

Reforming India's Party Financing and Election Expenditure Laws

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ABSTRACT

Competitive political parties and election campaigns are central to the health of democracies. Parties and campaigns require significant resources to be effective. India has developed complex election expenditure, political party funding, and reporting and disclosure laws. We suggest that these laws may have perverse impacts on the electoral system: they tend to drive campaign expenditure underground and foster a reliance on unaccounted funds or “black money.” This tends to lead to an adverse selection system, in which those willing and able to work with black money dominate politics. We conclude with some possible remedies, including partial state financing of political parties, that might restore the health of India's electoral system.

I. INTRODUCTION

INDIA LIBERALIZED ITS ECONOMY IN 1991, drastically reducing tax rates, tariffs, and detailed micro-control of economy activity. At the same time, they opened up sectors previously reserved for the public sector to private, including foreign, entry. These changes were expected to bring an end to the corruption that plagued India particularly since the 1970s. Yet in 2011, two decades after liberalization, an economically resurgent India, faced a crisis of governance. Scams and scandals dominated the headlines. A cabinet minister was jailed after resigning on charges of corruption pertaining to the allocation of telecommunication spectrum. Others jailed in the same case included a member of Parliament (whose father was chief minister of a major state when she was incarcerated), and senior executives of private sector companies alleged to have benefited from the minister's misdeeds. The

growing public dissatisfaction with corruption in public life triggered the emergence of a civil society movement which forced the government to initiate the establishment of a powerful ombudsman (called the *Lok Pal*) with the powers to prosecute corruption at even the highest levels of government.

From one perspective, the ability of formal government institutions and civil society initiatives to identify and target the corrupt demonstrates the resilience and corrective power of India's political system. But the question arises as to why corruption is so widespread and pervasive in India even after economic liberalization. We argue that there are two key drivers of corruption in India. One, economic liberalization has not ended the government's discretionary powers over resource allocation in numerous domains. Two, flawed political party funding and election expenditure laws drive parties and politicians to misuse the government's discretionary powers over resource allocation to raise funds for election campaigns and political parties. This article examines how the combined effects of these two factors lead to a decline in the integrity and effectiveness of India's electoral system.

The account of the Indian party and electoral financing system's operation provided in this article

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is substantially based on confidential interviews with political party functionaries, including some central and state ministers, and Election Commission officials. These interviews are necessarily confidential because they discuss, among other things, activities that are in breach of the laws and rules. Given the necessarily anecdotal character of our evidence, our findings and conclusions must necessarily be taken as somewhat tentative. These interviews are nevertheless helpful, painting a picture of a system in which campaign finance rules may actually help fuel corruption, rather than reducing it.¹

II. THE EVOLUTION OF PARTY AND ELECTION FINANCING REGULATION IN INDIA

We begin by tracing the evolution of India's legal framework with respect to political party fund-raising and expenditures. A well-functioning democracy requires vibrant political parties and competitive elections. Political parties perform several crucial functions, including: "1) the integration and mobilization of citizens; 2) the articulation and aggregation of interests; 3) the formulation of public policy; 4) the recruitment of political leaders; and 5) the organization of Parliament and government."² In order to function effectively and to fulfill these roles, to run for and win office, or to serve as an effective opposition, political parties and their candidates need significant financial resources. India has had a mixed record in coming to terms with this reality.

Traditionally, political parties in India financed themselves through private donations and membership dues.³ Corporate contributions to political parties were legal, subject to certain restrictions, and had to be declared in the company's accounts. The Representation of the People Act (RPA) of 1951 introduced limits on the amount that could be spent on election campaigns. Candidates who exceeded these limits faced the prospect of disqualification and annulment of their elections.⁴

By the 1960s, there were concerns in policy circles about a nexus between black money and political fund-raising. "Black money" is the term applied to funds on which taxes have not been paid or to money raised through illegal activities. The reports of the Santhanam Committee on Pre-

vention of Corruption (1964) and the Wanchoo Direct Taxes Enquiry Committee (1971) both shed light on the problem of black money infiltrating the political system. Black money was generated by businesses and individuals who evaded corporate and income taxes. This became prevalent because of the high taxation regime and highly regulatory and protectionist policy framework that was instituted from the 1950s onward. Some of this black money tended to be pumped back to political parties and candidates to garner favorable policy decisions.

In 1968, Prime Minister Indira Gandhi banned corporate donations to political parties. The ostensible reason for the ban was to prevent large business groups from exercising undue influence on politics. However, there has also been speculation that she may have introduced this measure partly because she feared that corporate interests would fund right-wing opposition parties. A particular target was the free market-oriented Swatantra Party which, in the late 1960s, had gained some influence in parts of the country and was opposed to the ruling

¹The authors have worked on the subject of party and election finance in India around the time of elections during 1995–96, 2000, 2005, and 2008–09, with follow-up work in 2010 and 2011. We have interviewed in confidence thirty-seven key political functionaries, including five former and two current Central ministers; treasurers of the Congress and Bharatiya Janata Party (BJP); five former ministers and a state treasurer of a national party in Karnataka state; key election strategists and office-holders of national political parties, all of whom were involved in party fund-raising; as well as top bureaucrats who have observed such operations at close quarters, Election Commission officials, and seven major business donors to parties. The interviews were conducted in confidence in Delhi, Mumbai, and Bangalore.

²Bartolini, S. and Mair, P. (2001). Challenges to Contemporary Political Parties. In Diamond, L. and Gunther, R. (eds.), *Political Parties and Democracy* (pp. 327–344). Baltimore: Johns Hopkins University Press.

³This section is extracted, with some changes, from E. Sridharan, Electoral Finance Reform: The Relevance of International Experience. In V. K. Chand (ed.), *Reinventing Public Service Delivery in India: Selected Case Studies* (pp. 371–5). New Delhi: Sage. The account in this section is indebted to the pioneering work of Pai Panandiker and Roy (1977, 1994), Singh (1986), Acharya et al. (1986), Ministry of Law and Justice, Government of India (1990), Reddy (1992), Manor (1992), Confederation of Indian Industry (1993), Jain (1994), and to several confidential interviews with politicians, industrialists, and industry association executives over the years between 1995 and 2011, press reports and relevant reports, and Press Notes of the Election Commission of India.

⁴Ramadevi, V. S. and Mendiratta, S. K. (2000). *How India Votes: Election Laws, Practice and Procedure* (pp.378–80, 391–95). New Delhi: Butterworths India.

Congress party's socialistic policies.⁵ The ban on corporate donations to political parties was not accompanied by state funding as a substitute for corporate funds. This tended to greatly increase politicians' reliance on black money for election campaigns, as there was no other adequate and legal source of funds.

In 1974, the Supreme Court ruled in the *Kanwar Lal Gupta v. Amar Nath Chawla* case that party spending on behalf of a candidate should be included in calculating that candidate's election expenses in order to determine whether the election expenditure limit had been violated. In response, Parliament amended the RPA in 1975 to nullify the Supreme Court's judgment. Specifically, Parliament amended Explanation 1 to Section 77(1) of the RPA, such that party and supporter expenditures not authorized by the candidate did not count toward the calculation of a candidate's election expenses. This made the limit on election expenditures largely ineffective, as it was limited to a candidate's direct expenditures only, while the party and the candidate's supporters could spend without any limit.

Effective in 1979, political parties were exempted from income and wealth taxes, provided they filed annual returns including audited accounts, listed donations of Rs. 10,000 (10,000 rupees, approximately \$1430 at the time) and above, and disclosed the identities of such donors.

The main development in the 1980s was the amendment of the Companies Act in 1985, which, through Section 293A, once again allowed corporate donations to political parties under certain conditions. The most important condition was that companies could donate a maximum of five percent of their average net profit over the previous three years, subject to approval by the board of directors and disclosure in the profit and loss account statement in the audited annual accounts of the company.

In 1990, the National Front government set up the Dinesh Goswami Committee on Electoral Reforms. The Goswami Committee Report recommended some state funding in the form of limited support in kind for vehicle fuel (usually the main campaign expense), rental charges for microphones, the issuance of voter identity slips and additional copies of the electoral rolls. It did not include spending by independent supporters in the election expenditure limit but made such unauthorized spending a penal offense (as in the United Kingdom). The committee also advocated a ban on cor-

porate donations to political parties. These recommendations left a gap in the parties' campaign finance requirements. While banning corporate donations, they did not provide for an adequate substitute in the form of public funding.

In 1993, Indian industry became publicly concerned about the issue of political funding for the first time. The Confederation of Indian Industry (CII) set up a Task Force which recommended that corporate contributions be made tax-deductible and that shareholder confirmation of board decisions about political contributions be required. CII also recommended state funding of elections with the funds to be raised either by a cess (earmarked tax) on excise duty or through contributions by industry to an election fund pool managed by the state. Money would be distributed to parties through a formula. This proposal, in effect, proposed a tax on industry to finance campaigns.⁶

Two important developments took place in 1996. In the *Common Cause* judgment (in response to a public interest petition filed by a non-governmental organization Common Cause) the Supreme Court issued notices to political parties to file returns by February 20, 1996, as required by the Income Tax and Wealth Tax Acts.⁷ Parties had previously failed to respond to notices in this regard issued by the Income Tax Department. In this judgment, the Supreme Court also interpreted Explanation 1 of Section 77(1) of the RPA so that election expenditures by a political party would not be included with that of a candidate for the purpose of determining compliance with the expenditure ceiling, only so long as the party had submitted audited accounts of its income and expenditures. To that point, no political party had submitted audited accounts. Now political parties were forced to declare their annual incomes; this brought about a degree of transparency in party finance.

In 1996, the United Front government passed the RPA Amendment Bill based on the Goswami Committee's recommendations. These amendments did not touch upon the key issues of public funding and spending limits but did facilitate cost reduction by reducing the campaign period from 21 to 14

⁵Confidential political interviews.

⁶Interview with R. C. Bhargava, then chief executive officer of one of India's largest companies, Maruti Udyog, and chairman of CII's Task Force, 8 December 1995, and CII sources.

⁷*All India Reporter 1996*, Supreme Court 3081.

days. Two years earlier, expenditure limits, which had been kept artificially low at Rs. 150,000 (then \$5000) for Lok Sabha (the directly elected lower house of Parliament) and Rs. 50,000 (then \$1667) for state assembly constituencies in most major states, had been revised to Rs. 450,000 (\$15,000) and Rs. 150,000 (\$5000) respectively, for most states. In 1997, these limits were further revised upwards to Rs. 1,500,000 and Rs. 700,000 (then \$43,000 and \$20,000) respectively for major states. However, Explanation 1 to Section 77(1) of RPA was not amended.

Another important development in campaign financing occurred in 1998. The government provided a partial state subsidy in the form of allocation of free time for seven national and 34 state parties on the state-owned television and radio networks. Airtime was distributed on the basis of a formula based on a certain minimum time topped up by additional time in proportion to vote share in the last elections.⁸ This initiative had commenced in the 1996 general election but at that time only one television and two radio broadcasts of 15 minutes were allotted to each party. Reporting requirements of candidates were made more stringent, per the 1996 Supreme Court judgment, and candidates now had to furnish details of the expenditure incurred by their parties and their supporters on their behalf.

A 1998 report of the Indrajit Gupta Committee on State Funding of Elections (Gupta Committee) recommended partial state funding, mainly in kind. In addition to free TV and radio broadcast time on state-owned media, it recommended that private channels make available sufficient free air time to recognized national and other parties during elections. It suggested that private channels and cable operators be regulated so that a fair and balanced picture of the views of all parties was available to the electorate. In terms of partial state funding in kind, the Committee recommended that the government should supply to political parties specified quantities of petrol and diesel, specified quantities of paper for printing election literature, postage stamps, copies of the electoral rolls of the constituency, loudspeakers, telephone facilities, counting day refreshments and food packets, all up to certain limits.

The Gupta Committee also recommended that parties that failed to maintain and submit audited accounts and income tax returns be denied state

funding. Under this recommendation, all parties receiving a state subsidy for campaigns would be required to file a complete account with the Election Commission in the format prescribed by the latter.⁹ All subscriptions or donations received by the party above Rs. 10,000 would be by check or bank draft and be mentioned in the party's accounts. The Committee also recommended a separate election fund to which the central and state governments would together contribute Rs. 6000 million (then \$166 million) annually. However, most of the state governments expressed their inability to do so. The Gupta Committee failed to make any specific recommendation on the advisability of allowing corporate donations to political parties. It remained non-committal about Explanation 1 to Section 77(1) of the RPA concerning party expenditures.

The period since 1999 has seen some important changes towards more detailed disclosure regarding the legal, financial, and educational backgrounds of candidates. In November 2000, in response to a public interest petition filed by a non-governmental organization called the Association for Democratic Reforms, the Delhi High Court directed the Election Commission to collect data on the criminal records of candidates. The Election Commission was also directed to make this information available to the public along with details of the candidate's educational qualifications, and his or her assets and liabilities, as well as those of his or her spouse and dependent relations.¹⁰ Despite challenges, this judgment was reaffirmed on March 13, 2003 and the Election Commission issued an order based on this judgment on March 27, 2003, making such declarations mandatory.¹¹

The most significant development in campaign finance reform since 1999 was the Election and Other Related Laws (Amendment) Act, passed by the National Democratic Alliance (NDA) government in September 2003. This made company

⁸Election Commission of India, Press Note: 15 January 1998.

⁹Report of the Committee on Electoral Reforms (Indrajit Gupta Committee), Ministry of Law and Justice, Legislative Department, Government of India, Delhi, 1998, pp. 11–45, 55–56.

¹⁰Jagdeep S. Chhokar, Reforming the Electoral System, *Seminar*, No. 521, January 2003, pp. 61–64.

¹¹Department of Legislative Affairs, Ministry of Law and Justice, Govt. of India (co-sponsored by Election Commission of India), *Background Paper on Electoral Reforms*, December 2010, p. 38.

and individual contributions to a political party 100% tax-deductible under Sections 80 GGB and 80 GGC of the Income Tax Act respectively (company contributions are still subject to the limits under Section 293A of the Companies Act, i.e., 5% of average net profit over past three years). For the first time, this set up an incentive for companies and individual donors to donate openly by check. It also made it mandatory, under Section 29-C of the RPA, for political parties to submit to the Election Commission a list of donations they received of over Rs. 20,000 (\$450) in Form 24-A. Absent this disclosure, the party would not enjoy exemption from income tax. The 1999 law also amended Section 13-A of the Income Tax Act, to require that parties list only donations of Rs. 20,000 (\$450) and above in their income tax returns, rather than donations of Rs. 10,000 (\$225) and above as under prior law.

While this law creates incentives for donors to contribute by check, it is not clear whether the incentive of a tax exemption outweighs the possible disincentive created by the loss of anonymity.¹² In addition, the donations are tax deductible only if made to political parties rather than to individual candidates. This may negatively affect the size of contributions, because there is no guarantee that the political party will distribute contributions to the donors' preferred candidates in a transparent manner.

The 2003 law also amended Explanation 1 to Section 77(1) of the RPA. Outside spending by parties and independent supporters must now be reported by the candidate and counted for the purpose of the expenditure ceiling. However, the 2003 law still left some loopholes for party and independent supporter spending. Specifically, it exempted travel costs for a recognized national party's top 40 leaders (and a registered state party's top 20 leaders) to a candidate's constituency during an election campaign. These costs are not counted as part of a candidate's expenditure. Another key loophole is that party spending and party supporters' spending on propagating the party's program does not count as candidate spending, and therefore remains unlimited, so long as it does not favor any particular candidate.

Another requirement of the 2003 law was that free air time be made available for recognized political parties and candidates on all electronic media, potentially lowering the cost and increasing the

reach of campaigning. This provision has not been implemented to its full potential, because, except in the case of state-owned media, the rules for operationalizing it have not yet been framed.

A final noteworthy development since 1999 was an increase in the candidate expenditure ceiling. In October 2003, this ceiling increased to Rs. 2.5 million (\$56,000) for a Lok Sabha election and Rs. 1 million (\$22,000) for an assembly election. In February 2011, it increased again, to Rs. 4 million (\$89,000) and Rs. 1.6 million (\$36,000) respectively.

III. INDIAN PARTY AND ELECTION FINANCE REGULATION IN COMPARATIVE PERSPECTIVE

It is instructive to compare India's system of party and election finance regulation with other major international models and patterns, particularly those of longstanding democracies like the United States and Western Europe. In this section, we briefly compare these systems on the dimensions of four major types of regulation: (1) limits on expenditure, (2) limits on contributions, (3) public funding of election campaigns, and (4) reporting and disclosure requirements. Viewed in these terms, India contrasts sharply with the United States and, in different ways, with most European models, as we elucidate below.

The U.S. system does not have any limits on expenditures but does on contributions, the opposite of India. The Supreme Court's decision in the *Buckley v. Valeo* (1976) struck down the Federal Election Campaign Act's individual expenditure limits as violative of free speech under the First Amendment, reasoning that expenditure limits would restrict the quantity of free speech. More recently, in *Citizens United v. FEC* (2010), the Court struck down limits on corporate independent expenditures. However, the U.S. has limits on contributions to candidates and political parties, as well as aggregate contribution limits. Further, since 1947 corporations and labor unions have

¹²Similar tax incentives in France did not work fully, in that over half the donors chose not to claim a tax benefit due to fear of loss of anonymity, despite confidentiality being assured. International IDEA, *Funding of Political Parties and Election Campaigns*, Stockholm: International IDEA, 2003, p. 147.

not been able to contribute directly to candidates. In contrast, India has candidate expenditure limits (and since 2003 these have included party and supporter spending in support of a candidate's election), while corporate and union contributions to parties are legal. In terms of reporting and disclosure requirements, the U.S. system is more transparent, in that all contributions above certain low limits have to be disclosed by recipients and donors.¹³

The system of party reporting and disclosure of expenditures is also much more limited than that of the United States. In India, parties began to file their required annual income tax returns (despite being exempt from the tax since 1979) only after a Supreme Court order in 1996. Political parties' tax filings were confidential and were not disclosed to the public, as is the case with other income tax returns. However, in 2008, using the provisions of the Right to Information Act of 2005, the Central Information Commission allowed disclosure of parties' income tax returns. Still, the level of detail of what is reported by parties leaves much to be desired. Parties only need to report donor identities for contributions of over Rs. 20,000 (\$450). To evade disclosure, it is quite possible for a single donor to write any number of checks or donate cash for less than that amount. Hence, the Indian system, despite seemingly strict reporting requirements, contrasts sharply with the U.S. system.

The Indian system also contrasts with most European models as it has no system of state funding of parties for electoral or general purposes. In India, the government undertakes to prepare and update the electoral rolls and manage the conduct of the elections. But apart from indirect subsidies like free time on the state-owned electronic media since 1996 and tax deductions for donations to parties since 2003, there are no direct subsidies to political parties. In most of Europe aside from the UK, by contrast, there are state subsidies, both direct and indirect, for political parties, whether for elections or for general purposes. Reporting and disclosure requirements are strict and the general thrust has been to move away from corporate donations to small-sum donations by large numbers of party supporters, i.e., towards grassroots financing.¹⁴ Thus, the Western European pattern is largely a combination of public subsidies and grassroots small-sum financing. India's system stands as a contrast in both respects.

IV. IMPACT OF PARTY FINANCING AND ELECTION EXPENDITURE LAWS

Our interviews with party functionaries, including political leaders, suggest that campaign finance laws in India—including those which regulate party funding and limit campaign spending—have tended to have unintended, counterproductive, and perverse effects on the electoral system.¹⁵ We consider the

¹³See Weintraub-Brown article in this issue for details on contribution limits and disclosure laws in the United States.

¹⁴See Nassmacher, K. (2003). Party Funding in Continental Western Europe. In International IDEA, *Funding of Political Parties and Election Campaigns* (pp. 117–138). Stockholm: International IDEA, for an account of the prevailing arrangements in Germany, France, Italy, Netherlands and Sweden, summarized below.

In Germany, tax deductions for small donations and party membership dues (since 1967) have existed alongside public funding since 1959. Since 1992 tax deductions for corporate donations have been removed. Public funding exists on a matching grant basis in which the ceiling for public subsidies is the income obtained by parties from private sources. Public funding is for parties with no earmarking for elections or other activities. There are no expenditure or contribution limits and disclosure of donor identities and amounts is limited to big donors. Over time this system has led to the bulk of party income from private sources coming from individuals rather than corporations, i.e., grassroots financing through small donations and membership dues.

In France, there was a frequently corrupt nexus between business and politics. Public subsidies for parties and candidates were introduced from 1988, and corporate donations were banned from 1995. Public subsidies were over 50% of party income in 1998 and 90% of headquarters income for small parties. There are both contribution limits and spending limits for both parties and candidates. Tax deductions are available up to 40% of individual donations and party membership dues. Parties have freedom and autonomy despite public subsidy but have to disclose all contributions received.

In Italy, there are no contribution limits on individuals or companies. Corporate contributions require board approval and must be disclosed in company annual reports. Spending limits exist for both parties and candidates. Public subsidies exist since 1974 but since 1993 are for elections only, and given according to the number of votes received.

In the Netherlands, while there are no contribution limits and no spending limits, parties are overwhelmingly dependent on small-sum grassroots funding. This is encouraged by tax-deductibility of donations and membership dues for both individuals and companies. Disclosure of sources of party income, including donor identities and amounts, has been mandatory since 1999. Public subsidies have existed since the 1970s. However, since 1999, the subsidies are not direct but are distributed via party foundations and exclude campaign spending.

In Sweden, there are no expenditure or contribution limits and no tax benefits. Since 1965, there are public subsidies for parties at various levels, without the need for disclosure.

¹⁵See note 1 for the number and range of interviews conducted with key political functionaries involved with party finance over a period of time.

range of possible effects below. As noted above, our conclusions about the precise effects of these laws are necessarily tentative, given the shadowy nature of much of this activity.

Demand for black money to finance parties and campaigns

Corporate donations to political parties were banned, effective April 1969, ostensibly because of concerns that they would enable large business groups to exert undue influence on the political system. As discussed in Part II, however, the ban was enacted without substituting public funding for state funding, as had been done in other democracies. Parties therefore found themselves faced with a shortage of adequate, legal sources of funding to enable them to run their organizations and election campaigns. This situation appears to have left parties with little choice but to rely on illicit sources of funds in the form of black money.

From 1948 on, the supply of black money grew in the broader economy, in parallel with a high-tax, tightly regulated economic policy framework.¹⁶ High tax rates induced many businesses and individuals to evade taxes. This highly regulated economy, derisively termed the “license-quota-permit raj,” mandated government licenses and permits for all manner of economic activity. This gave enormous discretionary authority to bureaucrats and politicians, some of whom could be induced to allocate licenses and permits in exchange for kickbacks. This led to a corrupt fund-raising nexus between business groups and ruling parties in the central and state governments. The ban on corporate donations therefore seems, in retrospect, to have entrenched the influence of business groups over politics in opaque ways.¹⁷

The demand for election funds increased with the 1975 delinking of party spending and candidate spending for the purposes of calculating campaign expenditure limits. After that, India witnessed electoral spending arms races in which parties tried to outspend each other and to attract voters with inducements of various sorts, e.g., providing free liquor during election campaigns. Without a limit on party spending and with a ban on corporate donations, money for elections had to be raised somehow. This appears to have accentuated the slide towards dependence on black money. Ruling parties at the central and the state level found that discre-

tionary regulatory powers gave them a competitive advantage over the opposition in terms of raising black money.¹⁸

The re-legalization of corporate donations to political parties in 1985 does not seem to have had its intended effect of reducing party dependence on black money and increasing transparency of political contributions.¹⁹ This was partly because it did not provide tax incentives for political contributions. Further, by that time, the system of contributions in black money had become so entrenched that there was no incentive for business groups to come above board. Businesses had to deal with a range of parties in power in the central and state governments, and with a range of individual politicians. Therefore, secrecy of political contributions became imperative so that those not so favored would not penalize the donor for supporting their political rivals. Since political donations would have to be made public in a company’s annual reports (with the potential for adverse reactions from shareholders) and since there were no tax incentives, companies tended to stick to the by-then customary practice of secret political donations.²⁰

In the past decade, there have been some positive developments from the point of view of transparency. For example, the mandatory disclosure of candidates’ assets (including that of spouses), educational qualifications, and criminal records at least enables voters to make more informed choices.

¹⁶Kar (2011) estimates that between 1948 and 2008, a total of \$213.2 billion was transferred out of India illegally, equal to about 17.7% of India’s Gross Domestic Product in 2008. Kar calculates that illicit transfers of funds abroad constitute about three-fourths of the black money generated in the economy with the rest being held internally. Dev Kar, *An Empirical Study of the Transfer of Black Money from India, 1948–2008*, *Economic and Political Weekly*, April 9, 2001, Volume XLVI, No. 15, pp. 45, 47–54.

¹⁷Confidential political interviews, see note 1 for details, with, among others, government ministers and party campaign managers. All our interviewees, with rare unanimity, took this position, in interviews conducted from 1995 to 2011.

¹⁸Confidential political interviews with political party functionaries support this point.

¹⁹In all our confidential interviews with both parties and donors that were conducted before the 2003 amendments of the law that made contributions to parties tax-deductible, the point was emphasized that donations were not tax deductible, and that confidentiality was of paramount importance.

²⁰Both party and donor interviewees emphasized the paramount need on the part of donors to maintain confidentiality and that the 1985 re-legalization of corporate donations had only a marginal effect on existing practices.

However, the 2003 amendments to the election and related laws also appear to have had some perverse effects. These amendments mandated that party spending in support of the candidate must be included for the purpose of the candidate's expenditure ceiling. However, it did not raise the ceiling substantially to accurately reflect the actual spending by candidate and party combined. As we show, the 1999 survey of election expenditure (discussed a little later in this Part) found that for the Congress and the Bharatiya Janata Party (BJP) the actual spending by all sources was between four and six times the then-existing ceiling. This meant that candidates were under pressure to under-report actual party and independent supporter spending on their campaigns. Similarly, parties were under pressure to falsely declare that spending in support of candidates was meant for general party propaganda. Thus, the reform tended to institutionalize deliberate evasiveness and false declaration of the amounts and nature of expenditures.

In addition, since the loophole of party spending for general party purposes remained open, there was no effective cap on actual spending, and the mad scramble to raise and spend money persisted. Though the 2003 introduction of tax incentives for openly disclosed contributions has had some cumulative effect, the bulk of actual contributions still appear to follow the black money route and not the transparent legal route, for the same reasons as before.²¹ This is because even after two decades of economic liberalization, the Indian economy remains one in which the central and state governments retain a host of powers to regulate economic activity. That is especially true at the state level and in sectors like real estate where land acquisition and use remain regulated. Hence, the same politically risk-averse priority is given to confidentiality of political donations by business donors as was the case in the years after the re-legalization of such donations in 1985.

The available data on party income and expenditures support the conclusion that a great deal of money is flowing through illegal channels. In 2008–09, the years immediately before the April–May 2009 election, the Congress Party reported an income of Rs. 4970 million (\$110 million) and expenditure of Rs. 2750 million (\$61 million), while the BJP reported an income of Rs. 2200 million (\$49 million) and expenditure of Rs. 1960 million (\$44 million). Between them the two parties won 322 seats. If one assumes an estimated expenditure

of Rs. 33 million (\$750,000) per victorious candidate, less one-third to one-half of what the Election Commission estimates (Rs. 70–100 million), the combined expenditure on winning candidates alone would be higher than the combined income of the two parties.²² This indicates an under-declaration of income by parties, a feature common across parties. There are three major sources of funds that account for this gap: (1) off-balance sheet cash donations by big and medium businesses in exchange for a quid pro quo, (2) similar donations in unaccounted cash from wealthy individuals, and (3) money illegally raised by politicians.²³

Another perspective can be obtained by looking at the proportion of donations of Rs. 20,000 (\$450) and above within total donations, i.e., the proportion that has to be mandatorily reported to the Election Commission with disclosure of donor identities. In 2008–09, the Congress received donations of Rs. 480 million (\$10.7 million) of its total income of Rs. 4970 million (\$110 million). Of these donations, only Rs. 280 million (\$6.2 million) was in donations of Rs. 20,000 (\$450) and above. The BJP, in the same year, received total donations of Rs. 1960 million (\$44 million) out of its total income of Rs. 2200 million, (\$49 million) but only Rs. 300 million (\$6.7 million) of this was in amounts of Rs. 20,000 (\$450) and above. Given that the great bulk of party incomes come in amounts below Rs. 20,000 (\$450) from non-identified donors, there is a possibility that this substantially represents black money being channeled into the parties rather than representing small donations from numerous individuals.²⁴

A recent paper by Kapur and Vaishnav (2011)²⁵ provides circumstantial evidence that black money

²¹This conclusion was gleaned from four major corporate donors in 2008, five years after the 2003 introduction of tax deductibility, and confirmed by major national party fundraisers and election strategists, including a Central minister in interviews during 2008–11.

²²See Merchant, M. (2011, December 11). How much does your Lutyens MP cost you? *Times of India*, for Election Commission estimates of victorious candidate expenditures.

²³See Merchant, M. (2011, July 14). Who Will Watch the Watchmen? *Times of India*.

²⁴See Merchant, M. (2011, June 2). Auditing Congress Inc and BJP Ltd. *Economic Times*.

²⁵Kapur, Devesh and Vaishnav, M., *Quid Pro Quo: Builders, Politicians, and Election Finance in India* (Center for Global Development Working Paper 276). Retrieved December 7, 2011, from <<http://ssrn.com/abstract=1972987>>.

may be finding its way into campaign spending. Kapur and Vaishnav sought to demonstrate the nexus between the real estate sector and election funding. Specifically, they examined the alleged relationship between politicians and builders, in which politicians invest their illegal wealth in the construction industry and builders cooperate because they are beholden to politicians for discretionary favors. Because builders would be expected to return cash to politicians to support their campaigns, there should be a contraction of construction activity at the time of elections. Looking at a monthly-level data set, Kapur and Vaishnav demonstrated that cement consumption (an indicator of construction activity) exhibited a “political business cycle,” i.e., there was a contraction in construction activity at election time. This suggests that funds may have been diverted elsewhere, possibly to elections.

Driving campaign expenses underground

There is also evidence that the mounting costs of election campaigns results in circumvention of expenditure limits. As described in Part II, much of the actual spending is not captured by these limits, which do not include party and independent supporter spending.²⁶ The only detailed study of actual election expenditures available is the National Election Audit ‘99 (NEA ‘99) conducted by the Centre for the Study of Developing Societies (CSDS), of which one author (Sridharan) was the National Co-coordinator. A summary of this report’s findings follows.

The aggregate data of 24 sample constituencies (of which 4 were urban and 19 rural or predominantly rural), suggests that the 57 out of 122 candidates who polled up to 3.4 percent of total votes spent in the range of Rs. 275,000 (then \$6,875). The fifteen candidates who polled 3.5 to 16.5 percent votes spent an average of Rs. 3.5–6 million (then \$87,500–\$150,000). The 50 candidates who polled over 16.5 percent votes, spent on an average Rs. 7.355 million (then \$184,000). This figure includes candidate, party, and independent supporter expenditures. The data suggests that to be competitive, candidates need to spend at least a certain minimum amount. However, above a certain threshold, spending alone does not correlate with vote shares.

Yet, the spending gap between winners and runners-up was not all that large. The average winner spent Rs. 8.287 million (then \$207,000) and the

TABLE 1. PATTERN OF SEAT RETENTION: LOK SABHA ELECTIONS, 1991–2004

<i>Year of Elections</i>	<i>No. of Seats Retained by Same Parties</i>	<i>No. of Seats Won by Different Parties</i>
2004	247	296
1999	282	261
1998	267	276
1996	266	277
1991	302	241

Source: Sanjay Kumar, *Increasing Fluidity in Electoral Contests: Is This Mere Anti-Incumbency?* In Rajendra Vora and Suhas Palshikar (eds.), *Indian Democracy Meanings and Practices*, New Delhi: Sage Publications India Pvt. Ltd., 2004, p 368, Table 14.5.

average runner up spent Rs. 6.809 million (then \$170,000). The study also found that national parties spent much more on average than the regional parties. With a few exceptions, this was the case even in states where the state parties were very strong or had been in power before.

Both BJP and Congress sources pointed out that higher spending does not necessarily produce victory. This is corroborated by the rapid turnover in power at the national level during the 1990s and repeated again in the 2004 election. As can be seen in Tables 1, 2, and 3, the percentage of seats retained by the same parties hovered around the 50% mark in 1996, 1998, and 1999 and was 45% in 2004. (In the 2009 election, delimitation or re-districting had changed the boundaries and names of a large number of constituencies; thus seat retention cannot be meaningfully calculated for the 2009 election). BJP sources maintain that parties have to spend a certain minimum to get their message across, but beyond that minimum there is no correlation between spending and victory.²⁷ In any case, the election expenditure estimates noted above are substantially larger than the ceiling on election expenses (four to six times the 1999 limits).

Former Prime Minister Atal Bihari Vajpayee once testified to a parliamentary committee that “every legislator starts his career with the lie of the false

²⁶This section is extracted, with some changes, from Sridharan, E. (2006). *Electoral Finance Reform: The Relevance of International Experience*. In Chand, V.K. (ed.), *Reinventing Public Service Delivery in India: Selected Case Studies*, (pp. 375–8). New Delhi: Sage.

²⁷Interview with former BJP treasurer, V. P. Goyal, January 4, 2005.

TABLE 2. PERFORMANCE OF BJP'S INCUMBENTS: LOK SABHA ELECTIONS, 1991–2004

Year of Elections	No. of Sitting MPs	Renominated	Re-elected	Incumbent Won (%)	Other MPs of Party in the Present House	Turnover of MPs for the Party (%)
2004	182	147	74	50	64	46
1999	182	159	105	66	77	42
1998	161	144	100	69	82	45
1996	121	86	58	67	103	63

Source: Sanjay Kumar, Increasing Fluidity in Electoral Contests: Is This Mere Anti-Incumbency? In Rajendra Vora and Suhas Palshikar (eds.), *Indian Democracy Meanings and Practices*, New Delhi: Sage Publications India Pvt. Ltd., 2004, p. 370, Table 14.9.

TABLE 3. PERFORMANCE OF CONGRESS INCUMBENTS: LOK SABHA ELECTIONS, 1991–2004

Year of Elections	No. of Sitting MPs	Renominated	Re-elected	Incumbent Won (%)	Other MPs of Party in the Present House	Turnover of MPs for the Party (%)
2004	113	69	30	43	115	79
1999	141	103	40	39	73	65
1998	140	101	52	51	89	63
1996	244	157	66	42	74	53

Source: Sanjay Kumar, Increasing Fluidity in Electoral Contests: Is This Mere Anti-Incumbency? In Rajendra Vora and Suhas Palshikar (eds.), *Indian Democracy Meanings and Practices*, New Delhi: Sage Publications India Pvt. Ltd., 2004, p. 371, Table 14.10.

election return he files.”²⁸ This situation arises because the ceilings on election expenditure are unrealistically low. Of course, no candidate is forced to break the law. Nevertheless, because the real cost of running a successful campaign has not kept pace with the rate of inflation, the high costs have a tendency to induce illegal fundraising and spending. Candidates have an incentive to doctor their accounts and report expenses below the official ceiling, because expenditure in excess of the limit can result in candidates' disqualification and the loss of their seats. This behavior seems to persist despite the inefficiency with which India prosecutes cases related to excess expenditures. Most cases are not resolved during the elected candidate's term of office,²⁹ and only one elected state representative has been disqualified because of the filing of false accounts to date.³⁰

Parties' preference for candidates who can finance their own elections

Given the magnitude of resources that political parties need to raise for campaigns, they can be expected to prefer candidates who can raise resources for the party and finance their own campaigns.³¹ In fact, wealthier candidates have significantly higher chances of winning their elections, as illustrated in Table 4 based on the Lok Sabha election of 2009.

Political party preference for wealthy candidates can give rise to a new breed of “political entrepreneurs” who are ready to invest in running for office in the hope of controlling the levers of government to further enhance their personal wealth.³² Vaishnav

²⁸Datta-Ray, S. K. (2008, July 26). Gangland Battles: Why Politics is Not a Career for the Meritorious Young. *The Telegraph*. <http://www.telegraphindia.com/1080726/jsp/opinion/story_9602998.jsp>.

²⁹See Section 15 of the Consultation Paper on “Review of Election Law, Processes and Reform Options,” National Commission to Review the Working of the Constitution, 2001. Available at: <<http://lawmin.nic.in/ncrwc/finalreport/v2b1-9.htm>>.

³⁰In 2011, based on an election petition, Umlsh Yadav, a member of the Legislative Assembly in the state of Uttar Pradesh was disqualified by the Election Commission of India, i.e., she lost her seat, and was barred from contesting assembly or Parliament elections for three years. In her official declaration of election expenditures, she was found to have suppressed an expenditure of Rs. 21,250 (about \$420) which her campaign had paid to newspapers for election-related advertisements. See <<http://www.rediff.com/news/report/election-commission-disqualifies-up-mla-for-paid-news/20111020.htm>>.

³¹Kondepati, R. (2011). *Minimizing Barriers for Legitimate Politics in India*. Policy Analysis Exercise, National University of Singapore, Lee Kuan Yew School of Public Policy. Retrieved March 9, 2012, from <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1912437>. See also Hardgrave, R. L. and Kochanek, S., Elections and Political Behaviour. In Hardgrave, R. L. and Kochanek, S. (eds.), *India: Government and Politics in a Developing Nation* (pp. 386–7). Boston: Thomson Wadsworth, 7th edition.

³²Gowda, M. V. Rajeev. (2011, April). *Karnataka: Descent Into Democratic Decadence*. Seminar, 620, pp. 42–46.

TABLE 4. ENTRY BARRIERS TO POLITICAL OFFICE: FINANCIAL ASSETS AND CHANCES OF WINNING

Value of Assets	No. of Candidates	No. of Winners	% of Winners
Very high (Rs. 50 million and above)	322	106	33%
High (Rs. 5–50 million)	1485	283	19%
Medium (Rs. 1–5 million)	1785	116	6%
Low (less than Rs. 1 million)	3437	15	0.44%
Total	7029	520	7.4%

Source: National Election Watch and Association for Democratic Reforms (2009): Analysis of Criminal and Financial Details of MPs of 15th Lok Sabha (2009): Interim Report, p. 11.

(2011) argues that parties' preference for wealthy candidates has the pernicious impact of increasing the participation of criminals in electoral politics, a growing phenomenon in India.³³ He bases his argument on a statistical analysis of the disclosure data required of candidates. In his analysis of all candidates who contested state elections between 2003 and 2009 he demonstrates the complementary relationship between money and "muscle," i.e., candidates indicted on serious criminal charges. He explains this correlation by arguing that parties choose criminals as candidates because of their ability to finance their own election campaigns. Thus, parties' preferences for wealthy candidates could possibly result in corrupt and criminal elements acquiring influence over parties.

V. ASSESSING IMPACTS OF THE PRESENT SYSTEM

What are the net impacts of the above system of party and campaign finance laws? Given the paucity of hard data due to the surreptitious nature of both fund-raising and expenditure, we can only be tentative. In this vein, we suggest six consequences that may flow from the current system.³⁴

First, the expenditure ceilings appear to invite evasion. Before 2003, party and supporters' expenditures were exempt from the purview of the expenditure ceiling, in effect ensuring that there were no real limits. After 2003, when party and candidate expenditures in support of candidates were brought within the limit, candidates seem to have resorted to incomplete and inaccurate expenditure statements. The low expenditure limits tend to induce such dishonesty, a profoundly unhealthy development for any democracy.³⁵

Second, the absence of public funding means that parties and candidates must raise and spend money on their own for each election. The combined effect of the ban on corporate donations in 1969 and the uncapping of expenditures in 1975 was an imperative to spend, without an adequate legal source of funds. This appears to have exacerbated dependence on black money and institutionalized corruption in the context of a highly regulated economy. Parties and candidates tend to use their term of office to accumulate war chests for future elections and for nursing their constituencies. There is evidence that they raise these resources through any means available, including through corrupt means such as kickbacks for regulatory and allocative favors while in office.³⁶

Third, the lack of any effective system of internal democracy, transparency, and accountability within parties reinforces corrupt fund-raising and the lack of financial accountability. In this respect, India stands in contrast to Germany, which regulates the internal affairs of parties. Parties in India have evolved to be top-down and often controlled by a founding family.³⁷ Given the dependence of the system on large electoral expenditures, compared to the nominal spending limits, parties remain opaque in

³³Vaishnav, M. (2011). *The Market for Criminality: Money, Muscle and Elections in India* (August 31, 2011). Available at SSRN: <<http://ssrn.com/abstract=1928011> or doi:10.2139/ssrn.1928011>. The larger issue of criminalization of politics is examined in the Vohra Committee Report on Criminalisation of Politics which identified the extent of the politician-criminal nexus and recommended ways to prevent corruption. See Department of Legislative Affairs, Ministry of Law and Justice, Government of India (co-sponsored by Election Commission of India), *Background Paper on Electoral Reforms*, December 2010, p. 7.

³⁴This is a pervasive problem with studies of election expenditures as noted by Pinto-Duschinsky (2002). See Pinto-Duschinsky, M. (2002). Financing Politics: A Global View. *Journal of Democracy*, 13(4), 69–86.

³⁵The raising of the expenditure limit to Rs. 4 million (\$90,000) for Lok Sabha elections and Rs. 1.6 million (\$36,000) for assembly elections in February 2011 should not be expected to have much positive impact on this institutionalized dishonesty, as these limits are still very low, even as measured by the National Election Audit '99 survey conducted a decade earlier.

³⁶Confidential interviews with former state-level ministers who were key fund-raisers for national parties, during 2008–11, as well as by key bureaucrats who have observed kickback deals at close quarters.

³⁷For top-downness, family control, and dynastic succession in Indian parties see French, P. (2011). *India: An Intimate Biography of 1.2 Billion People*. New Delhi: Penguin Books India, pp. 116–121.

their fund-raising and electoral expenditures, as well as in their accounting and reporting of both.

Fourth, the Companies Act's limit on corporate political contributions to parties (5% of average net profit over the past three years) may worsen the problem with corruption, despite the 2003 law's introduction of tax deductibility of political donations. If companies were able to contribute more legally, we would expect candidates' and parties' reliance on black money to be reduced. It has been recently suggested by the spokesman of the Congress party that this 5% limit needs review, and it might be better to leave it to company management and boards to decide how much to contribute to parties.³⁸ Also, contributions to individual candidates are not allowed under the current regulation. This may dampen corporations' incentives to make legal contributions, as their money is spread over an entire party rather than targeted toward favored candidates.

Sixth, under the current system, party leadership has no incentive to raise funds through large numbers of small-sum donations, given the large sums needed and the high transaction costs involved in raising many small contributions. It is far easier to raise the large sums needed in big tranches from a relatively small number of big donors, typically in unaccounted forms.³⁹

The available evidence thus suggests that a corrupt equilibrium has taken hold and now perpetuates itself. Part of this may be due to path-dependency following from the 1969 ban on corporate donations and the 1975 exemption of party spending from spending limits. Part of this might be attributed to the dependence on private funding in the absence of state funding. It is hard to see how large and medium private business groups could avoid tying their contributions to regulatory and allocative favors, in an economy where the government still has tremendous discretionary influence. The apparent result is that parties and politicians raise funds from businesses in black money form, in return for discretionary contracts and regulatory favors, and spend more than campaign finance laws allow without disclosure. There is no incentive to break out of this corrupt equilibrium. It is simply how "the system" works.

VI. POTENTIAL REMEDIES

In conclusion, we consider systemic reforms that might enable India to break out of the corrupt equi-

librium described above. To understand what reforms might be effective, it is necessary briefly to review the political-economic context of elections and campaign finance in India.

The key feature of the political-economic context is that, despite two decades of economic liberalization, Indian businesses remain highly vulnerable to discretionary government actions at both central and state levels. The licensing powers of the central and state governments have been reduced over the years. But when it comes to starting, operating, or expanding a business, there are numerous points at which government permission is required at both central and state levels. Major examples include land acquisition and environmental clearances required to set up new plants. Our interviews with industry chief executive officers (CEOs) over the past few years (both before and after the 2009 national election) indicate that these have become pressure points for extorting payments from businesses.⁴⁰ This is especially so in the mining and real estate development industries and also in large industrial projects.

Industry, being vulnerable to such discretionary regulation and extortion, is averse to alienating parties that are in power or that may come to power. Businesses thus prefer to be secretive about their political contributions. Our interviews indicate that the introduction of tax deductibility for political donations since 2003 has had only a very limited effect on the general practice of unreported donations in black money in return for governmental favors or to buy party goodwill. Maintaining confidentiality of donations helps avoid reprisals by political parties that might want to penalize the donor for favoring their opponents; this is generally regarded as more important than any tax benefit.

³⁸See Tiwari, M. The Colour of Money, *Indian Express*, March 11, 2011.

³⁹Parties claim that they raise large sums through members' contributions and other small donations of under Rs. 20,000 (\$450), the limit over which they must be reported to the Election Commission, but this may in fact be a way of laundering the unaccounted money raised by political parties. Interview with a senior Election Commission official, March 17, 2011.

⁴⁰Confidential interviews with donors and political fund-raisers conducted during 2008–11 in Delhi, Mumbai, and Bangalore, emphasized the role played by land acquisition and environmental clearances.

An indicator of such risk-averse behavior when it comes to political contributions is the fact that large industrial groups have been resorting to the device of setting up (tax-exempt) electoral trusts and making contributions to political parties across the spectrum on a formula basis, so that they keep all parties satisfied and protect themselves against the risk of political disfavor by any party or coalition. Of the 36 companies making legal donations of over Rs. 10 million (\$220,000) to political parties in 2009–10, 24 companies, including the four largest donors, made donations to both the Congress and the BJP.⁴¹ While this evidence is limited to the contributions that are publicly declared, our interview evidence also supports the fact that political contributions from major companies are distributed across parties, including contributions made in the form of black money.

Giving to multiple parties makes sense in light of India's recent political history that has seen multi-party coalitions in the central government since 1996 and a variety of parties and coalitions alternating in power in most states. Thus, most large companies with multi-plant operations spread across states have an incentive to maintain political goodwill across a range of parties. This militates against transparent donations to parties in return for tax benefits, the risks of incurring the wrath of one or more parties in the central or state governments being just too high.

Against this background, we suggest some possible reforms of India's party financing and election expenditure laws. It should be borne in mind that the range of reforms we describe here create their own incentives and side effects which are the subject of debate in their respective countries, and might themselves need further refinement. Hence, there are no off-the-shelf reforms that can readily be transplanted to India. Reforming India's electoral financing would require judicious borrowing and adaptation from successful initiatives elsewhere.

The evidence described in Parts IV and VI suggests a need to remove the incentives for illicit fund-raising by politicians and parties. The 2003 amendments of the Representation of the People Act (RPA) introduced tax deductibility for political contributions by individuals and firms as a step in this direction. This does not appear to have been very effective, however, since it requires transparency in donations, which can lead to individuals

and firms becoming vulnerable to reprisals from political parties and politicians. What is needed is a way to incentivize open, rather than under-the-table, contributions.

India can look at the international experience to reform the illicit fund-raising by politicians and political parties. There have been successful models in several countries, which have worked remarkably well to reduce the dependence on the corrupt practices and interested money from plutocratic sources to fund politicians and political outfits. The political financing patterns differ based on whether they involve public or private funding, are subsidized or not, or have limits on expenditures and regulations on donations and expenditures.

Some countries have had favorable results in curbing the nexus between big business and wealthy donors on the one hand and parties and politicians on the other. One means of achieving this goal is for parties to rely more on grassroots small-sum donors, which tends to make them more internally democratic and transparent.⁴² Public subsidies, including indirect subsidies like tax deductions and credits, have played an important role in effecting this shift. Canada has been the most successful among Anglo-Saxon democracies in this regard. Its move toward more small-sum donors was accomplished by introducing tax credits for individuals only (in which individuals could set off small political donations to parties and candidates against their tax liability) since 1974. Parties are required to disclose their sources of income and donor identities.⁴³ Continental Western Europe, with a mixed pattern of public

⁴¹These figures come from data obtained by the Association for Democratic Reforms under the Right to Information Act. Karunakaran, N. (2012, January 10). India Inc. Puts its Trust in Lawful Funding of Parties. *Economic Times*.

⁴²Particularly the cases of Canada, Germany, France and Netherlands in Nassmacher, K. (2003). Introduction: Political Parties, Funding and Democracy. In *Funding of Political Parties and Election Campaigns*, (pp. 12–13). Stockholm: International IDEA. The Funding of Political Parties in the Anglo-Saxon Orbit. In *Ibid.*, (pp. 37–45), and Party Funding in Continental Western Europe. In *Ibid.*, (117–138).

⁴³Nassmacher, K. (2003). Introduction: Political Parties, Funding and Democracy. In *Funding of Political Parties and Election Campaigns* (pp. 12–13). Stockholm: International IDEA. The Funding of Political Parties in the Anglo-Saxon Orbit. In *Ibid.*, (pp. 37–45).

subsidy and private funding, has seen the most effective shift towards grassroots funding along with intra-party democracy and transparency noted above.⁴⁴

One way to replicate the successful features of these democracies would be to introduce public funding of parties in proportion to the amounts they raise openly from identified small-sum private donors. State funding based on a transparent formula might encourage a shift towards broad based, small-sum, grassroots financing of parties. It could also lead to greater membership participation and internal democracy. To promote these ends, we suggest that public funding be conditional on parties' adherence to internal democracy, transparency and accountability; otherwise, the existing party leadership can be expected to deploy public funds for their discretionary use. This type of public funding has helped some countries to effectively check corrupt practices and shift towards grassroots funding, thereby nurturing grassroots participation that is vital for a healthy democracy.

There is, however, a problem with making public funding proportional to small-sum donations: it is still vulnerable to politicians rerouting black money through their supporters (a practice similar to the costs of party membership drives in India being paid for by politicians rather than individual members).⁴⁵ But there are ways of dealing with such circumvention. As India moves toward the implementation of a Unique Identity Number for every citizen, and links this number across bank accounts and tax returns, it would become more difficult to reroute black money through supporters. Strict auditing and disclosure of all sources of income and donor identities by political parties will help to combat evasion. We do not argue that public funding will completely eliminate corrupt fund-raising from private sources. However, public funding may help to reduce corruption by providing a financial floor for all major political parties in their respective stronghold states where they have a significant vote share.

Raising the current limits on corporate political contributions might also enable more transparent funding. Such a move would allow more legal money into the political system. Already some corporate houses, e.g., the Tata group, have taken the lead by establishing electoral trusts in accordance with the law. The Tata group's electoral trust allo-

cates half its contribution to parties on the basis of their strength in the current Lok Sabha, subject to a minimum of 17 seats, and distributes the rest to parties according to their strength in the newly elected Lok Sabha.

A more radical solution is offered by Yadav (2011).⁴⁶ He suggests that after every election

[A]ny party or independent candidate who secures more than 2% of the votes polled should be reimbursed [at] Rs 100 per vote secured by them from a special public fund. The amount should be deposited in the bank account of the local, constituency level, unit of the party organization. The party should be allowed to use these funds for any legitimate political activity, including elections, for a period of five years. The funds should be subject to rules of accounting, auditing and transparency that govern public funds.

In effect, it would mean that the assembly level unit of each of the major parties would have an assured sum of more than Rs 1 crore [\$10 million] over a five-year period (if the party polls, as they usually do in most big states, 50,000 votes or more in the assembly and Lok Sabha elections in their assembly segment). Assuming that they use up a substantial proportion of this fund for elections, it would give them a decent amount to stay in the electoral fray. It would not do away with "black" money but would encourage the parties to nominate an honest but resourceless political worker. This would also ensure that the lower party functionaries would not depend on the private resources of the party bosses. This is not a one-stroke solution to political corruption. But it should help reduce the compulsion to be corrupt

⁴⁴See Nassmacher, K. (2003). Party Funding in Continental Western Europe. In *Funding of Political Parties and Election Campaigns* (pp. 117–138). Stockholm: International IDEA, for accounts of Germany, France, Italy, Netherlands and Sweden.

⁴⁵Hardgrave, R. L., and Kochanek, S. (2008). Elections and Political Behaviour. In *India: Government and Politics in a Developing Nation* (pp. 386–7). Boston: Thomson Wadsworth, 7th edition.

⁴⁶Yadav, Y. (2011, February 27). Infuse white money in politics to fight black money. *Times of India*.

and encourage clean and accountable politics at each level. This would cost about Rs 8,000 crore [\$80 billion] over a five-year period, assuming one cycle of Lok Sabha and assembly election each.

If some viable combination of these proposed solutions were implemented, it could upset the prevailing equilibrium of covert corrupt practices in election funding and party financing.

While our suggestions for reform may have a limited impact initially, they would set in motion a movement toward transparent funding of parties and elections. This could ultimately result in a healthier political environment, one in which parties are more internally democratic and the political system is more hospitable to candidates who wish to practice clean politics.

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