

A Coffee House view of Governance

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Elephant in the room

Having a conversation with Indians about India drives home how differently the trajectory of the country is viewed by different groups of people, even when we abstract from the socioreligious issues that polarise people. Many Indians I speak to are obsessed with growth and manifestations thereof – perceived and real, whether a booming stock market, a strong rupee, a strong market for white collar jobs; everyone has his or her favourite marker for growth. These growth-focussed people have had it good since the nineties and do not want the party to end. There are Cassandras, however, who focus instead on rampant corruption at all levels, capture of economic and political institutions by individuals and alliances of politicians, criminals and the economic elite, factors which, they feel, will undermine India and its future in the long run.

In my experience these two

broad groups of people who see the glass either as half full or half empty talk with each other; talking to each other is the norm. More importantly, however, the elephant in the room – governance – remains unnamed and is barely discussed in a logically coherent manner. Yet whether these people talk about India's economic performance or about the factors that hold it back, it is governance quality they are talking about. The electoral success of NDA, for example, is explained in terms of the inaction and policy paralysis that was observed during the tenure of UPA II, the debates that rage about the many "scams" are about (absence of) transparency and accountability, and the much discussed political-criminal nexus in economic (and other) spheres is about the (absence of) rule of law.

What is governance?

UNESCAP has a useful definition for governance: it is "the process of decision-making and the process by which decisions

are implemented (or not implemented)".¹ In other words, it is as much about a government's decision to invest in physical infrastructure as its inaction in the face of rampant corruption and subversion of state machinery. It is as much about addressing socio-economic ills such as poverty and inequality as it is the transparency and inclusiveness of the processes through which the relevant policy mechanisms work. It is as much about responding to needs of the people after natural and other disasters as it is about developing consensus about the nature and direction of economic (and other) policies. Indeed, UNESCAP identifies eight different dimensions: participation (which I consider a nod to democracy), rule of law, transparency, responsiveness, consensus orientation, equity and inclusiveness; effectiveness and efficiency, and accountability.

Two things are worth noting at this stage. First, governance is much more than a collection of institutions that underpin a citizen's economic, political and civic lives on a daily basis. Economists, for example, argue that it is essential to have rule of law; each person has to know both what rules(s) he would have to abide by, and also that every other person knows and abides by these rules. This makes it easier for citizens to coordinate their actions in economic and other spheres of life and the more easily they can coordinate their actions the more beneficial it is

¹ Source: <http://www.unescap.org/sites/default/files/good-governance.pdf>.

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for the economy and the society. The simplest example of this is traffic rules. The rule says that we should drive when we see green and stop when we see red. If this rule is enforced without partiality or discrimination, the likelihood of accidents is low, with attendant economic and other benefits. But the way in which traffic rules is implemented – amount of fines, use of speed cameras etc. – are generally not decided through a consensus or even a democratic process. So, while rule of law is a manifestation of good institutions, governance is wider in its scope.

Second, a quick look at the

Worldwide Governance Indicators published by the World Bank paints a very depressing picture of the world. These indicators include measures of country characteristics such as voice and accountability, regulatory quality and rule of law, and each state of the world is highlighted in colour-coded maps. Green is the code for good governance while shades of red and pink account for questionable and poor governance; amber is the code for countries caught in between. The world is mostly pink and red, and green can only be seen in the developed world: North America, Western Europe, Australia and Japan. India hovers between pink and amber, depending on the indicator of governance, coming out ahead of both China and Russia. This raises the questions as to whether good governance can only come with widespread prosperity, in which case most Indians will not enjoy or experience good governance in their lifetimes, or whether good governance is a pre-condition for prosperity, in which case prosperity will remain elusive until India’s governance deficit is addressed.

An interesting observation has been made with respect to this by social scientists:²

“Clean, effective government is desirable, but what is not so clear is whether it is an essential or even important antecedent of

rapid economic growth – let alone whether it can be created through administrative and judicial reforms most commonly recommended by donor governments and international financial institutions. Such reforms may in the end be essential, but they may also be ineffective in the absence of economic development or simply find their emergence blocked until underlying socio-economic structures or socio-political interests are transformed.”

Not surprisingly, it is easier to characterise weak governance – we recognise it when we see it – and identify factors such as corruption that are correlated with it, but where good governance is an objective it is generally not clear as to how we can get to it. Countries with the same starting points may well end up with significantly different governance qualities in the long run, something that is well understood by residents and observers of South Asia.

Characterising governance

Like most other things, governance quality is easy to understand at the extremes. In a country such as Afghanistan or Iraq, for example, there is no effective central government, nor a set of rules of the game that all segments of the society and

2 Kurtz, M.J., Schrank, A. (2007). Growth and governance: models, measures and mechanisms, *Journal of Politics*, Vol. 69, No. 2, pp. 538-554.

polity find acceptable.³ The state, to the extent it exists, has low levels of legitimacy – allegiance is often pledged to local and regional warlords and politicians rather than to the state itself, and has nearly no organisational capacity to gather and organise information, formulate policies on the basis of the information and analysis, and implement those policies. Consequently, it is more common to witness tactical fire-fighting in these countries, for example, as a reaction to a natural or man-made disaster, rather than forward-looking and well thought out policies.

Weak governance is equally palpable in less extreme contexts such as Mexico where political strife and less than democratic governments have been commonplace throughout the 19th and the 20th centuries. Let us, for example, consider the evolution of a specific aspect of the Mexican economy, its banking sector.⁴ The modern banking sector of Mexico has its genesis in the regime of Porfirio Díaz (1876-1911) who attempted to stabilise the Mexican state after intermittent civil wars during the 19th century. The need of the hour was both to finance the state's military and other expenditures that were necessary to achieve this objective. Consequently, the Bank Nacional de México (Banamex) was created in 1884 through a charter, and state (or regional) governments were no

longer permitted to charter banks. Banamex was also protected from competition from other banks in different ways; for example, a 5 percent tax was issued on all bank notes issued by banks other than Banamex. In return, Banamex extended a significant line of credit to the government at below-market (i.e., very favourable) interest rates.

The system was further refined during the regime of Partido Nacional Revolucionario (PNR) that governed Mexico during most of the 20th century, to tighten control over the country's economy. For example, land rights were not vested in individual farmers and agriculture – the life blood of any developing country, if not for its contribution to the national income then surely for its share of the labour force – but was organised through cooperatives that were members of the National Peasants' Confederation which, in turn, was a formal part of PNR. Given the ambiguity about land rights, neither individual farmers nor cooperatives could sell or rent land, and they found it pretty much impossible to borrow money from anyone but government-owned development banks. At the same time, efficient cooperatives could not expand their operations and inefficient ones could not shut down operations. However, voting for PNR in elections ensured access to benefits such as subsidised purchases of cooperative output. In other

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words, the banking system was a vehicle to extend PNR's patronage and thereby enhance its control over the economy and the people. The more general proposition, whereby state machinery is expropriated for the benefit of individuals, groups of the elite and political parties, and where welfare of individuals can depend significantly on their relationships with these entities and their patronage almost certainly resonates with residents and observers of India.

Indeed, whereas discussions about governance quality among citizens or in the media often focus on corruption, state capture is arguably a much bigger issue in the context of governance. It has been defined as:⁵

“the undue and illicit influence of the elite in shaping the laws, policies and regulations of the state. In its emphasis on the formulation and shaping of

3 Grindle, M.S. (2007). Good enough governance revisited, *Development Policy Review*, Vol. 25, No. 5, pp. 553-574.

4 Calomiris, C.W., Haber, S.H. (2014). *Fragile by design: the political origins of banking crises and scarce credit*, Princeton University Press.

“The relationship between any two individuals depends uniquely on their identity within the dominant coalition; rules and laws do not apply equally to everyone within the society or country”

laws and regulations of the state, state capture departs from the conventional view of corruption which stresses bribery to influence the implementation of such laws and regulations.”

In other words, whereas corruption generally refers to a situation whereby a public sector contract is granted to a private company because of payments made to politicians and/or bureaucrats, in a context of state capture distribution of public sector contracts is preordained by way of an agreement among the political and economic elite. It is easy to see that in the Indian context discussions about scams, expropriation of public and natural resources by well-connected private individuals and businesses etc. conflate corruption with state capture. It is also evident

from the Indian experience that if state capture co-exists with (or manifests) weak governance then economic growth and good governance can be mutually exclusive; good governance may not be necessary for economic growth and, conversely, economic growth may not turn out to be a panacea for good governance. The implication of this observation for those seeking an economic panacea for governance in India borders on the pessimistic.

State at the heart of governance

Since governance is inseparable from the state, and given that economic outcomes like growth may not always be correlated with governance quality, one might have to think through how states are formed in order to get to the roots of good (or bad) governance. The narrative that I find most persuasive is that a “natural” state is a combination of parties (not to be conflated with political parties), each of which has its own interests and objectives. These parties continually engage with each other and form coalitions to further their interests, and at any given time one of these coalitions dominates. Importantly, coalitions are fluid by nature and the combinations of parties that are in any one coalition can change over time. This almost certainly resonates with India watchers. In the Indira Gandhi era, for example, the common

perception was that the Congress majority was driven by a coalition of upper caste Hindus, Dalits and Muslims. Over time, Dalits have found political voice through other political parties, and the common perception today is that the upper caste Hindu vote tends to gravitate towards the BJP.

Once formed, at its inception, a natural state is “fragile”. In a fragile natural state, the laws and rules that govern the relationship between the state and individuals (public law), and among individuals (private law) are simple – petty theft is to be punished with five lashes of a whip, for example – and patronage is the basis for many (if not most) of these relationships. Over time, as a fragile state matures, we have a “basic” natural state which has well defined public law institutions that address issues such as taxation and succession rules for the leadership. However, personal relationships remain the essence of such a state. The relationship between any two individuals depends uniquely on their identity within (or relationship with) the dominant coalition; rules and laws do not apply equally to everyone within the society or country. This indeed is the everyday reality of a resident of India or an India watcher, and it is easy to make the case that to the extent it is possible to identify evolution of governance quality, they should look for evidence of universal rule of the law rather

- 5 Kaufmann, D., Kraay, A. (2002). Growth without governance, World Bank Policy Research Working Paper No. 2928, <http://ssrn.com/abstract=316861>.
- 6 North, D.C., Wallis, J.J., Weingast, B.R. (2010). Violence and social orders: a conceptual framework for interpreting recorded human history, Cambridge University Press.

than for economic outcomes.

India has some characteristics of a "mature" state, the next and final stage of evolution. It is, for example, able to support institutions that are not intimately tied to the state, even though the possibility of state capture by the private elite muddies the water significantly. But at least by yardsticks such as universal rule of law, ability to carry out economic and other activities outside the bounds of patronage etc., the state remains more basic than mature. The question for India, therefore, is how to organise the institutions within the state that can rein in the elite, and ensure that mechanisms to formulate and implement laws, rules and policies are institutionalised (with commensurate state capacity) rather than be dependent on individual visions and coalitions among the elite. This, however, is easier said than done:⁶

"No teleology pushes states through the progression from fragile to basic to mature natural states. The dynamics of natural states are the dynamics of the dominant coalition, frequently renegotiating and shifting in response to changing conditions. If adjustments lead to more power and rents based

on personal identity, institutions become the progression of natural states. If adjustments lead to more power and rents based on personal identity, institutions become simple and organizations less sophisticated, and the society moves towards the fragile end of the progression of natural states. If adjustments lead to more power based on durable agreements, institutions become more complex and organizations more sophisticated, and societies move toward the mature end of the progression. No compelling logic moves states in either direction."

Can external intervention help, facilitating progression from a fragile to a basic to a mature state? Evidence suggests that economic intervention in the form of aid does not have any impact and may, in fact, affect governance quality adversely if donors require that scarce state resources (such as good bureaucrats) focus more on aid-funded projects than on wider governance issues.⁷ At the same time, casual observation indicates that neither military intervention (e.g., Afghanistan, Iraq) nor moral suasion (e.g., China, Russia) are panacea that lead to good

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governance. Not surprisingly, only a handful of countries in the world can be considered to be mature states, and it is by and large the same set of countries that are "green" coded in the maps generated by the Worldwide Governance Indicators.

What now?

So there we have it: Indian residents, expatriate Indians, and India observers in general yearn for good governance, but there is no magic bullet for it. There is not even a guarantee that there is a mature Indian state with good governance at the end of the tunnel. All of us, however, have hope and we thrive on it, looking for signs of a better tomorrow even when today there is cause for pessimism. The only question I suppose is who among us will be witness to history and who among us will take a crack at shaping it.

⁷ Brautigam, D.A., Knack, S. (2004). Foreign aid, institutions and governance in Sub-Saharan Africa, *Economic Development and Cultural Change*, Vol. 52, No. 2, pp. 255-285.

