review*, Vol. 84, No. 4 (December 1990), pp. 1149-66) suggests that U legislatures lead to higher allocations of public goods. It is not clear whether the Indian case fits the MWC or U legislature model, but interest group subsidies, including indirect or in-kind subsidies involved in the protections provided by legislation such as the Industrial Disputes Act (see Mrinal Datta-Chaudhuri, “Labor Markets as Social Institutions in India,” CDE Working Paper No. 16 (1994), Delhi School of Economics, Delhi, India; and Menon and Debroy, op. cit., Chapters 1 and 2), are different from local public goods, which are the focus of Inman and Rubinfeld.

4 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. Social norms and even psychological conditioning matter, in addition to legal institutions, but here we focus on formal institutions.

In practice, in many cases, the police and judiciary do not directly control or enter into the enforcement 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 as a back-up, of course, 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 (IAS).²²

In this section, we argue that judicial delays in enforcement and lack of clear enforcement of property rights and contracts are important drags on the Indian economy.

²² This has been particularly important in rural areas. Also in rural areas, traditional local councils (*panchayats*) had some judicial authority over a range of matters. 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. Despite flexibility of procedures in the NPs, there were considerable delays and arrears at that level due to the lack of training of personnel, of institution building in general, and ultimately to a lack of adequate funding. Overall, the NP system became effectively moribund (Marc Galanter, *Law and Society in Modern India* (Delhi: Oxford University Press, 1989), Chapter 4).

The Judiciary

The scarcity of resources of the judiciary is a fundamental problem 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. Siwach (op. cit.) estimated that by 1980 there were approximately 30,000 cases pending with the Supreme Court, up from about 2,000 twenty years previously, a rate of increase far exceeding the population growth rate. With the Supreme Court receiving considerable attention, this number, after increasing further, was actually brought down in the 1990s, and stood at about 20,000 in 2000.²³

Mookherjee reported data from the Malimath Committee Report²⁴, which provided estimates from 1989 of over 1.4 million cases pending at the High Court level. This figure represented a quadrupling since 1971, again much greater than the growth rate of the population. Recent estimates put the figure at over 3 million, with a total of 25 million cases pending at all levels. Table 3 gives a breakdown of pending cases by High Courts, and indicates two significant points. First, the worst problems are in civil cases, in terms of total numbers (and possibly also length of delay). Second, there are variations across the High Courts, indicating that there are implementation problems as well as systemic issues. We next discuss both these sources of inefficiency.

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.²⁵ 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

²³This figure, and other recent Indian data on judicial cases pending, were from <http://www.palpaonline.com/lawyer/topnews/backlog.htm>. (Accessed February 11, 2002). The site is no longer active.

²⁴ Dilip Mookherjee, "Redefining the Economic Role of the State: The Role of 'Positive' and 'Negative' Institutional Reforms in India," paper presented at conference on Economic Liberalization in South Asia, University of California, Berkeley (April 1993); V. R. Malimath, *Report of the Arrears Committee 1989-90*, headed by Justice V. R. Malimath (Delhi: Supreme Court, Government of India, 1990).

²⁵ He also observes that insufficient judicial strength was noted as a problem in India as far back as 1924.

by the Executive (i.e., the Home Ministry, the Chief Minister of the concerned state, or the Law Ministry).²⁶ The influence is, of course, for the purpose of distributing patronage. He 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 caseloads among different High Court Chief Justices. He (quoting the Malimath Committee) and Siwach also list other factors influencing disposal rates: antiquated procedures such as long oral arguments or the method of writing judgements, 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, in the context of the Supreme Court, provides some additional factors behind the crush of court cases. He notes that judicial procedures such as long oral arguments, or the method of writing judgments, are often antiquated. 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 economic impact 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 often substitutes for the creaky judicial system are the workings of the political system. Those in political power not only influence the judicial system through

²⁶ Mookherjee (op. cit.), p. 18.

patronage appointments, but also take over its functions. Disputes are 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 has its own costs, 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 also those who are already lawbreakers have a strong incentive to enter politics. All the evidence points to the pervasiveness of these developments in India.²⁷ Furthermore, these effects are self-reinforcing: politicians self-selected by a system that protects them from punishment have an incentive to weaken the judicial system, and the pervasiveness of a norm may affect the number who adheres to it. The further impacts on the environment for investment and economic growth can only be negative.²⁸

The Bureaucracy

Since the Indian bureaucracy has been an important enforcer of laws and regulations, including many involving the conduct of economic activity, its relations with politicians have also been subject to strain. There are direct political pressures on bureaucrats that distort supposedly impartial administrative decision-making, as well as incentive mechanisms such as frequent transfers of bureaucrats. Even in the 1950s, transfers were used to reward and punish

²⁷ For early examples of politicians in India being above the law, see Surendranath Dwivedy and G. S. Bhargava, *Political Corruption in India* (New Delhi: Popular Book Services, 1967) and B. Sivaraman, *Bitter Sweet: Governance of India in Transition* (New Delhi: Ashish Publishing House, 1991). *The Economist* (July 15, 1995, p. 26, 'Rascals Rule') makes explicit the argument that criminals have thronged to Indian politics because it affords safety from punishment for crimes. It quotes the chief election commissioner as noting that 180 of 425 legislators in Uttar Pradesh have criminal records. See also Susheela Bhan, *Criminalization of Politics* (Delhi: Shipra Publications, 1995).

²⁸ The macroeconomic impacts are clearly hard to measure. For a microeconomic analysis that identifies the impact of harassment of business on productivity, see David Dollar, Giuseppe Iarossi and Taye Mengistae "Investment Climate and Economic Performance: Some Firm Level Evidence from India", paper presented at 3rd annual Stanford Conference on Indian Economic Reform (June 2002).

bureaucrats (Sivaraman, *ibid.*). In some cases, transfers are a part of an elaborate rent-seeking and rent-distribution mechanism, where administrators and politicians may be equally complicit,²⁹ and which leads to self-selection for the bureaucracy that parallels what we noted is occurring in politics.

De Zwart, in providing a comprehensive overview of (horizontal) bureaucratic transfers in India, including his own fieldwork,³⁰ notes the theoretical justification as one of reducing corruption by increasing the distance between bureaucrats and their clients. Actual patterns, as documented by de Zwart and others, suggest much greater frequency, variability and arbitrariness than would be indicated by any such justification. The outcome is that, as in the case of the judiciary, the bureaucracy's role in carrying out administrative policies that are derived from underlying legislative goals (i.e., their part of enforcement) is severely hampered.

To some extent, the problem for the bureaucracy is unavoidable, since, in a democracy, it is properly subordinate to the elected representatives of the people. 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 to carry out efficiently their assigned tasks. 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.

²⁹ See Robert Wade, "Politics and Graft: Recruitment, Appointment, and Promotions to Public Office in India," in Peter M. Ward, ed., *Corruption, Development and Inequality* (London: Routledge, 1989), pp. 73-109, on South Indian irrigation systems from the 1960s.

³⁰ De Zwart's fieldwork was carried out in 1988-90. He also surveys studies from the 1970s and 1980s. There is nothing to suggest that the current situation is any different. See Frank de Zwart, *The Bureaucratic Merry-Go-Round: Manipulating the Transfer of Indian Civil Servants* (Amsterdam: Amsterdam University Press, 1994).

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 more directly, lest it become corrupted – rather than using mechanisms such as transfers, which are themselves corruptible – requires further analysis. Civil servants such as Sivaraman (ibid.) emphasize the positive role in Indian development played by the bureaucracy: for example, he played an important part in initiating the Indian ‘Green Revolution.’ 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.³¹ Bureaucratic governance has also been suggested as a positive factor in East Asian growth.³² In such cases, politicians and bureaucrats seem to have collaborated effectively.³³ In the case of Punjab, one can explain this in terms of politicians having appropriate incentives flowing from their constituents (e.g., middle peasants). In the East Asian case, one would have to appeal to factors beyond electoral pressures.

In contrast to these successful bureaucratic interventions, one is acutely aware of 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,³⁴ in discussing these cases, and their difficulties of transition from central planning, 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.

³¹ For example, see Naved Hamid, *Process of Agricultural Development—A Case Study of the Punjab*, Ph.D. Dissertation, Stanford University (Ann Arbor: University Microfilms International, 1981); Murray Leaf, *Song of Hope: The Green Revolution in a Panjab Village* (New Brunswick, N.J.: Rutgers University Press, 1984); and Lewis (op. cit.).

³² See, for example, Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press, 1990) and the references therein.

³³ This is similar to Evans’ idea of ‘embedded autonomy’, by which he means a societal structure with coherent institutions that are autonomous, but nevertheless connected through institutionalized channels for continual negotiation of goals and policies: Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995), p. 12. Evans notes the general lack of this ‘public-private symbiosis’ in India (pp. 150-151), but the Punjab case provides an exception.

³⁴ Andrei Shleifer, “Establishing Property Rights,” *Proceedings of the World Bank Annual Conference on Development Economics* (1994), pp. 93 -117.

According to Grossman and Hart,³⁵ 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 Coasian³⁶ bargaining are not enforceable by the courts, so Coasian bargains, and hence efficiency, cannot necessarily be achieved. Interestingly, this enforceability issue is another aspect of the ‘rules vs. discretion’ issue raised in the context of the durability of laws. The argument also extends the earlier discussion of bureaucratic incentives and political pressures.

The focus on property rights points out how to resolve the puzzle of different qualities of bureaucratic interventions. The answer to the puzzle is as follows. If the scope of bureaucratic control extends too heavily to physical property rights, rent-seeking, corruption, and inefficiency are likely results, 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 perspective seems to fit well with the Indian case, where Green Revolution 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.³⁷

³⁵ Sanford J. Grossman and Oliver D. Hart, “The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration,” *Journal of Political Economy*, Vol. 94, No. 4 (August 1986), pp. 691-719.

³⁶ According to Ronald Coase, “The Problem of Social Cost,” *Journal of Law and Economics*, Vol.3, No. 1 (1960), pp. 1-44, 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.

³⁷ Pranab Bardhan “Comment on 'The Impact of Constitutions on Economic Performance', by Elster,” *Proceedings of the World Bank Annual Conference on Development Economics* (1994), pp. 232-5, 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 a model of independent monopolists in bribe collection: Andrei Shleifer and Robert Vishny, “Corruption,” *Quarterly Journal of Economics*, Vol. 108, No. 3 (August 1993), pp. 599-617. He also characterizes the uncertainty in India as due to the ‘elaborately structured system of multiple veto powers built into the internal organization of the Indian state.’ As discussed earlier, this ‘multiple veto powers’ argument may be rooted in the details of electoral competition, rather than in bargaining among different classes.

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.³⁸ However, unlike the case of the bureaucracy in general, reducing the assigned role of the police cannot help.

The solution to the problems of enforcement—inconsistency, corruption, uncertainty, delays—may be to strengthen the organizational independence of the police vis-à-vis politicians, but allow greater control by a stronger judiciary. This line of reasoning, while rooted firmly in the concept of ‘checks and balances’ in governance, may seem naïve – 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. However, the interests of the armed forces are less in conflict with those of politicians than would be the interests of a strengthened judiciary.

³⁸ One aspect (though not the only one) of this politicization has been the encroachment of the central government into law and order, constitutionally a state subject: see B. C. Mukherjee, *Administration in Changing India* (New Delhi: Blaze Publishers, 1994), pp. 56-57.

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 would be more effective in dealing with sins of commission, rather than of omission, and would work better at the local level. 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.³⁹ However, a carefully planned and executed decentralization may 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 attention to the organizational structures within which the police operate.⁴⁰ Decentralization is discussed more broadly in 5.

Conclusion

It is fairly unobjectionable to argue that if enforcement of laws in India were improved by being more consistent and swifter, this would have favorable economic consequences. This contrasts with a less straightforward conclusion regarding durability. However, the dimension of enforcement complements that of durability. They are closely related, since nonenforcement amounts to completely 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 our schema, that of the degree of decentralization, is somewhat different, in bringing in questions of geographic scope or span of control.

³⁹ See, for example, the classic treatment of David H. Bayley, *The Police and Political Development in India* (Princeton, NJ: Princeton University Press, 1969), particularly Chapter 15.

⁴⁰ On organizational aspects, in addition to Bayley (ibid.), see S. K. Chaturvedi, *Metropolitan Police Administration in India* (Delhi: BR. Publishing Corporation, 1985); Ajay K. Mehra, *Police in Changing India*, New Delhi: Usha Publications, 1985); and Rashmi Mishra and Samarendra Mohanty, *Police and Social Change in India* (New Delhi: Ashish Publishing House, 1992).

5 Decentralization

The issue of the optimal degree or nature of decentralization is crucial in a country the size of India. Issues of durability can also be tied to questions of decentralization, since decentralization allows for experimentation and adaptation in legal frameworks. More directly, enforceability often requires decentralization to a level where monitoring and consequent actions can be more effective. We review a theoretical framework for looking at decentralization in the context of federal governmental structures and principles of assignment of tax and expenditure functions, as well as possible theoretical and empirical links between decentralization and economic performance. Thereafter, we turn to the Indian case, to examine its institutions in the light of the previous discussion.

Design of Federal Institutions

Inman and Rubinfeld (op. cit.) provide a conceptual paradigm for evaluating institutions of federal republics. They distinguish between a decentralized ‘confederate’ republic and a ‘compound’ republic, the latter form having an overarching central government capable of acting against local interests. This choice was addressed in the framing of the Indian Constitution, with the final structure being relatively centralized, both for reasons of political stability, and for protection of disadvantaged groups such as the ‘Scheduled Castes’ (so named from their constitutional status). For either type of republic, there are two federalist dimensions of its constitution: representation of the constituent units to the central government, and the assignment of governmental tasks between levels of government. Efficient federal institutions involve a preferred combination of representation and assignment.

Representation can be measured 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 where there is no layer of state or provincial

government, in which case the primary constituent units are parliamentary constituencies. With multiple layers of representative government, each with its own assignments of responsibilities, interpretation is less straightforward. However, comparisons can be 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, by this measure, the U.S. has a greater degree of representation at the level of the central legislature. Furthermore, 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*.⁴¹

Whether the potential for greater diversity of choices is realized with greater representation depends on the assignment of fiscal functions. 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 legislative business will be transacted (footnote 21). These institutions affect the outcome of any particular combination of representation and assignment, measured by the efficiency of public good provision.

Which form of republic is preferable? The traditional case for a confederate republic is made primarily on non-instrumental grounds, in terms of protecting democratic rights and encouraging political participation, debate and accommodation. Within a compound republic, the constituent units must have a role to play; else no federal structure at all would be required. An economic case for local governments can be made based on the idea that interjurisdictional competition can lead to the efficient supply of local public goods.⁴² The required conditions (such as mobility of households, full information, and no externalities across jurisdictions) are

⁴¹ 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. A 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 number of parliamentary constituencies will not have much impact on representation.

⁴² Charles Tiebout, “A Pure Theory of Local Expenditures,” *Journal of Political Economy*, Vol. 64 (October 1956), pp. 416-24.

not easily applied to the Indian economy. The failure of these assumptions to hold may tilt the scales towards centralization.

Inman and Rubinfeld argue for a tradeoff between increased representation, with its democratic advantages, and economic efficiency, which is impaired by overspending that accompanies more extensive political representation. The assignment of economic tasks (expenditure and revenue authorities) to the different levels of government may provide a way of resolving or softening the trade-off. How should tasks be assigned?⁴³ Based on economic efficiency considerations, the brief answer is that the central government should decide where spillovers are significant and/or the goods provided are national, otherwise lower level governments should be assigned the task of provision. Since the central government has *ex post* incentives to alter assignments, they are properly fixed in the constitution itself, an issue of commitment or durability. In the case of India, this was done in the Constitution with separate central, state and concurrent lists, but again with escape clauses that favored the center in eroding states' authority.

Given a clear assignment of tasks, a level of representation, and legislative institutions, one can compare the economic efficiency of different combinations of these three institutional variables. Inman and Rubinfeld make this comparison based on different types of transactions costs.⁴⁴ They straightforwardly 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 state or other lower level governments should provide lower level public goods.

⁴³ Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw Hill, 1959), provided the principles for the assignment of expenditure functions based on a threefold division of the public sector, into allocation, distribution and stabilization branches. The latter two were the primary responsibility of the center, with decentralization driven by the allocation branch. The assignment of responsibilities for taxes poses a somewhat different set of issues from the case of expenditure functions (Richard A. Musgrave, R. A. (1983), "Who Should Tax, Where and What?," in Charles McLure, ed., *Tax Assignment in Federal Countries*, (Canberra: Australian National University Press) pp. 2-19): highly progressive taxes and taxes on highly mobile tax bases should be centralized. On the other hand, benefit taxes such as user charges and fees are very suitable for lower levels of government.

⁴⁴ Here they build on Albert Breton and Anthony Scott, *The Economic Constitution of Federal States* (Toronto: Toronto University Press, 1978).

However, intergovernmental transfers with conditions attached, can make *de facto* assignment different from its ostensible manifestation in the constitution or other law.

The optimal assignment of expenditure functions and tax instruments does not imply that each government at each level must be in balance. In fact, it is typical for lower level governments to receive transfers from higher-level ones. In particular, 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, and the impact of the transfers depends on the incentives that they create or modify. For example, when the revenue goes to one level of government, and collection effort is incurred by another level, the latter's incentives may be weakened.

More generally, intergovernmental grants may be rationalized as serving three main objectives: subsidization of specific programs where there are spillovers across jurisdictions; greater equity in tax incidence; and equalization of fiscal capacity across subnational 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. In practice, the determination of intergovernmental grants is often the result of political considerations.⁴⁵ 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.

An offshoot of the broader 'governance and growth' literature considered in section 2 extends these concerns specifically to decentralization. Huther and Shah, in a pioneering study

⁴⁵ This is demonstrated for India by Chhibber op. cit.); M. Govinda Rao and Nirvikar Singh (2002), "The Political Economy of Center-State Fiscal Transfers in India", in J. McLaren, ed., *Institutional Elements of Tax Design and Reform* (Washington, DC: World Bank), pp. 69-123; and Sugato Dasgupta, Amrita Dhillon and Bhaskar Dutta "Electoral Goals and Centre-State Transfers in India", processed, Indian Statistical Institute, New Delhi (2001).

that uses cross-country data and their own indices of governance quality, find that there are positive correlations between the proportion of government expenditures that are subnational on the one hand, and measures of citizen participation and government efficiency on the other. Martinez-Vazquez and McNab provide a survey of similar studies, which suggests that, overall, the link between decentralization and growth remains to be established. In part, this reflects some difficulties in measuring the degree of fiscal decentralization in a consistent manner across countries.⁴⁶

Indian Federalism and Governance

The theories discussed earlier in this section provide 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 issues of intergovernmental 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 (section 3).

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 have emphasized the political economy of central-state fiscal relations, and suggested that

⁴⁶ Jeff Huther and Anwar Shah, "Applying a Simple Measure of Good Governance to the Debate on Fiscal Decentralization," World Bank Policy Research Working Paper No. 1894 (Washington, DC: World Bank, 1998); and Jorge Martinez-Vazquez and Robert M. McNab "Fiscal Decentralization and Economic Growth," *World Development*, Vol. 31, No. 9, (2003), pp. 1597–1616.

the increased use of discretionary transfers permits greater rent-seeking, or increases influence costs.⁴⁷

Another effect of the ascendancy of discretion over rules in intergovernment transfers has been the failure to significantly achieve horizontal equity goals through such transfers,⁴⁸ since discretionary transfers counteract the equalizing effects of formulaic ones made through the Finance Commission.⁴⁹ 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,⁵⁰ would be one possibility, reducing the problem of assignment becoming endogenously determined by the center through the transfer system.

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 (blocks, *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 grades based primarily on size. Under the constitution, local governments were recognized, but state governments retained statutory control. This changed with the 73rd and

⁴⁷ See Kletzer, Kenneth, and Nirvikar Singh “The Political Economy of Indian Fiscal Federalism,” in Sudipto Mundle, ed., *Public Finance: Policy Issues for India* (Delhi, Oxford University Press, 1997), pp.259-98, applying the work of Paul R. Milgrom and John Roberts, “An Economic Approach to Influence Activities in Organizations,” *American Journal of Sociology*, Vol. 94, Supplement, (1988), pp. S154-79; and “Bargaining Costs, Influence Costs, and the Organization of Economic Activity,” in James E. Alt and Kenneth A. Shepsle, eds., *Perspectives on Positive Political Economy* (Cambridge: Cambridge University Press, 1990).

⁴⁸ See M. Govinda Rao, “Intergovernment Transfers in India,” processed, paper presented at Conference on Fiscal Transfer Systems, Qingdao, China (July 25-29, 1994), for empirical evidence on this point.

⁴⁹ The Finance Commission is constituted every five years with a charge to make recommendations that cover a period that was initially 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. Its rationale 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.

⁵⁰ M. Govinda Rao, “Fiscal Federalism in India: Problems and Prospects,” processed (Australian National University, Canberra, 1995).

74th Amendments to the Constitution (1993), which gave local government bodies a more independent legal foundation. The Tenth Finance Commission, the first to report after the constitutional change, recognized that this was not sufficient, and explicitly draws attention to the issue of assignment in its report⁵¹: ‘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....’ This has remained a key flaw in decentralization in India.

Potentially, the strengthening of local government can do two things toward greater decentralization, and consequently greater responsiveness to local preferences and hence efficiency. First, it provides an easier route for channeling central funds directly to the local level. While this may not seem to get away from ‘top-down-ism’ (Lewis, *op. cit.*), it can have two positive effects, from the influence cost perspective. It reduces the possibility of ‘skimming’ of funds as they pass through multiple levels of politicians and bureaucrats. Also, the political influence equation is different 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. The previous fear was that such bypassing of the state government would be problematic in view of the danger of capture by ‘traditional rural oligarchs’⁵² at the local level. Not only has this danger lessened over the decades since independence,⁵³ but also it has been demonstrated that coalitions of such oligarchs at the state government level are not necessarily better.⁵⁴

⁵¹ Finance Commission, *Report for 1995-2000* (Government of India: New Delhi, 1994). para. 15.13.

⁵² This term is taken from Lewis (*op. cit.*), p. 201, but the concern has been quite pervasive, and was explicitly raised by B.R. Ambedkar in debates during the framing of the Constitution. A literary illustration is the fictionalized account of what happened to land reform in northern India shortly after the Constitution took effect, in Vikram Seth, *A Suitable Boy: A Novel* (New York: Harper Collins, 1993).

⁵³ A quote from the floor discussion of Elster (*op. cit.*) 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.’

⁵⁴ A *caveat* is in order here: the 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.

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 governments may be able to raise funds more effectively. While there are 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.⁵⁵ However, while local governments may not rely heavily on external funding, this goes hand-in-hand with an abysmally low the level of local public services. Expanding the authority of local governments may help in this regard, and must receive attention, as noted in the quote from the Tenth Finance Commission.

Expanding fiscal capacity is by itself not sufficient. Fiscal effort also matters. A property tax is theoretically the least distortionary for local government, which must be especially sensitive to the mobility of factors. However, municipal authorities have been reluctant to use or enforce such taxes effectively.⁵⁶ Some of the problems are managerial, including the use of outdated procedures for assessment and collection of such taxes.⁵⁷ 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 3 and 4. 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

⁵⁵ See Abhijit Datta, *Municipal Finances in India* (New Delhi: Indian Institute of Public Administration, 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. Rural local governments receive a much higher share from state governments, but their expenditure is often completely controlled by the state.

⁵⁶ 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.

⁵⁷ Paralleling his discussion of the judiciary, Mookherjee (op. cit.) 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 Datta (ibid.), Chapter 3. Again, it is important to note that there are great regional variations.

particularly deserves attention. One approach is to argue that effective local government in these dimensions will require a strengthening of local electoral democracy, something that the 73rd and 74th Amendments ultimately should make possible.⁵⁸

Conclusion

The broad conclusion we offer here is that more effective fiscal and political decentralization, with attention also paid to the durability and enforceability of laws at the decentralized level, is likely to be extremely beneficial in India, by improving the efficiency of provision of public goods and services. Decentralization provides a check on government rent-seeking through competition (Brennan and Buchanan, *op. cit.*). More importantly, responsiveness and efficiency may be directly promoted by decentralization. At the same time, decentralization must be implemented efficiently: the assignment of powers must restrict the ability of lower level governments to impose distorting taxes or quantitative barriers to inter-state trade and movements of capital and labor.

While it is again difficult to quantify the benefits of decentralization in terms of percentage points in the growth rate, one could argue that improvements in health, nutrition and education are important final goals for development, aside from any economic growth implications they have. Furthermore, primary education positively impacts growth: Lindert,⁵⁹ also using a case study approach, makes this point in comparing pre- and post-independence India to Britain historically, and the Asian Tigers' more recent performance. Finally, decentralization is not the only possible approach: privatization of some aspects of the system may help.⁶⁰

⁵⁸ See Nirvikar Singh, "Governance and Reform in India," *Journal of International Trade and Economic Development*, Vol. 6, No.2, (1997), pp. 179-208, for further discussion of these issues.

⁵⁹ Peter H. Lindert, "Voice and Growth: Was Churchill Right?", UC Davis manuscript, (October 2002).

⁶⁰ See, for example, J.L. Bajaj and Rita Sharma "Improving Government Delivery Systems: Some Issues and Prospects," *Economic and Political Weekly* (May 27, 1995), pp. M73-M80; and Lewis (*op. cit.*), Chapter 7.

6 Conclusions

This paper has focused on the structures of government, and their possible role in affecting economic efficiency in India. We have reviewed some of the theoretical and empirical approaches that have been taken to understanding this issue, and proposed a conceptual framework that is novel in some respects, focusing on three structural aspects of governance: durability, enforceability and decentralization. Our methodology has been similar to that employed by economic historians such as Douglass North, who have looked at such issues across countries and over long time periods, using examples combined with economic reasoning. While we cannot offer definitive conclusions, our discussion provides some indication of where changes in governance institutions might have positive impacts on India's economic performance.

Our discussion has been limited to government. In one sense, government is a special case of collective action, which can also include various kinds of nongovernmental organizations (NGOs). NGOs may be viewed positively as enhancing social capital and the workings of civil society. Again, there are instrumental and noninstrumental aspects of this perspective. Volunteer organizations, interest groups, social welfare associations, and traditional occupational and religious organizations abound in India. These are often 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 done effectively.

However, the economic rationale for 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 30-40% (author's estimate) 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. In cases where benefits are well-defined and excludable, self-governance, in areas such as local irrigation institutions (Ostrom, *op. cit.*) may

do well. This can be viewed as a form of specialized local governance, which in turn, relies on a system where laws and rules at a broader level are enforced clearly and consistently by government. In either case, these alternative forms of collective action are not a substitute for traditional governance.

Furthermore, issues of accountability and responsiveness arise for nonofficial bodies as well. Laws are enablers of this accountability, making government the key aspect of governance, and resolving 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 in India, to complement recent economic reforms that have partly redefined the role of government, may be the quality of the rule of law, including its durability, enforceability and reach.

Table 1: India's Governance

Measure	Rating	Relative Position	Source
Ratings of political rights and civil liberties	Free: 2.5 on 1-7 scale (Free 1.0-2.5, Partly Free 3.0-5.0, Not Free 5.5-7.0)	72 countries better 12 countries equal 100 countries worse	Freedom House, <i>Freedom in the World: The Annual Survey of Political Rights and Civil Liberties</i> 1999–2000, based on surveys
Voice and accountability	0.38 (0.17) Index (standard error)	China -1.38 (0.17) U.S.A. 1.32 (0.17)	Governance Matters III: Governance Indicators for 1996-2002, by Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, <i>The World Bank</i> , June 30, 2003, based on poll and survey data from 18 organizations and 25 sources. The six cluster indices are constructed from 250 individual measures. Year 2002 indices are reported here.
Political stability and absence of violence	-0.84 (0.20)	China 0.22 (0.20) U.S.A. 0.34 (0.21)	
Government effectiveness	-0.13 (0.15)	China 0.18 (0.15) U.S.A. 1.70 (0.16)	
Regulatory quality	-0.34 (0.17)	China -0.41 (0.17) U.S.A. 1.51 (0.18)	
Rule of law	0.07 (0.13)	China -0.22 (0.13) U.S.A. 1.70 (0.13)	
Control of corruption	-0.25 (0.15)	China -0.41 (0.15) U.S.A. 1.77 (0.16)	
Government antidiversion policy (GADP) index	0.591	China 0.641 U.S.A. 0.947	

Table 2: Number of Constitutional Amendments by Decade

Period	Number of Amendments
1951-1960	9
1961-1970	14
1971-1980	22
1981-1990	22
1991-2000	16
2001-2003	3
Total	86

Source: Compiled from <http://indiacode.nic.in/coiweb/coifiles/amendment.htm>; accessed September 2003

Table 3: Backlog Of Cases, High Courts (1997)

State/Location	Civil	Criminal	Oldest case
Allahabad	690,666	125,366	1961
Andhra Pradesh	127,047	8,518	1972
Bombay	260,165	24,098	1968
Calcutta	268,342	37,356	1955
Delhi	152,308	18,593	1966
Gauhati	33,034	5,003	1978
Gujarat	105,403	16,129	1973
Himachal Pradesh	9,345	2,583	1974
Jammu & Kashmir	69,917	2,034	1968
Karnataka	78,128	4,359	n.a
Kerala	87,015	9,888	1977
Madhya Pradesh	63,121	40,699	1950
Madras	323,712	33,383	1973
Orissa	105,242	9,306	1971
Patna	66,962	15,950	1966
Punjab/Haryana	148,837	29,160	1971
Rajasthan	97,720	21,778	1971
Sikkim	170	33	1985
Total	2,687,074	404,236	n.a

Source: www.palpaponline.com/lawyer/topnews/backlog.htm; accessed February 2002.