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India: Democracy and Corruption

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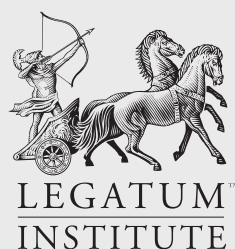
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Executive Summary

This working paper was prepared on 20 April, 2013 for presentation at the Democracy Works Project seminar at CDE.

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This paper surveys the relationship between democracy and corruption in India and puts forward some suggestions for possible solutions. It begins by outlining the problem and surveying literature on corruption, growth, and democracy in India and in other developing countries, situating the problem of corruption in the context of India's democracy and economic liberalisation since 1991. Outlines are then given of the body of anti-corruption and transparency laws, of the government institutions of India, and of the recent anti-corruption movement. Analysis is made of the state of economic liberalisation and discretionary regulation in India, which sets the political-economic context for corruption. The paper then zeroes in on the taproot of corruption in India, namely, the need for parties and politicians to raise funds for elections and other political activity in the absence of state funding; tracing the evolution of political finance regulation in India, the incentives that arise from it, the perverse effects of regulation, and the link to corruption. Lastly, it suggests some solutions to the problem of corruption that centre on political finance reform but include broader economic reforms.

Introduction

India liberalised its economy in 1991, drastically reducing tax rates, tariffs, and detailed micro-control of economic activity. This opened up sectors hitherto reserved for the public sector, including to foreign companies. These changes were expected to bring an end to the corruption that plagued India, particularly since the 1970s. Yet, in 2011, two decades after liberalisation, 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 a telecommunication spectrum, while 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 that forced the government to initiate the establishment of a powerful People's Ombudsman (the Jan Lok Pal), with the powers to prosecute corruption at even the highest levels of government. India's ranking has slipped in Transparency International's Corruption Perception Index from rank 90 in 2004, when the Congress-led United Progressive Alliance (UPA) government came to power, to rank 94 (tied with Greece) in 2012, when the UPA government was in the middle of its second term. In 2012, India was perceived as significantly more corrupt than South Africa and Brazil (tied at rank 69) and China (rank 80), although less corrupt than Russia and other post-Soviet states (Russia 128, Ukraine 144), Mexico, Argentina, Venezuela, Indonesia, Egypt, and most other South Asian states. In the Bribe Payers Index (2011), which measures the likelihood of bribery in government contracts, as perceived by companies, India was ranked 19 among the 28 largest economies, that is, more corrupt than Brazil (14) and South Africa (15) but less corrupt than China (27) and Russia (28).

From one perspective, the capacity 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 and society. However, the question remains as to why corruption is widespread and pervasive in India even after economic liberalisation. This paper will argue that there are two key drivers of corruption in India. First, that economic liberalisation has not ended the government's discretionary powers over resource-allocation in numerous domains. Second, that 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 fighting elections and sustaining political parties.

A Brief Survey of the Literature on Democracy, Corruption, and Growth

To situate the discussion of democracy and corruption in India, it is necessary to start with a brief survey of the literature available on democracy and corruption in general, particularly in developing countries. This literature, predominantly the literature emanating from economists, also deals with a third issue—that of growth. The survey below selectively correlates the findings, in brief, of the voluminous literature on democracy, corruption, and growth, including the principal arguments and findings. Another brief survey follows—again selectively but representatively—of the findings on corruption in India, a body of literature that takes India’s democratic system for granted.

Surveying the literature on democracy, corruption, and growth from representative survey articles, an overarching picture emerges. Starting with the definition of corruption as ‘the abuse of public office for private gain’, the discussion of corruption is restricted to the public sector. Discussion follows of the two direct relationships involved—that between corruption and growth, and that between democracy and corruption, and a third relationship, direct and indirect, between democracy (and its obverse, authoritarianism) and growth.

The general finding (Mauro 1995) is that corruption reduces growth through dis-incentivising and making private investment more costly, due to the cost of bribes and uncertainty. Pranab Bardhan argues that “higher bribes imply declining profitability on productive investments relative to rent-seeking investments, thus tending to crowd out the former” (Bardhan 1997, 1328). This is contested empirically by the fact that several countries ranked highly corrupt by agencies such as Transparency International, including China, Indonesia and Vietnam, and, among democracies, India, post-1999 Indonesia, and several others, have had comparatively high growth rates over several years or decades. It can be argued that corruption in many countries, including in America’s ‘gilded age’ in the late nineteenth and early twentieth centuries, was a product of growth, rather than a restriction on growth. Eventually, this corruption would be checked by the institutionalisation of anti-corruption measures and transparency, as a result of the democratic process.

Addressing types of corruption and their effects, Rose-Ackerman (1996) argues that corruption is more distortionary than taxation for market incentives. Shleifer and Vishny (1993), basing their conclusions on the post-Communist experience, principally Russia, argue that decentralised corruption, where several ‘independent monopolists’ (independent public agencies controlling complementary public permissions and services) exist, is worse for corruption and growth than centralised corruption.

This is supported by Rock (2009) with reference to post-democratisation Indonesia and Thailand, where corruption was perceived to have increased due to the decentralisation of state controls. It is argued that centralised corruption imposes lump-sum costs, which are lower and less distortionary than multiple and cascading bribe demands that create greater uncertainty for private investment and are worse

for growth (Bardhan 1997, 1325). A comparison is drawn between Olson's 'stationary bandits' and 'roving bandits' in that the former has an incentive not to make demands that choke off growth (Olson 1993).

It is also argued, like in the early rent-seeking literature (Krueger 1974), that competition among rent-seekers will pull down the bribe rate. Also, given an authoritarian political system or a corrupt democracy, corruption provides a channel of private sector influence and favours the most efficient, lowest-cost firms, as these will be the ones that will win out in the competition to bribe (Leff 1968; Bardhan 1997—1322), and hence favour efficient outcomes. Besides which, it is argued, certain types of bribe such as 'speed money' for clearances (bribes for moving up the queue for various permissions) favour the efficient and also favour efficient outcomes in terms of investment and growth (Bardhan 1997, 1323). Hence, high growth rates and at least some types of corruption can co-exist.

On democracy and economic performance, some democracy-supporters argue that the electorate's capacity to remove 'bad' leaders helps check corruption and cronyism (North 1990; Olson 1993; Przeworski and Limongi 1993) as does the transparency that comes with democratic freedoms and free institutions such as a free press and civil society. Lipset (1959, 1960) argues that wealth and democracy reinforce each other because a large middle class of producers, historically speaking, is a stakeholder in a system of political and economic freedom and choice that permits the creation of more wealth. Democracy could also lead to greater spending on education and health, due to public demand, both of which have growth-enhancing effects in the long run (Baum and Lake 2003; Helliwell 1994). Shen and Williamson (2005) argue that economic freedom, encompassing deregulation, liberalisation, and privatisation of economic activity have the strongest effect on reducing perceptions of corruption. They also argue that ethno-linguistic fractionalisation has negative effects.

The more pessimistic view of the relationship between democracy and corruption argues the following points. First, rapidly expanding political participation by poor electorates leads to expanding demands on government and excessive government expenditure, leaving fewer resources in the hands of productive investors and reducing growth potential (Huntington and Nelson 1976). Second, that democracies, over time, accumulate 'distributional coalitions' of special interest groups that garner particularistic privileges for themselves from the government and reduce efficiency and growth potential (Olson 1982). Third, Przeworski and Limongi (1993) argue that democracy could, in a poor country, threaten property rights, create economic uncertainty, and reduce growth. However, all scholars agree that democracy has only an indirect effect on growth, through various mechanisms and institutions.

Drury, Kriekhaus, and Lusztig (2006, 126) argue that democracy may not only reduce the level of corruption, but also change the composition of corruption. Politicians, who can be thrown out of office, will avoid those types of corruption that impede growth because they anger the public, for example corruption that "impedes important investment in physical infrastructure and education". Bribes for access to government officials might continue as they have only minor political costs. Essentially, they argue that while democracies may be corrupt, democracy mitigates the worst effects of corruption and reduces its negative effects on growth.

Rock (2009) argues that the relationship between democracy and corruption, by which he means the democratisation of erstwhile non-democracies, is like an inverted 'U'. Corruption tends to rise after democratisation and then decline after peaking as democracy matures. Rock's argument resembles that of Shleifer and Vishny (1993) in that he argues that centralised corruption under authoritarian rule yields to wider and less efficient corruption under democracy, referring particularly to the cases of Indonesia and Thailand. Citing Mohtadi and Roe (2003), he argues that "competitive entry into rent-seeking driving the returns to rent-seeking down while aggregate rents and corruption rise, at least for a while" (Rock 2009, 58). However, Rock also claims that "increased competition among rent-seekers and increased sanctions against rent-seeking and corruption drive the returns to rent-seeking so low that aggregate rents (and corruption) fall when the state of democracy is sufficiently well-developed" (Rock 2009, 58).

Blake and Martin (2006) reinforce Rock (2009) by showing that democracies need to be in existence for about 20 years for the perception of corruption to come down and this behavioural change happens because corruption's negative impact on growth damages outcome-based sources of legitimacy in a democracy.

Bardhan (1997, 1331), citing Sah (1988) makes the point that corruption is an example of a "frequency-dependent equilibrium" in which expected gains from corruption depend on what percentage of other people are expected to be corrupt. Once perceptions shift to a belief that fewer people are corrupt, there is a shift in the behaviour of agents, resulting in a shift to low corruption equilibrium, an explanation that dovetails with those above. Bardhan points out the danger of being "locked in" to high corruption equilibrium if a society starts from a high initial incidence of corruption and a widespread belief in its ubiquity (Bardhan 2005, 344).

Lastly, there is the sociological view of corruption that focuses not on economic or political incentives but on social norms and values that tend to accept or reject corruption with varying degrees of strength. Moreno (2002), based on World Values Survey data, argues that social acceptance of corruption is most prevalent in post-Communist societies, then in Latin America, followed by South Asia. However, the sociological view does not offer any suggestions of policies to curb corruption, and hence is not the focus of this paper.

There are two broad views on how to curb corruption, they are not mutually exclusive and they are based on two types of analyses. In the Crime and Punishment model of corruption (Becker 1968; Becker and Stigler 1974) rational government officials choose a level of corrupt activity "that equates the marginal benefits from legal activities (government wages, promotion possibilities, and a government pension) with the marginal benefits from corruption (the size of potential bribes net of the probability and punishment of getting caught)" (Rock 2009, 57). Bardhan (2005) also makes a distinction between bureaucratic corruption and political corruption, depending on the level at which bribes are extracted and paid. Base (2011) refers to a "bribe hierarchy" and to "towers of bribery" in which an entire hierarchy of officials might be corrupt and collusive. Bardhan (2005, 342) refers to situations in which political corruption, based on exchange of campaign contributions for legislative favours, might be prevalent even while bureaucratic corruption might be minimal, making a distinction between corruption in the enactment of laws and the enforcement of laws.

In this framework, reducing corruption depends on measures such as increasing government wages; reducing discretionary government regulation and intervention in the economy; and increasing the probability of getting caught, such as through the introduction of transparency measures; less official secrecy; campaign contribution rules; independent auditors and anti-corruption agencies; an independent judiciary; an ombudsman; active NGOs investigating corruption; and an independent and investigative media.

The other analytical model of corruption is the Principal-Agent model (Rose-Ackerman 1978; Klitgaard 1988) in which principals (voters) do not have full information and control over the agents (politicians) they elect. The solutions lie in greater transparency, accountability, and investigative measures like those outlined above, “increasing horizontal competition within government” (Rock 2009, 57), and perhaps also decentralisation to lower levels of government that are closer to people and more able to be monitored. The two sets of measures are not mutually exclusive and in fact dovetail well in a democracy that is following economic liberalisation policies.

However, neither of these models capture the indirect effect of democracy on corruption through the mechanism of party and electoral finance, a flaw recognised by Bardhan (1997, 1327), highlighting that it is the need for campaign finance that causes corruption. This aspect can be applied to India, as discussed in this paper.

A brief survey of corruption in India

Das-Gupta (2007), Basu (2011), Bardhan (1997, 2005), and Quah (2008) together bring a succinct and almost comprehensive survey of corruption in India, a subject on which there is a very limited academic literature. Das-Gupta (2007) makes a distinction between coercive bribes and voluntary bribes. Coercive bribes are what Basu (2011) calls “harassment bribes”, bribes to be paid for what is an entitlement or what an official is bound to do as part of their duties anyway. Voluntary bribes refer to bribes for favours, such as the award of a licence or a contract. Coercive bribes include bribes for refraining from using power to cause harm, for example, bribes to the police or to tax officials to get a refund. Coercive bribes benefit bribe-takers only, while voluntary bribes make the bribe-taker and bribe-giver partners in crime at the expense of the exchequer and the general public, as well as those deprived of equal opportunity to compete for contracts and licences.

Das-Gupta (2007) cites a Transparency International survey of 2002 which ranks the following seven government agencies in decreasing order of corruption: police, judicial services, land administration, education, tax, and health services. Bribes to the police are paid to avoid harassment. A significant finding is that bureaucratic corruption payments were paid directly to officials and not to middlemen, and mostly to officer-level staff and not to subordinate staff. Related to the ubiquity of bureaucratic corruption, there is also large-scale corruption in government recruitment, and postings, and transfers to ‘lucrative’ positions, those in which coercive bribes can be extracted. The rate of bribes ranges from 10–20 percent of the legal sums involved for various services.

It was found that companies tend to know what rate they have to pay in bribes for various favours and this is built into their cost calculations. As for 'speed money' promoting efficiency within a regulated economy, Bardhan (1997, 1323) and Banerjee (1994) point out that officials cause administrative delays and red tape to increase their capacity to extract bribes.

A second major form of corruption is large-scale or 'grand' corruption in the form of huge bribes on major government contracts, particularly on large imports of arms, an inherently non-transparent area, subject to national security considerations; bulk commodities; large infrastructure contracts; allocations of natural resources, such as minerals; or the telecom spectrum, all of which are controlled by politicians in certain key economic ministries with carefully selected bureaucrats colluding with them.

A third major form of corruption is direct theft of government funds from development programmes such as irrigation and roads, from social and anti-poverty programmes, from publicly funded loans to the poor, and the diversion of price-controlled goods, that are in short supply, for sales at higher market rates. These involve both bureaucratic and political corruption and overlap with cultivating electoral constituencies. This form of corruption, that is, direct embezzlement of government funds and materials, takes place down to the village-level.

The causes of bureaucratic corruption are a combination of discretionary regulatory powers along with very weak monitoring and accountability mechanisms, the latter being deliberately designed to be weak in many programmes.

Anti-corruption and transparency measures in India

The anti-corruption regime in India consists of a set of laws and agencies that have been introduced in a haphazard manner over the years and have been largely ineffective (Quah 2008). The first measure was the Prevention of Corruption Act (POCA) of 1947, which incorporated sections of the Indian Penal Code. The growth of a highly regulated, public enterprise-led planned economy in the 1950s led to a perceived increase in corruption. This led to the decision to set up the Santhanam Committee in 1963 to review measures available to check corruption. The Santhanam Committee made three recommendations: (1) the formation of a Central Vigilance Commission to investigate any complaint or suspicion of improper behaviour against a civil servant; (2) appointment of a Chief Vigilance Officer in each ministry; (3) the amendment of the POCA to make the possession, by a civil servant, of assets disproportionate to income criminal misconduct. The POCA was amended again in 1988 and remains in use today.

In 1963, the Central Bureau of Investigation (CBI) was set-up to investigate crimes. Its ambit includes corruption but it is essentially a police agency, and not a dedicated anti-corruption agency, and cannot operate in individual states since law and order comes under the jurisdiction of each state. The 28 states in India have their own anti-corruption bureaus and over the past two decades a relatively toothless ombudsman called the Lokayukta has operated in most states, which is set up at the discretion of the states, and which does not have police powers of investigation or arrest.

In 1964, following the Santhanam Committee's recommendations, the Central Vigilance Commission (CVC) was formed, headed by a commissioner appointed for a five-year term. In 1998, the CVC was transformed into a statutory body to supervise the CBI's operations.

India also has a constitutional office called the Comptroller and Auditor-General, an independent auditor who scrutinises the government's accounts and has, in recent years, been effective in pointing out possible scams where the accounts are suspect.

The period since 1999 has seen some important changes towards more detailed disclosure about the legal, financial, and educational backgrounds of candidates. In November 2000, in response to a public interest petition filed by the NGO the Association for Democratic Reforms (ADR), the Delhi High Court directed the Election Commission to collect data on the criminal records of candidates, if any existed. The Election Commission was also directed to make this data available to the public along with details of the candidates' educational qualifications, and his or her assets and liabilities (as well as those of his or her spouse and dependent relations). Despite challenges, this judgment was reaffirmed and the Election Commission issued an order based on it, dated March 27 2003, making such declarations mandatory. This development forced a significant advance in transparency as far as the criminal records, educational qualifications, and the assets and liabilities, including those of spouses and dependent relations, of candidates were concerned.

A further development was the Right to Information Act (RTI), passed in 2005 under the Congress-led United Progressive Alliance (UPA) government that mandated disclosure of official information on almost everything other than matters associated with national security or personal privacy within six weeks of an appeal being filed. The RTI is not perfect, but it is a vast improvement on the earlier lack of transparency and has helped the media and public in accessing government information which earlier might not have been revealed.

As of April 2013, a People's Ombudsman (Jan Lokpal) bill has been passed by the lower house of parliament and has been awaiting passage in the upper house to become law. It plans to set up an ombudsman with investigative powers on corruption that can be activated by appeals from members of the public about public servants. The criticism from large sections of the opposition and the media is that the bill is too weak and not broad enough in its coverage.

On the whole, however, this set of laws (POCA) and agencies, in the centre and in states (e.g., the CBI, CVC, CAG, state ACBs, and Lokayuktas), have not been effective in checking corruption. Yet the combination of these agencies with the RTI and a fiercely independent private, investigative press and television, and various NGOs, have been successful in exposing several mega-scams over the past two decades, particularly in the past five years. However, in comparative perspective, it is important to bear in mind that in non-democracies like China, such laws, agencies, and civil society and media initiatives are near-absent.

The recent anti-corruption movement

Since 2011, a large-scale anti-corruption movement has emerged in India in response to a series of scandals that have been exposed by the media since 2010. This has undermined the legitimacy of the Congress party more than that of other parties. Several major scandals, which involve amounts running possibly into billions of dollars, have erupted since 2010. These involve federal ministers and state chief ministers of the ruling UPA II coalition, including the Congress party. This includes the 2G (second generation) cellular telephony scandal involving the former telecom minister A. Raja of the DMK, a coalition partner of the Congress; the Commonwealth Games scandal of 2010, involving Congress politician Suresh Kalmadi; the Adarsh real estate scandal, involving former Maharashtra Chief Minister Ashok Chavan; the 'coalgate' scandal, involving allocations of coal mining permits to favoured firms by the UPA II government; and, most recently, a payoff in the Agusta-Westland arms-import deal. Each of these scandals involves bribery charges related to allocation of publicly owned or regulated resources to favoured private firms, or to government contracts in the cases of the Commonwealth Games and the arms-imports. The combination of RTI and a vigilant opposition, media and NGOs, is making it increasingly difficult to hide major corruption for long. The likelihood of exposure at some time in the future might have a quiet deterrent effect on corrupt politicians and bureaucrats.

These scandals sparked off huge public agitation led by the charismatic, septuagenarian rural leader and anti-corruption crusader Anna Hazare demanding the passing of a law that would institute an ombudsman to investigate corruption charges against public officials. The Congress party was defensive, and the Anna Hazare movement appeared at first to be co-ordinating its positions and attacks on the government and ruling party with the Bharatiya Janta Party (BJP)-led opposition. However, after huge demonstrations in Delhi and saturated media coverage, particularly in the summer of 2011 and during a large part of 2012, the movement split and entered formal politics in 2012 with the registration of a single-issue, anti-corruption political party called the Aam Aadmi (Common Man's) Party. Among other things, the Aam Aadmi Party has called for transparency of political party incomes and expenditures. The anti-corruption movement required the Congress party to justify their stance, and, for a time, made it look as if it had no credible response. The anti-corruption movement is part of a wider process of an active civil society and activist media that takes up and magnifies public discontent. This was again reflected in the massive public agitation and media coverage of the issue of women's safety following the horrific gang rape of a student in Delhi in December 2012. Such largely urban, middle-class movements and the associated media coverage has unsettled politicians and the ruling parties, at national and state levels, who are not used to such public outcry and activism and for whom a degree of corruption is routine. The anti-corruption movement was initially felt to have made the ruling Congress, and its allies in particular, vulnerable electorally, but its fallout also affected the BJP due to corruption scandals associated with iron ore-mining and sand-quarrying in Karnataka and Uttarakhand respectively, and corruption charges against the president of the BJP.

The post-liberalisation context: government regulatory powers

Before discussing possible solutions it is necessary to discuss the scope of government regulatory powers in the post-liberalisation context. This is because, as existing literature on corruption and growth emphasises, discretionary regulation creates opportunities for corruption and liberalisation, and transparency can go a long way in reducing the opportunity for corruption. Despite more than twenty years of economic liberalisation since 1991, there still remains a plethora of government clearances, especially at the state-level, which remains highly discretionary rather than transparently rule-based, offering opportunities for corrupt extortion of funds by those who control decisions. Deregulatory reforms at the state-level still have a long way to go. Some clearances, especially ill-defined ones like environmental clearances, are now being used for such purposes. Companies find it necessary, or at least prudent, to maintain a working relationship with politicians in power, which militates against openly siding with or funding their opponents. Hence, transparent funding of parties by business is not yet a viable proposition from the point of view of most companies. While some regulation, for ensuring equitable land-acquisition and for environmental health, for example, is necessary, the problem is that key controls are in the hands of the politically controlled bureaucracy and not independent regulatory bodies.

Economic reform can be categorised into three broad types of policies—deregulation, macroeconomic stabilisation, and public sector reform (including privatisation). Deregulation and macroeconomic stabilisation are ‘first generation’ reforms, while public sector reforms including, centrally, privatisation are ‘second generation’ reforms. However, the backlog of ‘first generation’ reforms must also be considered part of the agenda of ‘second generation’, and that backlog is considerable. The economy remains fairly heavily regulated and fiscal stabilisation is yet to be achieved with the combined fiscal deficit of the centre and the states at over 10 percent of GDP, which is where it was in 1990–91. As for public sector reform and privatisation, there has been only a marginal fall in total public employment, largely due to recruitment freezes and Voluntary Retirement Schemes, and barely half a dozen central public enterprises have been truly privatised, with government ownership falling below 50 percent of equity. The number of central public enterprises in which the government, after divestment of minority stakes, still controls at least 51 percent equity is still around 225, concentrated in petroleum, natural resources, defence, heavy industry, and infrastructure. These are the sectors in which very large foreign and domestic contracts are given out and are under top political control.

Deregulation can be expected to command widespread support, as regulation is identified with corruption and inefficiency. Regional capital and medium-scale businesses would welcome deregulation, especially central deregulation. However, there is likely to be a contrary pull from the rising backward caste component of the middle classes, who may not want to give up statist regulation for patronage (job quotas in public employment), especially at the state-level. This is regulation and patronage politics but not necessarily corruption, as job quotas are legal in India, as are anti-poverty measures, and preferential treatment of disadvantaged groups.

Macroeconomic stabilisation, particularly reduction of subsidies benefiting various interest groups, for reducing the fiscal deficit, would also bring forth mixed responses. The urban middle class would tend to resist giving up high administered interest rates on savings schemes of public-sector banks and financial institutions, and the rural rich would resist giving up subsidies to agriculture. Likewise, the removal of subsidies to public higher education would invite middle-class protest. On the closely related issue of public sector reform and privatisation, the public employee component of the middle classes could be expected to resist downsizing and wage restraints, although it is possible that a snowballing support effect could occur after a certain point among those who are not laid off but who stand to gain in the increasingly privatised public enterprises and among those whose family members gain from the growth of the private sector. All in all, given the largely public employee and publicly subsidised farmer characteristics of the broadest middle class, support for second-generation reform, consisting of de-subsidisation and privatisation policies, can be expected to grow only very gradually.

Anti-poverty programmes, which are milch cows for whole chains of corruption of the embezzlement type, from top to bottom, are there to cultivate political constituencies, and would be very difficult to reduce. However, it might be in the interest of party leaderships to redesign them to reduce embezzlement and ensure that the money reaches the poor. An example of how to implement this would be the shift from the existing public distribution system, which stores food and sells it at subsidised prices but which is plagued by corruption and leakages of stocks, to direct cash transfers, that was announced in 2013. This is because widespread petty corruption, beyond a point where there is a public-government interface, such as in anti-poverty and public employment programmes, can lead to vote losses for the ruling party, or parties, exceeding any political gains from patronage politics.

Party and electoral funding in India

What the foregoing account of democracy and corruption leaves out is the key relationship between democratic politics and corruption, through the need for party funds for electoral and inter-election activities. The evolution of India's legal framework, with respect to how political parties can raise funds and expend resources on election campaigns, can be summarised as follows (see also Gowda and Sridharan 2012; Sridharan 2006a, 2006b). Traditionally, political parties in India financed themselves through private donations and membership dues. Corporate contributions to political parties were legal, subject to certain restrictions, and had to be declared in the donor company's accounts. The Representation of the People Act (RPA) of 1951 introduced limits on the amount that could be spent on election campaigns. By the 1960s, there were concerns in policy circles about a nexus between 'black' money (the term applied to funds on which taxes have not been paid or to money raised through illegal activities) and political fundraising. The issue of black money infiltrating the political system was mentioned in the Reports of the Santhanam Committee on Prevention of Corruption (1964) and the Wanchoo Direct Taxes Enquiry Committee (1971).

Subsequently, 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 having undue influence on politics. However, there has also been speculation that Prime Minister Gandhi may have introduced this measure partly because she feared that corporate interests would fund right-wing opposition parties. The ban on corporate donations to political parties was not accompanied by state funding as a substitute for corporate funds, thus opening the door to the entry of black money, initially as a necessity as there was no adequate and legal source of funds.

The supply of black money had grown in the broader economy, in parallel with a high-tax, tightly regulated economic policy framework. High tax rates induced many businesses and individuals to evade taxes. The highly regulated economy, or 'licence-quota-permit raj', mandated that government licences and permits were required for all manner of economic activity. Bureaucrats and politicians could often be induced to allocate licences and permits in exchange for kickbacks. This led to a corrupt fundraising nexus between business groups and ruling parties in the Centre and the states. Thus, the ban on corporate donations would have, in retrospect, entrenched the influence of business groups over politics in opaque ways.

In 1974, the Supreme Court ruled that party and supporter expenditure not authorised by the candidate did not count towards the calculation of a candidate's election expenses. This made the limit on election expenditure largely ineffective as it was limited to candidate expenditure only, whereas the party and the candidate's supporters could spend without any limit. The demand for election funds increased with the 1975 de-linking of party spending and candidate spending for the purposes of calculating campaign expenditure limits. This measure subverted electoral spending limits and made them farcical. India now witnessed electoral spending arms races in which parties tried to outspend each other and tried to attract voters with a variety of inducements (e.g., providing free liquor during election campaigns). Since spending was uncapped, corporate donations were banned and money for elections had to be raised somehow, the slide towards dependence on black money would have been accentuated. Ruling parties at the centre and the state-level found that discretionary regulatory powers gave them an advantage in terms of raising black money.

Political parties were exempted from income and wealth taxes from 1979, provided they filed annual returns including audited accounts. The main development in the 1980s was the amendment of the Companies Act in 1985, which once again allowed corporate donations to political parties under certain conditions. The re-legalisation of corporate donations to political parties in 1985 did not have its intended effect of reducing party dependence on black money and increasing the transparency of political contributions. 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 at the Centre and in various states, and

with a range of individual politicians. Therefore, secrecy of political contributions became imperative so that those not so favoured would not penalise 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 stay with the by then customary practice of secret political donations.

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 board decisions about political contributions be required to be confirmed by shareholders. CII has also recommended state funding of elections. The 1998 General Elections witnessed another important development. The government provided a partial state subsidy in the form of allocation of free air time for seven national and 34 state parties on the state-owned television and radio networks.

Under the RTI of 2005, the ADR filed a petition to the Chief Information Commissioner demanding disclosure of the income tax returns filed by political parties (something they were legally bound to do since 1980 but have actually only been doing after a Supreme Court order from 1996) to make public their income and expenditures including the identities of donors of amounts of Rs. 20,000 and over, as a matter of public interest not subject to national security or privacy concerns. All parties resisted this attempt at forcing transparency but were forced to relent after the CIC accepted the legitimacy of the petition in 2008. Party incomes and expenditures since the Election and Other Related Laws Amendment Act 2003, that is from 2003—04, have been disclosed. Taken together with the Election Commission's 2003 order mandating disclosure of candidate assets and criminal records, this was a major leap forward in transparency.

The most significant development in political and electoral finance reform since 1999 has been the law called the Election and Other Related Laws (Amendment) Act, passed by the National Democratic Alliance (NDA) government in September 2003. This made company and individual contributions to a political party 100 percent tax-deductible (company contributions are still subject to the limit of 5 percent of average net profit over the past three years). For the first time, this set up an incentive for companies and individual donors to donate openly. While this law creates incentives for donors to contribute in the open, it is not clear whether the incentive of a tax exemption on donations will outweigh the possible disadvantages of the loss of anonymity. Further, the donations are tax-deductible only if they are made to political parties rather than to individual candidates. This is likely to affect the magnitude of contributions because there is no guarantee that the political party would distribute contributions to the donors' choice of candidates in a transparent manner. However, this law did lead to a steep rise in transparent contributions (where donor identities and amounts have to be disclosed), those of over Rs. 20,000 (about \$400 at the time) between 2003 and the election year of 2009, for both the Congress (from Rs. 28.52 million to Rs. 968.30 million), and BJP (from Rs. 97.10 million to Rs. 881.08 million). However, it must be noted that transparent contributions remain only a small fraction of declared party incomes.

The 2003 amendments to the Election and Other Related Laws Act 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. A 1999 survey of election expenditure found that, for the Congress party and the BJP, the actual spending by all sources was between four and six times the then ceiling. Also, since the loophole of party spending for general party purposes remained open, in effect there was no cap on actual spending and the mad scramble to raise and spend money remained. Furthermore, though the 2003 introduction of tax incentives for openly disclosed contributions has had some cumulative effect, the bulk of actual contributions follow the black money route and non-transparent legal route, for the same reasons as in 1985. This is because even after two decades of economic liberalisation, the Indian economy remains one in which the central and state governments retain a host of powers to regulate economic activity. This is the case particularly at the state level, and in sectors like real estate where land-acquisition and use remain regulated.

The overwhelming bulk of party funds are from corrupt payments in return for contracts or clearances according to politicians across parties as well as bureaucrats. Large corporations do, however, donate to political parties at the national or state-level, particularly to national parties and to parties important in their principal states of operation, not for a *quid pro quo*, and usually in response to specific requests, just before elections. Real estate-developers have reportedly become the single top source of funds for parties and politicians. National political parties are able to use their control of large-scale government contracts through central ministries and large central public-sector enterprises to raise campaign funds. This is especially true in sectors like petroleum, but also in defence imports, meaning that national political parties no longer need to depend on small-scale corruption downstream in public service delivery or infrastructure-development.

Equally, it can be argued that full privatisation, going beyond divestment of minority stakes by the government, was unlikely in the foreseeable future in large lucrative industries, such as petroleum. National parties' central offices are also able to leverage their rule over, typically, several major states, to raise funds. Hence the argument frequently encountered that, since they have access to large funds from 'top-level' sources and channels, they actually have an interest in cleaning up downstream small-scale, decentralised corruption in public service delivery or development projects, to make themselves electorally popular, despite the present reality of political acquiescence in bureaucratic corruption at various levels.

Net impact of party and election finance laws

There are several key outcomes of the net impact of the current system of party and campaign finance laws. First, expenditure ceilings have been ineffective and, indeed, farcical. Farcical because, before 2003 party and supporters' expenditures were exempt from the purview of the expenditure ceiling, in effect ensuring that there were no real limits.

Second, the absence of state funding means that parties and candidates have to plan to raise and spend money on their own for each election. This led to deeper dependence on black money and the institutionalisation of corruption in the context of a still highly regulated economy.

Third, the lack of any effective system of internal democracy, transparency, and accountability of parties reinforces corrupt fundraising and the lack of financial accountability.

Fourth, under the current system, party leaderships have no incentive to raise funds through large numbers of small-sum donations, this being a laborious method of raising the large sums needed and involving high transaction costs. 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.

Hence, a corrupt equilibrium has taken hold and now perpetuates itself. Part of this is 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 can 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 would not tie their contributions to regulatory and allocative favours in an economy where the government still has tremendous discretionary influence. The result is that parties and politicians raise funds from businesses in black money form in return for discretionary contracts and regulatory favours, and spend unlimited amounts, far above the candidate ceiling without reporting such expenditures. The absence of open funding has enabled the politicians who can raise resources to take over parties, and parties have become top-down, internally undemocratic and opaque. There is no incentive to break out of the corrupt equilibrium that has resulted from the working of the present electoral and campaign finance laws. It is how 'the system' works.

In the Indian context, corruption scandals and the high costs of elections can be possible drivers of reform towards state funding. Equality of political opportunity is still skewed due to mass poverty but a rising middle class, activated by a vigilant media and civil society organisations, might be motivated to demand changes that would redirect the skew in favour of the very rich towards greater opportunities for the educated, professional middle class. However, what is likely to incentivise national and possibly state party leaderships is not so much the exposure of spectacular corruption scandals, as seen in Japan or Korea, since these can be pinned on particular individuals, but the deleterious effects of pervasive petty corruption in public service delivery, development and welfare programmes, with a broad voter interface on party popularity, weighed against the relatively paltry 'take' from such corruption.

Possible solutions

While there is no magic pill to cure corruption, systemic and entrenched as it is, the following are possible solutions, starting with the root cause—party finance—and moving on to other complementary reforms.

The Election Commission of India has proposed that political parties should be required to maintain their accounts and have them audited by agencies specified by the Commission. If parties fail to do so they can be de-registered. The Commission also supports company contributions to political parties, provided these are made in a transparent manner. The Commission has also proposed the inclusion of all expenditures by parties and supporters of a candidate in the election expenses of the candidate. This would be to create a ceiling on expenditure, in effect, against the retention of Explanation 1 to Section 77(1) of the RPA. Most recently, in March 2013, the Commission has recommended that all donors to parties, including those of amounts below Rs. 20,000 be identified by the parties. This is being resisted by the government since it will remove the last remaining obscurity of sources of funds and identities of donors, since the under-Rs. 20,000 channel is used to disguise large, unidentified sources of funds.

However, this does not go far enough. In a low-income country such as India, voluntary private donations will never be enough to fund elections let alone sustain parties between elections. The introduction of state funding, whole or partial, must be considered as a policy option, although it is vital to design any state funding scheme in a manner that ties it to intra-party democracy, transparency, and accountability.

In addition to the above focus on political finance reform as a solution to corruption, three other complementary reforms are needed to operate in tandem.

First, the abolition of case-by-case regulation and the move to a transparent rule-based system; even the so-called 'single window clearances' become one more window in effect. Without this in place at both state and central levels, the kickbacks on every government contract or clearance, and the *quid pro quo* system of political contributions, would continue. What is needed is a more far-reaching deregulation of the economy.

Second, the laws which protect politicians and bureaucrats from prosecution for misuse of power should be abolished. An individual citizen should be able to initiate legal action to prosecute officials for misuse of power, something that exists in several democracies. The Right to Information (RTI) Act is an important step forward. For example, the Association for Democratic Reforms (ADR) used the RTI to ask the Income Tax Department for the tax returns of political parties, on the grounds of public interest, and eventually gained access. The idea was to compare the income tax returns filed by parties with the expenditure returns filed by the same parties with the Election Commission. The RTI needs to be logically followed up and strengthened by laws that enable a citizen to file a civil or criminal complaint against public servants and politicians, for example, against police officers or tax officers. Strengthening the RTI might be politically easier than deregulation of the economy and can make economic decisions such as public-sector contracting more transparent.

A people's ombudsman, appropriately designed and empowered, might go a long way in checking corruption. It should be stressed that politicians on their own cannot raise corrupt funds in any of the above ways without the knowledge of, and very often the active collusion of, the state bureaucracy. The morale of the bureaucracy at the state-level varies and is a function of the state's political and administrative history. Transfers and postings are the political class' weapons in controlling, and in the long run demoralising, the bureaucracy and bringing them to heel. One way to hamper corruption is to institute administrative mechanisms to make transfers and postings less arbitrary and whimsical and to make bureaucratic tenures more secure, a by-product of which would be longer time horizons, greater performance orientation, and reduced rent-seeking orientation among bureaucrats.

Third, the role of the media and NGOs in exposing misuse of power is vital and they must be legally protected as well as enabled when carrying out investigative journalism or exposing the misuse of power. What is needed is public pressure, generated from below by grassroots NGOs and the media, first on local governments at the lowest unit or urban ward level, and then, at least indirectly, on local ruling party units, no matter which party is in power. This would help expose and deter corruption and would, at least indirectly, help democratise parties, by generating pressures from below which will be transmitted up the hierarchy to party leaderships.

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NOTES

- ¹ This was confirmed by all industrialists interviewed for a project on political finance and also by politicians, some of whom did not blame industrialists for wanting anonymity but their own ilk for extorting money.
- ² See E. Sridharan, "Reforming Campaign Finance to Tackle Corruption in India", Table 2.1, 80, in Samuel Paul, ed., *Fighting Corruption: The Way Forward*, New Delhi: Academic Foundation, 2013.

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