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The 'Intermediate Regime' and 'Intermediate Classes' Revisited: A Critical Political Economy of Indian Economic Development from 1980 to Hindutva

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The theory of Intermediate Classes and Regimes was originally developed by Kalecki in a general way as being relevant to many developing countries, recognised as relevant to India by K.N. Raj, fiercely and critically contested by Namboodiripad and Byres, but also refined and applied to conditions of stagnation by Jha. In this paper we re-evaluate this theory, first for the period for which it was intended and then for a period in which it predicts its own irrelevance. First, we examine the disappearance of class based political economy since liberalisation. We rediscover it tracing the genealogy of the concepts of intermediate classes and the intermediate regime, by criticising their theoretical and empirical weaknesses and flaws, and examining their strengths, mainly from a comparison with the New Political Economy. We use predictions derived from Kalecki-Jha to show how these notions fare in a period of growth and to trace the development of the 'crisis' of 1991 in terms of the factors central to the Kaleckian model. These factors, we argue, account for the differential stickiness of the economic reforms. Finally, we track the fate of the intermediate classes during the course of liberalisation in which their power should be comprehensively challenged and we speculate on the political and ideological responses (Hindutva and Swadeshi).

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1. Introduction

"All happy families resemble each other, each unhappy family is unhappy in its own way".

So Tolstoy began *Anna Karenina*. Political economy consists of happy and unhappy families. Perhaps its main consensus, its largest happy family, is that of the neo liberal school and of its New Political Economy (NPE).[2] Every other political economy has a unique objective. For the Rudolphs (1987) it was an explanation for centrism in the Indian polity. For Roy (1998) it is fiscal failure. Every class analysis has a specific objective. For Thorner it was the mode of production in agriculture (1983); for Bardhan an explanation for the proliferation of subsidies (1984); for Byres the class coalition controlling the process of planned development (1996). All dissenting accounts in political economy are marked by a strong individualism. In this paper we add to the unhappy families in political economy by examining the analytical strengths and weaknesses of an unorthodox class theory for an era of history *later* than that for which it was elaborated. The theory of Intermediate Classes and Regimes was originally developed by Kalecki (1967/1972) in a general way as being relevant to many developing countries , recognised as relevant to India by K.N. Raj (1973), fiercely and critically contested by Namboodiripad (1973) and Byres (1996), but also refined and applied to conditions of stagnation by Jha (1980).

When the predisposing conditions for a Kaleckian class coalition atrophy or are otherwise threatened, as we will argue happened in the 1980's and 1990's, the questions i) whether the power of this coalition is crushed or contained and ii) how this coalition reacted to the circumstances of the era of liberalisation and globalisation become significant and relevant.

This paper is (the macro) part of a larger project seeking to juxtapose the story of India's intermediate classes as theorised at the macro level (and told with appropriate data) with the story told from local level field research (Basile and Harriss-White, 1999; Harriss-White,

[2] That this consensus is based on flaws in assumptions and logic has been fully exposed (Udehn, 1996 and Leys, 1996 are exemplary) but is beside the point here.

forthcoming). Since all accounts of India's political economy have non-trivial problems with the kind, degree of systematisation and status of evidence, we will also pay attention here to the evidential basis of the theories and arguments we review.

The route for this analytical expedition proceeds as follows: first, we examine the disappearance of class based political economy since liberalisation. We rediscover it, tracing the genealogy of the concepts of intermediate classes and the intermediate regime, by criticising their theoretical and empirical weaknesses and flaws, and examining their strengths, mainly from a comparison with the New Political Economy. It is then possible to investigate how these notions fare *not* in a period of stagnation but during those of growth. We trace the development of the 'crisis' of 1991 in terms of the factors central to the Kaleckian model, which we will argue account for the differential stickiness of the economic reforms. Finally, we track the fate of the intermediate classes during the course of liberalisation in which their power should be comprehensively challenged and we speculate on their political and ideological responses (Hindutva and Swadeshi).

2. The Disappearance of Class Analysis

Class analysis has been jettisoned during the era of Indian economic liberalisation, a result, partly, of the logic of IMF policy orthodoxy and of the neo-classical economics informing it. There is no role for class within a neo-classical framework which does not allow for the exercise of power in economic relationships. Agents are atomistic. The imposition of any burden on the economy such as a tax rise or a shift in the terms of trade will lead to a one-off process of adjustment to re-establish marginal equalities. According to this paradigm, liberalisation will result in a predictable pattern of adjustment as resources are allowed to flow freely in response to variations in marginal returns. Interest group pressure is a consequence of intervention in these free flows. Trades Union legislation, for example, will result in a less competitive labour market, raising wage levels and reducing labour demand. Those employed will benefit and consequently have a vested interest in the preservation of the status quo. With liberalisation the restoration of a competitive labour market will stymie attempts to maintain wages above the market clearing price and the status quo will be undermined by new entrants.

In this paradigm, class is thus a special case of a general phenomenon. Class will not have any effect on the long term position of a liberalised economy. Any implicit or explicit attempt to depart from atomistic competitive behaviour, or to engage in a political process such as the struggle between classes will be undermined by individualised competitive behaviour. From the perspective of capital the collapse of the OPEC cartel is exemplary. An attempt to restrict the output of oil, a good with inelastic demand, will raise the price more than proportionately and result in higher collective revenues for cartel members. Each individual member then has an incentive to raise their own output by some small margin to benefit from the higher price. As each member free rides and pursues private rationality, aggregate output will rise, the price falls and the cartel collapses. The analysis is similar to that of the formation of special interest groups (see Olson, 1982). In the case of a cartel, there is a direct economic incentive, other than mere apathy, that will ultimately lead to its collapse. This logic can be extended to any action by a group to subvert the working of the market. Incentives will be created which will ultimately restore the competitive equilibrium. There is no role for class in the neo-classical model of a liberalised economy. The free operation of market forces will eventually respond to economic incentives and prevent the operation of power in any economic exchange. The profits of a village moneylender will draw in more lenders and the market will become competitive. In a liberalised economy, class at most will be a temporary phenomenon due to failures of information or an artificial construct created by non-competitive state intervention.

This is the kind of thinking which has removed class from the analysis of Indian economic development since the state's endorsement of markets as developmental primer movers in 1991. But markets are not abstract entities isolated from the socio-political environment in which they operate. Markets are suffused with politics and embedded in political structures, political and social institutions, history, cultural norms and class structure (White, 1993; Harriss-White, 1996) [3].

3. The Origins of the Ideas of the Intermediate Regime and Intermediate Classes

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[3] An example is social capital. Putnam (1993) argues from his analysis of Italian civic society that markets work better in an environment of trust.

The concept of the Intermediate Regime arose from attempts to explain not growth but economic stagnation. Baran (1957) provided insights into the roles both of the state and of foreign capital in frustrating economic development and causing stagnation. Baran's political economy distinguished between 'capital' and 'class' logic: whether the state was reduced to being a puppet on strings pulled by international capital and the (developed) states which supported it (“foreign capital logic”) or was strong, "well entrenched socially within a dominant class carrying out self-strengthening policies at the expense of neo-classical economic rationality" (Toye, 1993, p124) (“local capital/class logic”). Latin American neo-Marxists seized on 'capital logic' and located their (under) under development within the context of the international economy [4]. By contrast, Indian political economists, nurtured in conditions more approximating economic, if not academic, autarchy, theorised 'class logic'. Bardhan [5](1984) examined the role of three dominant proprietary classes in an open and heterogeneous polity, none being strong enough to dominate the process of resource allocation. Under the compulsions of electoral requirements the state resorted to the multiplication of subsidies to placate all of them, thereby undermining the dynamics of state-led accumulation. Chandrasekhar and Patnaik (1995) saw the Indian polity as dominated by the big bourgeoisie and foreign capital and thus forced into a general deflationary bias in its macroeconomic policy so as to prevent capital flight.

This kind of analysis bears a striking and uncomfortable similarity to the later orthodoxy of the 'New Political Economy' (NPE) particularly with respect to the ways in which interest groups - in the earlier case classes - can generate economically irrational outcomes. The essential insight of NPE is that policies which are erroneous in terms of neo-classical rationality have identifiable beneficiaries with an interest in their perpetuation. When their socio-political context is understood, they are not errors. But they are “inefficient” [6]. An overvalued exchange rate for example has predictable effects on income distribution, favouring importers (often urban based parastatals) and disadvantaging exporters (often a dispersed peasantry).

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[4] E.g. Frank (1969) and the Dependency School.

[5] Bardan (1984, 1988, 1989).

[6] See Toye (1993) chapter 3.

P.S. Jha (1980) sought to integrate this New Political Economy of 'Rent Seeking' inspired by Kreuger (1974) [7]with his political economy of Indian development during the years of stagnation (1965-1980). His immediate influence was the analysis of 'Intermediate Regimes' by Kalecki (1967) [8]and its initial application to India by K.N. Raj (1973). The Intermediate Regime is a governing alliance of various intermediate classes.

3.1 The Intermediate Classes

From Kalecki, Jha observes, "It is the rise to dominance of an intermediate class or stratum consisting of market orientated peasant proprietors, small manufacturers, traders and other self-employed groups which benefited from economic stagnation and had a vested interest in its perpetuation" (Jha, 1980 pvii).

The context for Kalecki's analysis is an economy and state in an incomplete transition to mature capitalism [9]. In such conditions of underdevelopment, most people are not wage earners. The self-employed and small farmers form a distinct socio-economic class. The distinctive characteristic of the composite classes of the Intermediate Regime is that there is no contradiction between labour and capital and labour and management. The composite intermediate classes of the regime thus stand between the bourgeoisie and proletariat. "Its earnings can neither be classified as a reward for labour, nor as a payment for risk taking (i.e. profit) but are an amalgam of the two. The self-employed thus lie midway between the large scale, professionally managed capitalist enterprises of the private sector, and the working classes" (Jha, 1980 p95).

The classes of the Intermediate Regime cut right across the Marxian definition of class. The distinction is not according to the relationship to the means of production but rather between

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[7] The expenditure of resources to capture economic rents created by artificial government constraints on competition. NB Kreuger did not analyse rent seeking in the context of private rents e.g. monopolistic competition.

[8] Reprinted in Kalecki (1972).

[9] The analysis was first applied to Indonesia and Egypt.

a scale of gain and loss. The classes composing the Intermediate Regime, however, must have similar interests that do not coincide with those of labour and capital.

3.2 Preconditions of the Intermediate Regime

What Kalecki calls the “native bourgeoisie” is theorised as being small and regionally isolated, facing imperfect, fragmented markets and severe capital constraints. Social overhead capital necessary to provide the foundations for more directly productive investment is characterised first by a high minimum efficient scale relative to the small domestic market and second by a long gestation period. The Intermediate Regime nationalises economic development in preference to the only alternative to a weak domestic bourgeoisie (which is foreign capital). International capital will guide itself to specific sectors (such as railways) to facilitate the extraction and export of resources rather than to integrate and develop the national economy. It will respond to already existing infrastructure rather than create it.

Kalecki argued that there were specific conditions peculiar to a less developed economy that may allow an Intermediate Regime to perform the role of a ruling class.
1) An incomplete land reform that deprives the feudal class of its position in economic life and benefits the self-cultivating middle peasant. With respect to India, Rudolph and Rudolph (1987) have argued the case that the middle peasant (or 'bullock capitalist') was the principal beneficiary from Zamindari abolition and subsequent land reform programmes.
2) Non-alignment in international relations so as to utilise credit from socialist countries as a counterweight to foreign capital. "Such a position in international relations defends the intermediate regimes...against the pressure from imperialist powers aimed at restoration of the 'normal' role of big business in which the foreign capital would play an appreciable role" (Raj, 1973, p1191). In this, the Cold War was helpful. It allowed non-alignment from ‘capital’ without the constraints of autarchy. Thus Germans, British and Soviets all provided aid for steel mills while the U.S. gave aid for foodgrains purchases.
3) A developmental state. The weakness of the "native" upper middle class leaves them unable to perform the role of dynamic entrepreneur. The state steps into an active role in accumulation.

These features distinguish the Intermediate Regime, which erects a form of state capitalism for its own benefit, from classical capitalism. Investment in the economic base has to be carried out via the state. Thus the numerically dominant, yet essentially composite classes of an Intermediate Regime foster state capitalism to promote and nationalise economic growth, from which they specifically benefit. The Regime works through politics as a mode of accumulation. Since the state plays a dominant role in the economy, a struggle among various classes is provoked over the penetration and control of its institutions. Private, (middle) caste and class accumulation is enhanced to the detriment of "collective" or more broad based growth and development. The state is used for accumulation by elites rather than for their legitimation. In Kalecki's descriptive model, the benefits from state-promoted economic development were the cement binding together the lower middle class and middle peasants. However, Kalecki is vague on the modalities by means of which state capitalism benefits the composite classes of the Intermediate Regime whilst simultaneously excluding those outside the ruling alliance, particularly big capital. This question is also one of methodology and evidence, for to answer it we need to trace the process by which a policy was initiated by, and benefits, a particular class. There are formidable empirical barriers to any answer. Kalecki himself relies on the unsubstantiated assertion that small businessmen defend themselves against displacement under unfettered capitalism. He does not analyse the potential synergy between large and small business. On the one hand, the state provision of social overhead capital in the form of irrigation, roads, power and essential agro-inputs like diesel, credit and fertiliser did, in the era of the Green Revolution, benefit agrarian capitalists. On the other hand, in urban areas the state was simultaneously providing inputs complementary to big business through its policy of public sector investment in key upstream industries (iron and steel, coal, transport, power, minerals, atomic energy, arms and ammunition). Within the framework of Kalecki's pre-conditions, state capitalism is far from sufficient to link the elements of an avowedly heterogeneous ruling alliance whilst excluding big business. The explanation is intuitive rather than firmly empirically based.

So, when K.N. Raj (1973) introduced the Intermediate Regime to a wider audience and suggested that the concept was applicable to the then contemporary India, he was challenged dismissively by E.M.S. Namboodiripad in the same year on the simple grounds that both

Kalecki and Raj underestimated the pivotal role of the domestic big bourgeoisie. This exchange anticipated a later debate between P.S. Jha (1980) and P. Bardhan (1984) which used more solid evidence. Jha sought a political economy of the period of stagnation: 1965-80. The sole necessary precondition he identifies is the existence of pervasive shortages and consequently inflationary conditions. The response of the ICs distinguishes them from the big bourgeoisie.

Within the context of 'shortages', the self-employed can engage in mark up pricing. Small-scale business and traders can avoid central price controls by engaging in parallel trade and speculation and by siphoning resources into the black economy. The entrepreneur can gain directly from such activity, unlike the shareholder of a professionally managed company. Besides, the peasantry use the marketed surplus to benefit from shortage. Due to the inelastic nature of demand for foodgrains, especially cereals, peasants and their creditors make an absolute income gain from the increase in official procurement and the greater increase in residual “open” market prices during drought years. The bureaucracy are salary earners but since officials also derive income from bribes, fraud and the private sale of state goods such as licenses and sanctions, they are de facto self-employed and earn a fee from the provision of a service. Cemented by shortages into an alliance, the Intermediate Regime is the numerically dominant class in the country. Jha estimates that in 1980 there were thirty million intermediate income earners with eight to ten times as many dependents. In contrast to the big bourgeoisie which is a numerical minority, the 'gaining' intermediate classes are a large majority.

Jha offers policy examples from licencing and price controls. Licencing (justified as intended to prevent the excessive concentration of economic power) generated a specific bias against large-scale investment along with anti monopoly provisions and capacity constraints in consumer industries. Over a hundred industries were reserved exclusively for the small-scale sector. Since banking nationalisation in 1969, credit and raw materials were targeted to the small-scale sector [10]. The combination of a striking over-achievement in ‘targeted’ credit disbursement to a residual category of “other”, and virement from the remaining sectors of directed credit worked to the advantage of smaller and/or unregistered businesses. The prices

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[10]See Joshi and Little (1994) for a description of economic regulations.

of eighty-four major commodities were controlled which reinforced the drift of capital from large to small-scale industry and from industry to (parallel or black) trade. Rising costs squeezed formal sector profits and prevented an adequate provision for depreciation. Controls on steel, fertiliser, bulk drugs, shipbuilding and oil refining were based on 1971-2 prices and costs. Subsequent high inflation meant that by 1974 no single plant in these sectors was capable of earning even a ten-percent return on capital. Inevitably, production was siphoned into the black market and subcontracted to smaller-scale production. Investment was diverted from productive activity to "financing smuggling and cornering stocks of goods in short supply" (Jha, 1980, p60). Price controls on crucial intermediate goods such as cement, steel, non-ferrous metals, cotton textiles, coal and chemicals and necessities such as foodgrains, bread and edible oil helped perpetuate the very shortages that originally inspired state intervention in price setting, both by reducing supply incentives and by increasing the leakage to the black market. In the public sector this resulted in chronically low capacity utilisation.

3.3 Summary: Jha on the Structure of an Intermediate Regime

State policies systematically diverted investment from areas of government control, from public and large scale private enterprises, to small scale industry and trade. Systematic biases in tariffs, price controls and licensing affected the pattern of economic activity and the consequent distribution of economic gains. Licensing benefited small enterprises at the expense of the large houses (such as the Birlas and Tatas). Price controls pressed down on the commanding heights of the economy and were easily avoided by small producers and traders. Government policy thus openly and systematically favoured the self-employed classes and was subsequently subverted to their further benefit through more or less organised and politicised corruption.

3.4 The Weaknesses of the 'Shortage' Model

The shortage model has a number of weaknesses. Some are theoretical and intrinsic to its construction and others are empirical and relate to the case of period of stagnation in Indian development.

1) The Underestimation of the Big Bourgeoisie. Jha underestimates the centrality of the big bourgeoisie to the Indian domestic economy. Nationalised industry complemented big business by providing industrial inputs at low prices, necessary social overhead capital and guaranteed domestic markets through trade controls. The fixed costs of licence application (both legal and illegal) were better borne by big business and served to prevent entry and protect oligopolistic profits. In addition, the state served as a "risk absorber of the last resort and a charitable hospital where the private sector [11]can dump its sick units" (Bardhan, 1984, p42). In 1976, the top twenty business houses controlled two thirds of total productive capital in the private corporate sector [12]. Between 1972 and 1981 the total sales of this same group rose from 61 to 87% of the total [13]. Sandesara (1991) shows the size structure of Indian industry to be dominated by large-scale industry and tending slightly towards an increasingly top-heavy distribution.

Table 1: Size Distribution measures of Indian Industry 1966-7 to 1986-7.

Measurement	1966-7		1976-7		1986-7	
Share of fixed capital	8	(92)	6	(94)	6	(94)
Share of employees	36	(64)	34	(64)	36	(32)
Output	30	(70)	24	(76)	36	(62)
Value added	23	(78)	17	(82)	17	(82)

Source: Sandesara. J.C. (1991), p2424

Note: Number in brackets for large firms, without for small firms. All figures in percentages.

The figures for the share of small business are overestimated in so far as some registration of small business was undoubtedly fictitious (large enterprises seeking to benefit from preferential regulations and taxes). They are underestimated in so far as the prevalence of a large

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[11] Specifically big business i.e. bankrupt textile mills.

[12] In 1981/2 the proportion contributed by the manufacturing sector to net domestic product, in 1970/1 prices was 15% (Bardhan, 1984 p17).

[13] See Bardhan (1984) who lists the big bourgeoisie as one of the three dominant proprietary classes of the Indian polity, with rich farmers and the public sector bureaucracy.

unrecorded informal sector will bias the figures downwards. The exact balance is obviously difficult to ascertain.

2) Policy Implementation. Jha ignores the subversion and transformation of policy in the course of its implementation. Planners undoubtedly sought to benefit the small-scale sector. Between 1971 and 1981 the number of industries reserved for the small-scale sector rose from 128 to 844. This was underpinned by capacity controls and licensing biased towards the small-scale. Price controls applied to the more easily monitored formal large-scale sector and were either not applicable to, or easily avoided by, owner-managers of small enterprises who had both the means and incentives [14] lacking among salaried professional mangers of large-scale enterprises. However, the process of policy implementation reveals a different story. Policy initiatives could be rendered "ineffective in the face of the indirect power of quiet sabotage and everyday forms of resistance by local power groups" (Bhagwati, 1993, p329). Big business houses could use influence to capture the process of licence and control, make preemptive licence applications to prevent entry and preserve monopolistic profits. Capacity controls, intended to divert marginal output growth to the small-scale sector were never actually enforced. Illegal excess capacity was eventually regularised ex post in various amnesties. The big bourgeoisie was "manifestly one of the dominant classes in the Indian social formation" (Byres, 1996, p67).

3) High Growth, High Corruption Societies. Jha's argument associates corruption with stagnation in India, through the diversion of resources from productive to non-productive and/or speculative outlets. However this association cannot be extrapolated to the high-growth, high-corruption societies common in East Asia (Khan, 1996; White, 1996). The deliberate creation of shortages benefits the Intermediate Regime in the short term but is simultaneously unsustainable in any longer perspective, as it causes inflation and economic stagnation. There is an awkward juxtaposition of static rationality and dynamic myopia. Growth in East Asia was both rapid and egalitarian yet (the 1997 financial crisis not withstanding) it served to benefit those at the apex via massive corruption.

[14]Owner-managers are more able to personally profit from tax evasion. Near bottom of page 8 after "enterprises who had both the means and incentives"

4) Conflict in the Ruling Coalition. While Jha analyses the forces causing disparate classes to coalesce into a single alliance, he does not refer to the possibility of conflict within that ruling coalition and therefore also not to its economic consequences. Bardhan (1984) conducts an analysis of the political economy of Indian development focussed on this possibility, which draws eclectically on ideas from both Marxist and mainstream economics. The coalition of dominant classes is borrowed from Marxian analysis. Policy outcomes are, however, due to internal conflicts within the coalition and not to the outcomes of class struggle (between exploiters and exploited). The state is not autonomous. Rather, its personnel are a proprietary class in themselves. The dominant proprietary classes during the period of stagnation are the Industrial Bourgeoisie, Rich Farmers and the Intelligentsia. This alliance is unstable and heterogeneous. As the ability of the Congress Party to manage conflict and absorb dissent declined with the fading legitimacy of its leadership, the state turned instead to a proliferation of subsidies and patronage to hold together the Indian polity. State revenues are increasingly frittered away on non-productive current expenditures. State investment declines and the impetus to growth is lost thus leading to the period of stagnation, 1965-80. The dominant classes are in contradiction with themselves, by undermining the process of development and ultimately their own self aggrandizement. "When diverse elements of the loose and uneasy coalition of the dominant classes pull in different directions and when none of them is individually strong enough to dominate the process of resource allocation, one predictable outcome is the proliferation of grants and subsidies to placate all of them " (Bardhan, 1992, p321). The conflict of interests within the ruling coalition is a useful organising framework with which to examine the growth of *subsidies*, which sit uncomfortably with the analysis of the Intermediate Regime, whose focus is on the growth of *regulation*. While regulatory intervention was a striking characteristic of the period before the 1980s, Bardhan focuses on the later decades in which the growth of subsidies became a marked and growing characteristic of Indian state expenditure.

However, where Bardhan helps explain one problem he creates another. The inability of any one class to impose its own narrow economic interests to the detriment of other classes or the general social good, a situation made explicit in Jha, ought to insulate the state. Indeed Bardhan suggests this. "The relative autonomy of the state was also enhanced by the fact that the dominant socio-economic groups [15] in India were (and are) extremely heterogeneous and highly divided, which potentially gives the state more room to manoeuvre" (Bardhan, 1992, p323). But Bardhan does not explain why the state does not utilise this relative autonomy to enforce a developmental agenda. He ignores evidence for the autonomous developmental role of the state: the Green Revolution in the 1960s; the steady rise in saving and investment ratios since Independence; the maintenance of low inflation and the evident autonomy of the top leadership in 1985 resulting from a shift in ideology. By contrast, Rudolph and Rudolph (1987) ascribe to the state an important role as a powerful third actor in the Indian polity, whereas Bardhan's regulatory state is embedded in an uneasy coalition of dominant proprietary classes. Bardhan's dominant proprietary classes are a numerical minority with a determining control over the economy. Jha, however, focuses on a numerical majority with an increasing influence in politics. The examination of conflict within the ruling coalition is a useful addition to the analysis of Jha.

The complexity and diversity of India's political economy suggests that, although we are specifically focussing on one interpretation, it cannot be to the exclusion of others.

5) Use of Evidence. While evidence to test the Jha-Kalecki theory is hard to come by, Jha tends to use weak evidence. The rising proportion of agriculturists in the Lok Sabha rather than an analysis of public expenditure is offered as evidence to illustrate the increasing influence of rural interests. The faster growth of employment in trade and transport than manufacturing is used to illustrate the diversion of finance from productive activity to speculation, begging the question that the elaboration of distribution is an inevitable concomitant of development as the structure of production becomes more complex.

The analysis of the Intermediate Regime is fraught with problems of evidence. A focus on the black economy and small-scale informal sector will by definition be plagued by the unavailability of systematic evidence (Kumas, 1999). However, Jha does not even utilise such obvious strong evidence as the relative share of production in the large/small-scale sectors or

[15] Defined roughly as being the top decile of income earners in both rural and urban areas.

organised/ unorganised sectors, or show profits and investment according to firm size. In all we would expect a systematic inverse relation to firm size, if his hypothesis holds.

3.5 Only a Special Case of NPE?

Toye labels Jha's brief examination of the soap, vanaspati and tyre industries "economic vignettes" (Toye, 1993, p162), crediting him only with adding price controls to the conceptual framework for rent seeking of Kreuger (1974) which was confined initially to import controls. Toye's critique of Jha goes beyond castigating him for his poor use of evidence. He suggests that in adding price controls to the general concept of rent-seeking, Jha’s political economy of scarcity and the concept of the Intermediate Regime are effectively subsumed by, and only a special case of, NPE. For Toye, Jha is apparently part and parcel of a general failure of left thinking. "The left’s usual view of the role of the state as the guardian of vested social (class-based) interests is too limited and too static to counter the policy proposals of the development counter revolution effectively. The new right has constructed its own political economy of the state rooted in self-interest, which taps just as deeply into popular distrust of state action to promote national well-being" (Toye, 1993, p118). Such thinking had reached its apogee in Rudolph and Rudolph (1987), who argued that class was simply one among many of the motivating forces of political economy. Jha may be said to be exemplary in ignoring others such as caste, religion, language, locality, gender etc. NPE infers from the promotion of economic distortions that the interest groups concerned have a subsequent incentive to propagate them. Such interest groups are not confined to class. Equally NPE makes a great noise about being based on the rigorous microfoundations of optimising agents rather than on Marxist class contradictions. NPE identifies its categories as being any group or individual that seeks to distort state policy to its own benefit at the expense of collective rationality. NPE economists can end up sounding much like Jha: "These institutions created the interests - the politicians who profit from the corruption, the bureaucrats who enjoy the power, the business and the workers, who like sheltered markets and squatters rights" (Bhagwati, 1993, p53)

To summarise the weaknesses of the 'shortage' model, Jha is weak on the role of big business in the Indian domestic economy and the actual implementation of policy and he devotes insufficient attention to explaining why corruption reduces growth. While the problems of data are at the heart of any empirical analysis of the black and informal economy and of tax evasion, Jha misses some obvious 'strong evidence'. While Jha tackles the forces causing a heterogeneous alliance to coalesce, Bardhan, in tackling conflict, provides an alternative analysis. In a polity as complicated as that of India, we cannot necessarily expect one kind of political economy to answer every question. The more serious criticism is that of Toye, who finds Jha to be subsumed by NPE. It is in response to this criticism that we discover the originality and value of Jha's interpretation.

3.6 Strengths and Value of the Intermediate Regime

In response to Toye's evaluation, the conceptual framework of the Intermediate Regime can be argued to possess distinct analytical advantages over NPE for an understanding of the Indian economy.

1) The Role of Interest Groups. The mode of analysis of NPE is unidirectional, linking policy outcomes to vested interests. NPE does not seek to gauge how different interest groups are variously able to influence policy and how policies act on the relative power positions of these various groups. By contrast, Jha does precisely this for the powerloom industry and the middle farmers of Uttar Pradesh. Controls on mill cloth production intended to benefit the small scale handloom sector instead led to the rapid growth of powerloom production. Jha found that its representatives had infiltrated the Congress Party and sought to perpetuate this apparent policy anomaly. The rise of the middle and rich Jat peasants in Uttar Pradesh then underpinned the rise of a political representative in Charan Singh who likewise sought to perpetuate their economic position through further beneficial legislation under the Janata regime (1977-1980).

2) A 'Political Economy of Development'. Jha's analysis is rooted in a dialectic of state-society relations which are shaped by social and historical processes. NPE relates erroneous policies to specific beneficiaries but is crudely economistic and ahistorical. The methodology involves finding a policy anomaly then tracing the beneficiary. The process has no historical context and ignores the possibility of mistakes in policy formulation. Jha illustrates the manner in which unintended policy outcomes can lead to a process of path dependency. His analysis is rooted in a specific historical dialectic. Controls came first, in 1955 on essential commodities and subsequently on exchange dealings (in response to the 1957 balance of payments crisis). In both cases policy was made in response to an exogenous shock:- an ideological shift in 1955 and an international trade shock in 1957. However, "the system which once distorted produces a polity which then defends and protects the distorted incentives that have created it" (Toye, 1993, p160). Controls and licencing altered the pattern of economic activity and income gains in society, thereby strengthening the Intermediate Regime and giving it a vested interest in the continuation of such policies: "every new control created a new avenue for corruption" (Jha, 1980, p123) [16]. Its members gained directly from resulting shortages, stagnation and even drought -"they fatten on the debilitation of the economy" (Jha, 1980, p121)- and sought to maintain their hold on power by perpetuating shortages. This political economy generates a big prediction. A precondition for liberalisation is the formation of a class alliance stronger than that of the Intermediate Classes.

3) Stylised Patterns of Indian Development. Jha's analysis is firmly anchored within the stylised patterns of Indian economic development even *outside* the period on which he focuses [17]. The Intermediate Regime begins in 1957 when an exogenous shock from the international economy leads to a balance of payments crisis. This is met with the imposition of trade and exchange controls, which in turn generate shortages. Hence, "since this class has benefited from economic controls, it tried, not unnaturally to perpetuate and even strengthen the regime of shortages" (Jha, 1980, pviii). This cumulative process is disrupted during the Emergency, reestablishes itself under the Janata government, is again disrupted during the early years of

[16] The implications for reform are obvious, an unintended policy outcome can snowball, creating a vested interest in its continuation and perpetuation and obviously a status quo opposed to reform.

[17] Jha is published in 1980 and primarily deals with the period of stagnation 1965 to 1980, particularly the events leading up to the declaration of Emergency in 1975.

liberalisation under Rajiv Gandhi and ends definitively with liberalisation ‘proper’ in 1991. In this way, Jha provides a political economy of development, not treating political and social factors as parameters of the economic system.

4) Embedded State and Markets. Markets and the nature of state intervention in Jha's formulation are made dependent on social relations and embedded in the class configurations of a numerically dominant Intermediate Regime, welded together by shortages. This is a radically different formulation from that of the autonomous state which is the implicit, abstract ideal used for their (different) comparative evaluations by Bardhan (1984) or of Joshi and Little (1994).

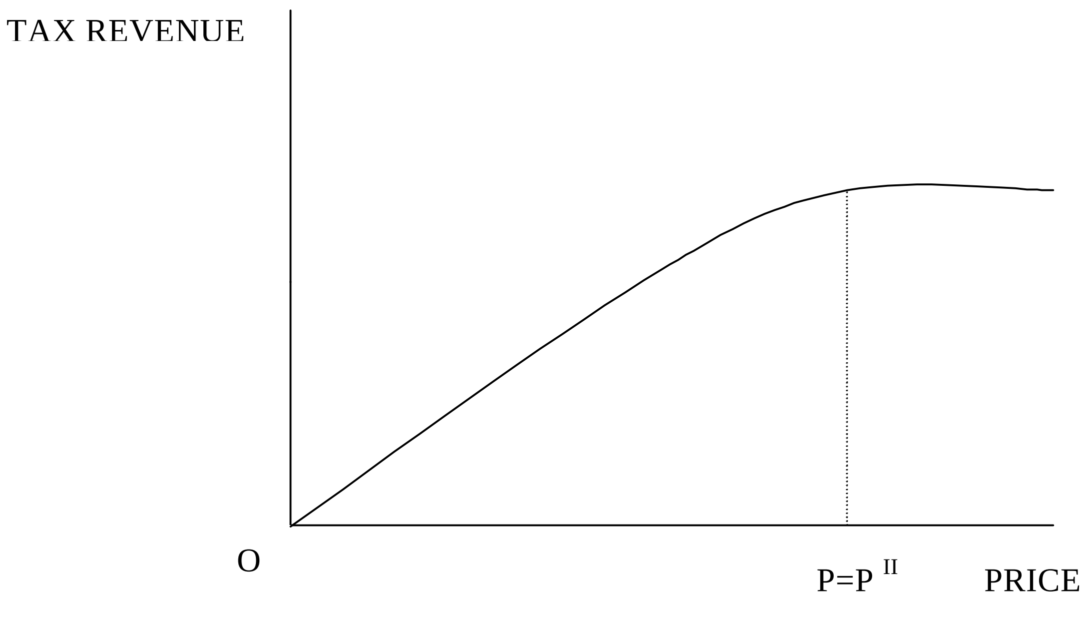
5) Deficits, Development and Fiscal Conservatism. The orthodox view is that the 1980s witnessed a dilution of fiscal conservatism and that the resulting budget deficits contributed both to rising current account deficits and to inflation: "it was the failure of the government to use tax and expenditure policy to increase public savings that was the main reason for the lack of current account adjustment" (Joshi and Little, 1994, p188). By the late 1980s as the domestic debt profile worsened and approached a ceiling, its finance increasingly affected the growth of money. In the manner of Sergeant and Wallace (1981), fiscal deficits were increasingly being monetised. During 1989-90, there was a notably rapid increase in monetary growth. "It is probable also that the government's mounting fiscal difficulties added to inflationary expectations and arrested the rising trend in the demand for money. The inflation of 1990-1 was more worrying than India's periodic inflationary bubbles because it was not triggered by a drought." (Joshi and Little, 1994, p189). Thus, according to the orthodox position, rising fiscal deficits were a symptom: "the dilution of fiscal conservatism was clearly manifested in the upward creep in fiscal deficits after the mid 1970s" (Joshi and Little, 1994, p68).

This "dilution of fiscal conservatism" can be explained by two paradigms covered and tested by Roy (1996). Both seek to explain rising budget deficits as an outcome [18]. The Marxist explanation is encapsulated in a contradiction between the objectives of the state and its position in state-society relations. Specifically, Patnaik (1998) argues that what has undermined the state-led accumulation process is the inability to impose direct taxes on property owners. In contrast, the liberal-pluralist paradigm sees the state breaking down under acumulative process of 'demand overload' [19]. Formal political institutions were undermined, leading to a breakdown of accommodative social politics. Current expenditures expanded as the state budget constraint became progressively softer.

Now Jha offers a distinct re-interpretation of the causal relation between inflation and deficits. Jha's mode of analysis reverses this causation. Inflation causes the deficit to increase because

FIGURE: Prices, Shortages and Indirect Tax Revenue

Fig. 1 a



P^{II} Market Price in Absence of Price Controls.

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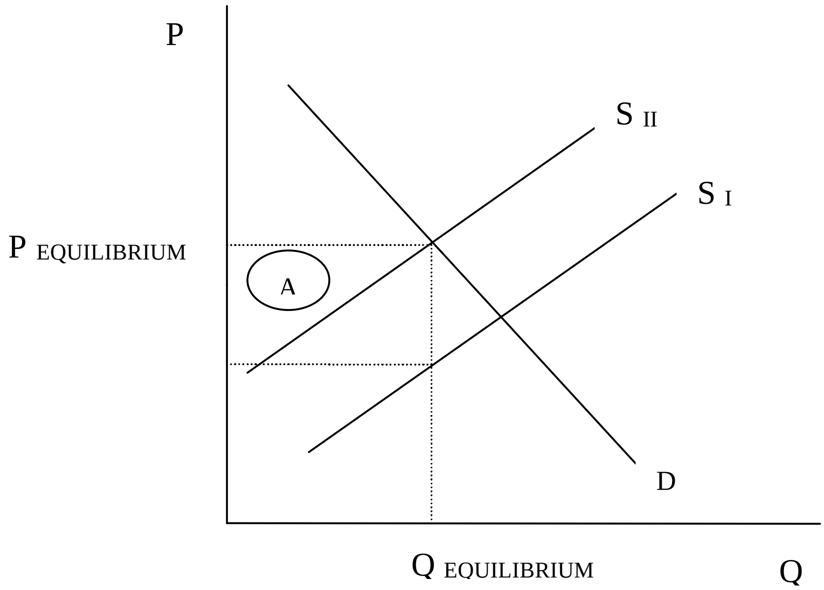
[18] The analyses are compatible, the Marxist focuses on class and the liberal -pluralist may be taken to include class as one among many possible interest groups generating 'demand overload' see section 'Only a Special Case of NPE?'.

[19] See Rudolph and Rudolph (1987), Bardhan (1984), Kohli (1990).

Fig. 1b

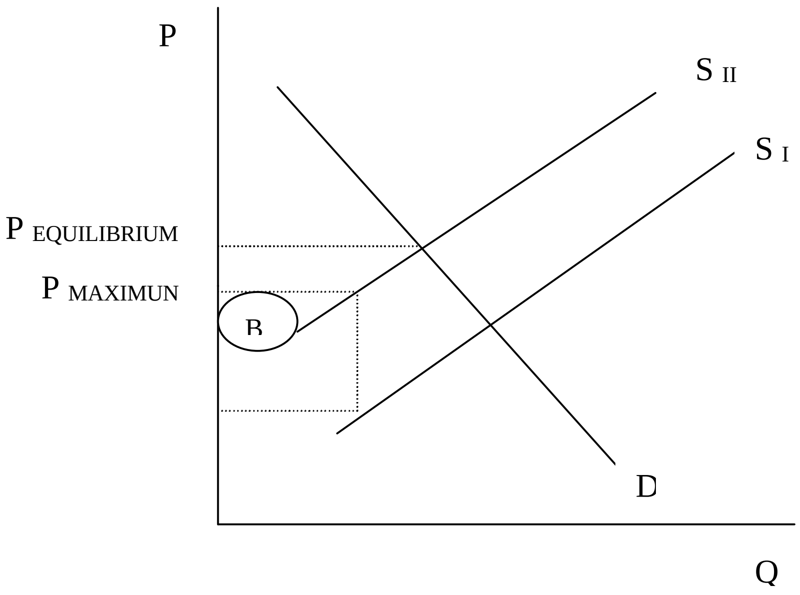


of the policy structure thrown up by the Intermediate Regime. Jha argues that since the 1950s the Indian government has created conditions whereby a rise in prices caused disproportionate increase in the government's current expenditure and fall in government savings. The low employment elasticity of growth inherent in the capital-intensive, heavy-industrial Mahalanobis model generated enormous political pressure on the state to act as employer of the last resort for the burgeoning numbers of lower middle class graduates. The millions of 'sinecures' thus created were protected by an automatic dearness allowance that neutralised the adverse effects of inflation on real wages. The procurement of grain operated perversely according to a very short term logic which minimised working capital requirements: low achievement to target ratios and buffer stock levels in times of abundance and high ratios to supply the public distribution system (PDS) in times of scarcity (Harriss, 1984). So, the inelastic demand for foodgrains led to a disproportionate rise in procurement prices and open market prices during times of drought and consequent rising expenditure to resource the extensive PDS. Price controls and shortages will then interact in times of inflation to reduce government revenue from indirect taxation sales tax will shift SI to SII initially raising area A in revenue. The imposition of a maximum price below the market equilibrium reduces government revenue from A to B. The droughts of 1965-7, 1973-4 and 1979-81 led to rapid foodgrain price inflation. Rising input costs can be shown by shifting both SI and SII leftwards. With a fixed nominal maximum price, real government revenue will fall further. We can hypothesise that tax evasion and black marketing are a positive function of the divergence of market and fixed maximum prices.

Re = b (P" - P$) (1)

Where Re is proportion of legal tax evaded, P" is the market price in the absence of price controls and P$ is the fixed nominal maximum price, b varies between 0 (complete tax evasion) and 1 (complete tax compliance) and depends on such factors as the efficiency of the state's revenue department and the ethical commitment of taxpayers. Both Jha and NPE economists have argued that compliance has declined over much of the postwar period. The financial incentive for corruption generated by shortages had a "corrosive influence on the moral ethics and the integrity of political and public life" (Bhagwati, 1993, p56). This would be reflected by a secular decline in b. Cost inflation increases this divergence and generates a

Fig. 1c



second round impact, further reducing revenue. We can construct an alternative Laffer curve for an Intermediate Regime [20]. In a market economy there is a hypothetical non-monotonic relation between tax revenue and the tax rate based on work effort. In an Intermediate Regime, the relation is between tax revenue and equation (1). There is no backward bending portion characteristic of the original Laffer curve. Revenue reaches a maximum when the nominal maximum price equals the market equilibrium price,

i.e. as (P" - P$) « 0

Re « 0

The stylised pattern from Jha that reverses the orthodox pattern of cause and effect can now be summarised.

a) There is an exogenous impact on the economy, typically a drought, that reduces the availability of foodgrains.

b) Due to the inelastic structure of the demand for foodgrains, prices rise rapidly and lead to a general inflationary process.

c) Inflation interacts with the policy structure generated by the Intermediate Regime (as described earlier) benefiting Intermediate Classes and both directly and indirectly causing the state's fiscal deficit to increase.

d) Typically (and very notably in 1965-7) the state reacts to the growing deficit by cutting capital expenditure rather than reducing current expenditure or allowing an inflationary momentum to develop.

e) Inflation thus undermines the process of accumulation by the state and momentum of development.

6) Political Economy of Inflation. The problem of inflation sits uncomfortably with the orthodox analysis of eroding fiscal conservatism. In the context of a prior breakdown in state-society relations inflation is tacked on as an extra, entering the scene as an exogenous

[20] At very high rates of tax there is no incentive to save, work or invest. Reductions in taxes will increase such incentives and raise the level of economic activity to such an extent that tax revenue will actually rise. After a point, the effect of reducing taxes will lower revenues as increased incentives no longer offset lower tax rates.

shock and exiting through sudden newly found policy autonomy. The fiscal deficit is the essential variable in orthodox political economy: "the fiscal problem has often changed the course of history" (Joshi and Little, 1994, p346). Undoubtedly it has, but works such as Rowthorn (1977) (as well as the experience of Russia over 1989-98) show that inflation is a crucial element of political conflict in an LDC.

The NPE typically has no macro perspective[21], see for example Joshi and Little (1994) who have an exclusive focus on the fiscal deficit. In such accounts, inflation enters the stage exogenously much as divine intervention it has no structural role in their political economy of development. The status of inflation in orthodox arguments ignores the recurrent bouts of inflation hysteria from the Indian polity faced with the faintest hint of an inflationary bubble. Indian history reveals the "hypersensitivity of the polity to even moderate inflation" (Bardhan, 1992, p321).

All competing orthodox paradigms addressed to the erosion of fiscal conservatism fail to explain what can be called the 'ten percent paradox'. An inflation rate of ten percent has been the signal for policy shifts in all the major postwar crises:- drastic cuts in public capital formation in 1965-6, policies to reduce real incomes in 1973-4, an IMF loan in 1979-80 and finally liberalisation in 1990-1. It is difficult to reconcile such political behaviour with the passive regulatory state of Bardhan (1984), the class state of Patnaik (1994, 1996) or a state subject to simultaneous 'political awakening' and 'political decay' from NPE authors, notably Joshi and Little (1994). None of the competing paradigms adequately explain why the state suddenly acquires sufficient autonomy to shift the structure of policy when inflation reaches ten percent or indeed why inflation at such a level should be perceived as such a threat. Explanations are at best tenuous. "The missing element lies, as already suggested, with the inherited character of the bureaucracy and its traditions of guardianship as well as with the austerity of India's first generation of politicians. The bureaucrats did not even see to it that their salaries were indexed (until the 1980s) and so they imposed on themselves an incentive to keep inflation low." (Joshi and Little, 1994, p12).

[21] The analysis of the political business by Nordhaus (1975) is a rare exception.

Jha explains inflation as originating, not from the failure of clever management, but rather from exogenous shocks of various sorts to the economy, in 1964-5 the drought, in 1973-4 and 1979-80 droughts and oil price rises, in 1989-90 sudden changes in policy. Inflation then interacts with the structure of policy generated by the Intermediate Regime. It leads to increases in the state budget deficit. In turn, this which necessitates cuts in public investment and encourages recession which negates the process of modernisation and the rationale of state-led development.

3.7 Kalecki, Jha and NPE

Kalecki explains the initial dynamism of the Indian economy from the benefits of state capitalism and of large-scale provision of social overhead capital. Jha’s analysis is rooted in the subsequent stagnation as regulative controls proliferated and the fiscal competence of the state declined in times of inflation and shortage. NPE analysis can account for particular policy anomalies rather than for the dynamic process of change.

During the 1980s, inefficiency in Indian state owned enterprises was chronic, the state electricity boards made losses of 0.7% of GDP and were a major contributor to the states’ weak fiscal position. Although the issue of subsidies is not given full attention within the context of an Intermediate Regime, once we identify specific interest groups we can say, as with respect to the power sector, that the industry was used "as a politician’s welfare state instrument to secure middle class votes" (Joshi and Little, 1994, p187). Consider the free electricity to farmers in Tamil Nadu, made for electoral considerations and also the perpetual difficulties in reducing the scope of, or targeting, the public distribution system. But the link suggested by Kalecki between state capitalism and the Intermediate Regime is by no means exclusive. Rosenstein-Rodan (1943) demonstrated an inherent need for state intervention in an LDC whatever the composition or otherwise of the 'ruling class'. The concepts of state capitalism from Kalecki and that of shortage from Jha need theoretical integration.

In contrast to the NPE, Jha examines how interest groups are affected by (and how in turn they influence) policy. Jha's analysis is made in a dynamic dialectic of state-society relations.

He demonstrates how an external shock or even a mistake in policy formulation (he needs not rely on conspiracy) can snowball and create an interest concerned with perpetuating and expanding that policy. His analysis fits the stylised patterns of Indian development. He offers an alternative explanation of the deficit in the 1980s, and his analysis can be extended convincingly far beyond the period he focused on (1965-80). The orthodox Liberal-Pluralist and Marxist explanations tend to focus on the erosion of fiscal discipline leading to rising deficits. But Jha explains how inflation can directly increase the state’s deficit. So he also offers a striking and plausible explanation of 'inflation paranoia' in the Indian polity. Inflation will directly impact on the process of state-led economic development and undermine the legitimacy of the ruling alliance. Without the structure of regulation resulting from the Intermediate Regime, the link between inflation and a growing budget deficit is broken and inflation tolerance can (and indeed did) increase.

3.8 The End of the Intermediate Regime?

By 1990, India had lost what according to Kalecki were two of the three pre-conditions for the Intermediate Classes to perform the role of a ruling regime. First, the collapse of the USSR and its satellites from 1989 deprived India of aid from the Socialist Block, the benefits of the Rouble zone, and most importantly an ideological counterweight in international bargaining. The ‘debt crisis’ and IMF conditionalities led to attempts at compliance by reducing the size of the state in terms of personnel, expenditure, direct and regulative roles (Cassen *et al.*, 1995) and a dilution of state capitalism. Public investment was reduced and replaced by incentives for private and international investment in infrastructure. Although liberalisation was highly selective, focusing on trade and finance, it marked a profound ideological break from the state-led, autarchic development strategy that endeavored to subordinate financial to productive capital.

Kalecki perceived the intermediate regime to be vulnerable to pressures from foreign capital or feudal elements rather than to the self-defeating nature of its own economic strategy about which Jha is explicit:- "the intermediate class fattens on the debilitation of the economy" (Jha, 1980, p121). But Jha effectively ignores the role of international influence, the second of

Kalecki's preconditions, for his political economy of the period 1965-80. In fact the drought in 1966 was used by the U.S. to lever both devaluation and trade liberalisation in return for emergency grain deliveries. A closer examination of the situation prevailing in 1991 reveals the crucial role of international political pressures.

The financial situation prevailing in 1991 was precarious: a current account deficit of $10bn, reserves which had fallen to two weeks worth of imports, inflation up to 13% and NRI deposits fast flowing out of the country. In February, the national budget was postponed; in March the government fell. India's credit rating was downgraded, making commercial borrowing impossible. The temporary rise in oil prices consequent on the Gulf war was of little significance. An economy with a minimal degree of fiscal leeway would have been able to smooth over the temporary shock by borrowing on the international capital market. The crisis was specifically a state fiscal crisis resulting from a progressive worsening of the national debt profile during the 1980s. The real economy was doing well. Agriculture and industry were healthy in April 1991. There was a surplus on the merchandise trade account and no pattern of increasing structural imbalance. During the 1980's with the aid of a crawling peg, the Rupee had depreciated 55% against the dollar and by 60% against the pound.

The events of 1991 were specifically a crisis of confidence, a short-term liquidity crisis. With a weak debt profile and international ideological monotheism, concessional finance came with the obligations not only to adjust but also to underpin short-term policies with a long-term programme of deregulation and liberalisation.

4. The State of the Indian Economy in 1991

In 1979-81 India faced shocks emanating from higher oil prices, higher interest rates and a world recession. An IMF loan was obtained with minimal preconditions. By contrast, in 1991 a temporary rise in oil prices consequent to the Gulf War led to an abrupt policy shift away from the Mahalanobis model that had characterised Indian development efforts since the early 1950s towards a package of neo-liberal orthodox policies. The difference in these two experiences lies in the state of the Indian state in 1991.

1) The Fiscal Problem. Pace Patnaik (1996) who argued that the state was unable to impose effective taxation on property owners, the Long Term Fiscal Policy (LTFP) initiated in the early years of Rajiv Gandhi was in terms of its own objectives a revenue success. Between 1985-6 and 1989-90 (the Seventh Five Year Plan), central government revenue, net of the states' share, was targeted to rise from 7.8% to 9.4% of GDP. In practice the targets were exceeded in every year. The fiscal problem was not resource mobilisation but expenditure growth which rose even faster, and accelerated throughout the 1980s.

Table 2: Expenditure Growth

Time Period	Real Expenditure Growth (Centre and States)	Real Expenditure Growth (Centre only)
1974-79	+ 6.9 %	+ 2.6 %
1979-83	+ 6.9 %	+ 8.1 %
1983-87	+ 9.5 %	+ 11.5 %

Source: Mundle and Govinda Rao (1992)

The two fastest rising components of government expenditure were subsidies and interest payments on past-accumulated government debt, leading to both an increasing deficit and increasing borrowings.

Table 3: Proportion of Central Government Expenditure.

Category	1971-2	1980-1	1987-8
Interest	8.43	13.21	19.29
Subsidies	6.14	12.07	14.85

Source: Mundle and Govinda Rao (1992)

Making room for committed expenditures, the proportion of central government expenditure it accounted for fell from 56.18% in 1971-2, through 38.62% in 1980-1 to 30.45% in 1987-8. The central government's fiscal deficit rose from an average of 4.5% in the 1970s to 8.5% between 1985-6 and 1991. Public savings had risen between 1966-7 and 1976-7, then fluctuated at about 4.6% of GDP until 1981-2, after which it fell steadily to 1.6% of GDP by

1989-90. The Indian state was increasingly borrowing to finance current expenditure, the fastest growing component of which was interest payments.

2) The Tax Structure. State revenue was high when compared to other countries with a comparable distribution of incomes. However, its rise over the 1980s was consequent upon a rise in the share of indirect taxes, especially import taxes. Revenue from direct taxation (income and corporate taxation) declined relatively over the same period. In 1990-1 15% of total tax revenue came from direct taxes [22], raising only 2.3% of GDP. Such a pattern is comparatively unusual. Trade taxes are more commonly replaced by direct taxation as income rises. In India, the income and corporate tax base has been narrow. In the 1960s the top marginal rate of income tax reached a maximum of 97.5% yet there were only eight million income tax payers from an eligible middle class estimated to be between one and two hundred million. Recovery rates on social and economic services declined over the 1980s, from an average of 55% in 1977-8 to 41% in 1987-8. Mundle and Rao (1991) estimate total subsidies, both indirect and direct to have reached 15% of GDP by 1987.

3) The Debt Profile. The debt profile of the Indian economy worsened significantly during the course of the 1980s. Between 1980-1 and 1989-90, external debt rose from $20.6bn to $64.4bn, the debt to GNP ratio from 17.7% to 24.5%, the debt to exports ratio from 210% to 265%, the share of private debt in long term debt from 28% to 41%, the share of non-concessional debt from 42% to 54%, the proportion of debt held at a variable interest rate from 11% to 19% of long term debt and the average maturity of debt declined from 27 to 20 years. Buiter and Patel (1992) found the growth of public debt to be non-stationary: it was on an explosive growth path. A decade of expenditure-driven fiscal and current account deficits had undermined the fiscal safety margin of the Indian economy and weakened any opposition to externally imposed, aid-related conditionalities.

The financial crisis of 1991 contrasts vividly with the crisis of the real economy in 1979. After the second oil price shock, India's terms of trade declined by 33%. During the concurrent drought, agricultural output fell by 13%, foodgrains output by 18%, inflation rose beyond

[22] The developing country average is 30% (Joshi and Little, 1994).

10% and industry went into recession. India's debt profile was strong enough to give it a certain leeway in acquiring official finance and being able to pursue a policy of expansion rather than liberalisation. Low levels of domestic and international debt allowed India to utilise IMF funds for an expansionary form of adjustment. Public investment was sustained. Even though loans conditional on structural adjustment were being pushed through in Subsaharan African countries from 1978 onwards, the Indian economy recovered with no commitment to a long-term programme of liberalisation.

4.1 The End of the Intermediate Regime?

By 1991 the state had lost the three preconditions identified by Kalecki as being necessary for the Intermediate Classes to perform the role of a ruling alliance. The heavy burden of profligacy during the 1980s (inherited debt and unproductive expenditure which reduced both India's credit rating and prospects for future growth) left the Indian economy vulnerable to even moderate shocks in interest rates. However, in section 3.6 (on the strengths of the theory of the Intermediate Regime), we found that Jha's analysis offered a powerful political economy of development which generated a strong prediction. To undermine the Intermediate Regime by policy changes is not enough. This happened with a shift to authoritarianism with the 'Emergency' in 1975 but 'reform' was rolled back after 1977. It was also the case with liberalisation under Rajiv Gandhi after 1985, when, after the loss of the Harayana state elections in 1987, reform all but halted [23]. An effective challenge to such a regime requires a new alliance, with the power to replace the numerically dominant class coalition and to prevent the juggernaut of reform from rolling backwards. Structural changes in the Indian economy during the course of the 1980s created just such a set of countervailing class forces.

5. The Future of the Intermediate Regime

While Kalecki described preconditions necessary to make an Intermediate Regime possible, Jha described the internal contradictions of its *modus operandi*: the generation of economic scarcity and stagnation. During the 1980s it became clear that pressure on the Intermediate

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[23] See Kohli (1990).

classes in India had both increased and changed in nature. It became less increasingly plausible to argue that the economy was being run in the interests of an alliance of a heterogeneous but numerically dominant class. An alternative trinity began to emerge well before the 1990s that effectively set the foundations of (or in Kalecki's terms, the preconditions for) liberalisation and an end to any semblance of an Intermediate Regime in 1991. The 'Gulf War' oil shock of 1991 was only a proximate contingent trigger, made effective by the underlying process of structural change.

1) International Capital. "Conventionally a simplistic reading of what are national income identities is used to suggest that the fiscal deficit is a determinant of the current account deficit. But historically read, the Indian experience suggests that the 'causality' if it is unidirectional, runs the other way" (Chandrasekhar and Ghosh, 1993, p667). Joshi and Little (1994) make the simplistic reading that the absence of shocks to exports or interest rates during the late 1980s meant that the balance of payment deficit was generated domestically. But the opposite reading is actually more convincing. Until the early 1970s, limits to the current account deficit were set by the limited access to international finance [24]. This constraint determined domestic stop-go policies. Expansionary policy was inflationary, government deficits spilled over into domestic excess demand and therefore inflation. Inflation hypersensitivity was thus the binding barrier on a government's efforts to stimulate growth. The steady liberalisation and globalisation of finance throughout the 1980s increasingly permitted non-inflationary, deficit-financed growth. After the debt crisis of 1982, institutions with ever larger volumes of finance to lend had a smaller area in which to spread their portfolios (Amin, 1999). For India, with previously low levels of international debt, the current account deficit was no longer a binding barrier to access during the 1980s. So a process of liberalisation to stimulate import-led growth was encouraged. The inflation barrier became inoperative. The ability to finance a current account deficit encouraged liberalisation and with it financial profligacy. The causation is in reverse. Pressures from international capital prompted increasing liberalisation. The removal of the barrier to deficits led to a growing current account deficit.

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[24] See Chandrasekhar and Ghosh (1993).

Trade liberalisation became an autonomous force. The current account was less easily controlled by means of demand management policies. Fiscal adjustment was no longer as reliable as it had been at ensuring balance of payments adjustments [25]. The balance of payments only partly reflected the difference in flows of imports and exports. Deficits increasingly reflected a stock-flow disequilibrium between total foreign debt and current income. Most debt was held publicly. The small portion held privately was largely guaranteed, so any external crisis would have a direct impact on the fiscal deficit. Capital expenditure became increasingly determined by the state of international confidence in the international foreign exchange market. This undermined any lingering preference for state capitalism. Patnaik (1994) argues there was a general deflationary bias to prevent capital flight. As capital controls were weakened and interest rates were increasingly set internationally, national economic planning and Keynesian demand management were undermined.

2) Markets and the Shift to "Comparative Advantage". The rationale of an Intermediate Regime is to subordinate "the market" to a progressive reshaping of the social and economic environment to the benefit of its composite classes. It works by guiding the process of development via state capitalism (according to Kalecki), and/or by the creation of shortage (according to Jha). During the 1980s there were signs and symptoms that the Indian economy was being increasingly driven by market forces. Marketisation set up a powerful momentum that undermined the Intermediate classes. The process was initiated by liberalisation during the late Indira period and dramatically endorsed during the early months of Rajiv. Marketisation was therefore well consolidated by 1991 (Ahluwalia, 1992).

Thirty-two industry groups had been delicensed and investment limits removed. By 1988 delicensing was complete except for a restricted number of industries on a small negative list. Domestic barriers to entry and expansion were reduced, competition in domestic industry increased and promoter-family use of so-called corporate capital received its first international challenges (Banaji, 1997). Better access to technology was permitted through liberalisation of capital imports and a shift from the principle of reliance on domestic supplies. Some

[25] The merchandise account was in balance before devaluation in 1991.

simplification of procedure gave a greater flexibility to already installed capacity. There were ample signs that Indian industry was utilising a given set of factors more efficiently and moving towards the "production possibility frontier".

Table 4: Growth Rates of Employment, Capital Stock and Value Added.

Industry Classification	Employment	Capital Stock	Value Added
Manufacturing	(3.5) û0.7	(7.0) 7.6*	(5.0) 7.5
Intermediate goods	(2.9) 0.8	(7.4) 7.7*	(4.4) 6.5**
Consumer non durables	(4.4) û3.0	(6.0) 7.2*	(4.8) 7.6**
Consumer durables	(4.7) 2.4**	(10.2) 11.1*	(8.0) 14.2
Capital Goods	(2.2) 0.4**	(7.7) 7.4*	(6.7) 7.8*

Source: I.J.Ahluwalia (1992)

Note: Figures in parentheses are for the period 1965-6 to 1979-80, second figures are for 1980-1 to 1985-6.

* Not significantly different from the growth rate of the earlier period

** Significantly different from the growth rate of the earlier period only at the 10 per cent level.

Three distinctive characteristics make the first and second periods distinctively different: (i) a uniform acceleration of labour productivity, (ii) no significant change in the growth rate of the capital stock and (iii) a large positive increase in the growth rate of value added.

The trend break in growth[26] was not associated with increased inputs. Ahluwalia's examination of trends in productivity shows a) capital productivity to have halted its long term trend decline and b) a rapid rise in capital intensity during the 1980s leading consequently to a sharp turnaround in the growth of labour productivity.

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[26] Between 1985/6 and 1989/90 Indian GDP grew by 5.6% p.a., breaking through the long run 'Hindu Growth Rate' of 3.5%.

Table 5: Trends in Productivity Growth.

Industry Classification	Total Factor Productivity	Labour Productivity	Capital Productivity
Manufacturing	(-0.3) 3.4	(1.4) 8.3	(-1.9) 0.0
Intermediate Goods	(-0.8) 1.4	(1.5) 5.6	(-2.7) 1.1
Consumer non-durable	(-0.5) 5.2	(0.3) 10.9	(-1.1) 0.4*
Consumer durables	(0.9) 6.6	(3.2) 11.5	(-2.0) 2.8
Capital Goods	(1.7) 3.4*	(4.3) 7.4	(-0.9) 0.4*

Source: I.J.Ahluwalia (1992)

Note: Figure in parentheses is for the period 1965-6 to 1979-80.

* Not significantly different from the growth rate of the earlier period.

During the years of stagnation, the growth of employment slowed much less than could have been expected given the sharp deceleration in industrial growth after 1965 (Ahluwalia, 1992). By 1980, this had generated a substantial overhang of employment. Nagaraj (1994) finds an intensification of effort; mandays per worker rose 16% between 1980-1 and 1986-7. The sharp rise in labour productivity reveals improvements in the efficiency with which labour and capital were utilised. Liberalisation (underpinned by the rapid growth in demand) generated significant improvements in the allocative efficiency of a given stock of labour and capital. There was a downward trend in the capital-output ratio throughout the 1980s, from 6% in the late 1970s to 4% during the next decade (Jalan, 1992, p43). Existing resources were used more efficiently and as marginal investment decisions were increasingly made in favour of capital-light investment projects (reflecting India's historical comparative advantage), there was a dramatic shift in the structure of the manufacturing sector towards those industries consistent with India's comparative advantage in labour- and skill-intensive industries, such as garments, gems, jewellery, handicrafts, computer software (though quite import intensive) and light engineering. Resources were moving to industries offering a higher static return.

Table 6: Structure of Industry in India 1970-1 to 1985-6 (Percentage Shares).

Classification	1970-1	1980-1	1985-6
Cotton Textiles	12.6	12.74	8.36
Iron and Steel	9.82	10.46	7.63

Food Manufacturing Except Sugar	5.58	4.47	5.99
Sugar, Khandasari and Gur	3.53	1.33	2.42
Petroleum and Coal Products	2.02	1.56	3.42
Man Made Fibres/ Synthetic Products	1.75	2.06	3.48
Cement	1.66	1.44	2.22
Railway Equipment	2.40	2.32	1.41
Jewellery and Related Articles	0.17	0.12	1.06

Source: I.J.Ahluwalia (1992)

3) The Growth of the Middle Class. The middle class is a different concept from the intermediate classes. Intermediate classes are defined by reference to the means of production rather than to income. The middle classes are defined by income, lifestyle, education and attitude. The professional manager is middle class but not a member of the intermediate classes. A middle class farmer has aspirations for his children beyond the farm, whereas the sons of a 'bullock capitalist' would invariably work the family farm they inherited. The 1980s saw an increasing contradiction between the pattern of production on the one hand and the consumption pattern desired by the growing middle class on the other. Bardhan’s three dominant proprietary classes (1984) were becoming increasingly homogenised. The Indian economy was not simply subject to the globalisation of capital but also to the globalisation of a middle class lifestyle that came in its wake bringing "the inculcation of a desire to emulate the fashionable lifestyles prevailing in the metropolitan countries (which), among segments of the underdeveloped economy, acts as a powerful instrument in the hands of metropolitan capital" (Chandrasekhar and Patnaik, 1995, p3066). The increased import intensity of consumption led to a progressive thawing of autarchic attitudes. Foreign investment by Pizza Hut, McDonalds, KFC, Levi's, Polaroid, Carlsberg, Ford, Volvo, IBM, BMW exposed the Indian middle classes to world 'consumer icons'.

Kohli (1990) estimated the middle class to number between sixty and eighty million urban dwellers in the mid 1980s: those in the civil service, professions and many self employed. The homogenising impact of consumerist culture among this influential minority is symbolised by the growth of television, especially during the 1982 Asian Games, which is said to have created for the first time in Indian history a national network around a medium vastly more powerful than either print or radio. The middle classes were personified by Rajiv Gandhi, a westernised enthusiast for technology, especially electronics, dispensing tax-cutting liberalising budgets and ending the shortage of consumer goods [27]. Even so, the growth of consumerism was underestimated in official statistics, automobiles, electronics and computers being wrongly classified as capital goods (Chandrasekhar and Patnaik, 1995).

Stock market investment in the 1980s created a structural link between business and the middle classes further homogenising the dominant proprietary classes. Taking the February 17th 1990 issue of Economic and Political Weekly as ‘text’, the consumerist ethos is striking. The back cover offers the slogan,"At Hindustan Lever we don't just make products, we fulfill needs". The products they are selling are washing-up liquid, soap, washing powder, toothpaste and the 'needs', beauty, glamour, sparkle and whiteness. The middle classes are associated with an income and a consumerist attitude, the intermediate classes by a particular set of relations to the means of production.

6. The Intermediate Classes During Liberalisation

Now we can examine how the Intermediate classes, which flourished in conditions of stagnation, fare in conditions of liberalisation, beginning with tax reform.

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[27] Manufacturing and services by 7% p.a. capital goods by 10% p.a. and consumer durables fastest of all at 12% p.a. very top of page 26 after "ending the shortage of consumer goods"

6.1 Tax Reform

A reduction in tax rates was sustained throughout the 1990s.

Table 7: Tax Reform During the 1990s.

	Income Tax %		Corporation Tax %		Customs Duties %
Year	Basic Rate	Surcharge	Basic Rate	Surcharge	Peak Rate
1990-1	50	8	40	8	200
1991-2	50	12	40	15	150
1992-3	40	12	45	15	110
1993-4	40	12	45	15	85
1994-5	40	-	40	15	65
1995-6	40	-	40	15	50
1996-7	40	-	40	7.5	50
1997-8	30	-	35	-	45

Source: Chakraborty (1997)

In conjunction with the cuts in the marginal rate, the income tax exemption was raised, in 1992-3 from Rs 22,000 to Rs 28,000, one of the highest ratios to per capita income in the world. The initial evidence on the results of tax reform may suggest a Laffer type relation. There was a persistent upward trend in the share of revenues from direct taxes.

Table 8: Direct Tax Revenue of the Centre (percentage of GDP).

Year	Total Revenue from Direct Taxes	Corporation Tax Revenue	Personal Income Tax
1980-1	2.18	1.01	1.06
1990-1	2.07	1.00	1.01
1993-4	2.67	1.32	1.19

Source: Bagchi (1994)

The revenue structure of the centre moved increasingly away from indirect to direct taxation.

Table 9: Share of taxation in revenue of the revenue (proportion of total revenue).

Year	Direct Tax	Corporation Tax	Income Tax	Indirect Tax
1980-1	22.56	10.47	10.95	72.44
1990-1	19.16	9.27	9.33	80.84
1993-4	27.64	13.68	12.38	72.36

Source: Bagchi (1994)

Rising yields from direct taxation were not sufficient to offset cuts in indirect taxes, especially trade taxes conducted as part of the programme of external liberalisation. Tax revenue as a share of GDP rose from 14.59% in 1980-1 to 17.01% in 1989-90 then declined during the reform period to 15.58% in 1993-4. Direct taxation dropped by 0.5% during this period to 2.6% of GDP, compared to an average among LDC's of 5.5% and a Chelliah Committee target of 5%. Rising yields may suggest a Laffer type relationship. However, the original Laffer curve was developed for a developed economy when the share of direct taxation in GDP is substantially higher and the relationship turns on the effect of incentives on work effort. An examination of estimates of income tax elasticities suggests this relationship does not hold well for India and that a new explanation should be sought.

Table 10: Income Elasticity of various components of tax revenue.

Year	Income Tax	Corporation Tax	Customs Duty	Total Taxation
1991-2	1.39	2.21	0.49	1.00
1992-3	1.19	0.95	0.52	0.79
1993-4	1.37	0.84	-0.52	0.11
1994-5	1.30	1.85	1.16	1.22
1995-6	1.77	1.25	1.94	1.32
1996-7	1.37	1.05	1.51	1.27
1997-8	1.03	1.02	1.26	1.08
Source: Chakraborty (1997)				
Average Elasticity 1991-5	1.35	1.46	0.72	0.89
Average Elasticity 1996-7	1.19	1.17	1.08	1.02

The income elasticity of tax revenue shows by what extent the various components of government revenue can be expected to increase as GDP growth occurs. The figures have been constructed so as to offset the effect of tax reductions from the impact of other factors e.g. changes in income distribution, efficiency of tax enforcement etc. If there is a Laffer effect operating we would expect to see a rise in tax revenues due to growth. Liberalisation and tax cuts, in reducing the scope of the black economy, will increase revenue elasticity (see Table 10). However, it is difficult to relate the years in which tax cuts were made to subsequent increases in the income elasticity. The income tax cuts in 1992-3 and 1997-8 were years of particularly low-income elasticities, 1.19 and 1.03 respectively. Similarly, the drastic cuts in corporation tax in 1997-8 when the basic rate was reduced to 35% and the 7.5% surcharge was abolished saw a fall in the income elasticity from 1.05% in 1996-7 to 1.02 in 1997-8.

Jha's analysis once more offers an interesting way of re-interpreting this relationship. The infusion of money into the black economy to avoid price controls, licensing, capacity regulation - what may be termed the structure of regulation - ought to be being reversed during a period of liberalisation and deregulation. While in mature developed economies the Laffer relation between tax rates and work effort may be found, in Intermediate Regimes, the relation is rather between the structure of regulation and tax revenue. Thus, the upward trend in the elasticity of customs duty may be related to the gradual liberalisation of the external account, plus the shift from import controls to tariffs and the consequent increase in the marginal import intensity of growth. The big bang budget of Manmohan Singh in 1991 dispensed with much of the structure of regulation. This is reflected in a leap in the income elasticity of corporation tax to 2.21% in 1991-2. The 1994-5 budget emphasised incentives for private investment, thereby liberalising industry further, reducing interest rates as well as cutting corporate taxation. This is reflected in a jump in the income elasticity of corporate taxation to 1.85. This is entirely consistent with a prediction due to Jha that profits and revenue will rise with deregulation as income from wholesale and retail traders shifts back to producers and as industrial capital is strengthened at the expense of financial capital.

6.2 Liberalisation and the Triple Alliance in the 1990s

The Intermediate Regime slowly decayed throughout the 1980s under the onslaught of the triple alliance: foreign capital, a growing middle class and the increased role of market forces in the theatre of capitalist expansion. The political foundations of liberalisation were nurtured throughout the 1980s. 1991 was not so much a moment of shock therapy as the final acknowledgment of a shift in the underlying political economy of India. The intensified reform period of the 1990s was marked by a distinct shift in political strategy that both recognised this process and sought to utililise its potential to underpin further reform. To remove the entrenched system of patronage, shortage and regulation generated by the Intermediate Regime, a simple commitment to reform was not sufficient - as had been demonstrated by the gradual ebbing of reform under Rajiv Gandhi. To unblock the processes of market competition would require more than well meaning proclamations from Delhi. New and stable alliances needed to be formed to enable a durable and effective reshaping of the Indian economy. The triple alliance did precisely this, systematically undermining the constituents of the Intermediate Regime and benefiting the new set of fractions of capital.

1) Liberalisation. Liberalisation and deregulation systematically undermined the policy props upon which the edifice of the Intermediate Regime rested. Licensing was abolished, small sector reservation liberalised, the Monopoly and Restrictive Trade Practices Act (MRTP) was abolished, prices decontrolled, restrictions on the expansion of capacity were lifted, a market for foreign exchange was kick-started by the gradual move towards the convertibility of the Rupee by way of a dual rate.

2) Privatisation of State Capitalism. The Indian state sought to privatise certain of its state capitalist enterprises removing at a stroke one of Kalecki's preconditions and enlarging the domain of the big bourgeoisie and foreign capital. Private investment increasingly broke with its dependence on public investment through a programme of reduced controls, improved access to imported capital goods, raw materials, intermediaries, increased foreign collaboration and tax cuts.

Public investment stagnated, at between 8.6% of GDP in 1990-1 to 8.4% in 1994-5, while private investment rose little from 12.7% of GDP to 13.7%. Although the decline in public investment was slight in absolute terms, it marks a huge shift in ideological terms. The relative growth of the state sector had been central to the Mahalanobis model of planned development. "As the relative share of the public sector increases, its role in economic growth will become more strategic and the state will be in a still stronger position to determine the character and functioning of the economy as a whole" (Govt. of India, 1961, p14).

In the 1990s, policy shifted the responsibility for even 'basic' economic investment onto the private sector. The state increasingly sought to withdraw from infrastructure provision (e.g. the five year tax holiday for private enterprises embarked on building and operating roads, bridges, ports and airports). Oil, power, telecommunications were opened to foreign investment. The 1992-3 budget, unconcerned with stabilisation, marked a distinct ideological shift in the conception of the role of the state in India through its structural reforms. The budget abolished controls on Indian companies' raising equity funds in the domestic market. It sharply raised the exemption limit on income taxes and cut the top rates. It removed inflation from long term capital gains; reduced capital gains taxation for stock market investment, excluded bonds and shares from wealth taxation and made the Rupee partially convertible. It was a budget that aimed to enhance economic incentives, productively to employ what has already been created and free the movement of capital, both local and international. The revenue deficit in 1991-2 was 2.8% of GDP, higher than the average of 2.6% in the pre-crisis years 1985-6 to 1989-90. The fiscal deficit was targeted by reducing capital expenditure. The current account deficit at the beginning of liberalisation was 3% of GDP, after falling to 1% in 1991-2 it again widened to 2.8% in 1992-3. The 1993 and 1994 budgets combined cuts in capital expenditure with incentives to increase private industrial investment. The user cost of capital was reduced by cutting corporate taxes, tariffs on capital goods, capital gains tax on companies and also by reducing bank lending rates. The ideological shift in Indian policy formation restored the confidence of international investors. International capital[28] surged in to India. By 1995 foreign exchange reserves reached $21bn. Stabilisation was subordinated to ideology as the Indian state sought to nourish capitalism.

3) The Retreat of the State. Financial liberalisation undermined the ability of the state to appropriate resources and initiate development. Monetary policy had previously sought to make room for fiscal deficits without generating excess monetary growth. Low inflation was achieved at the expense of a subordinated, repressed financial system, large loan-deposit spreads, and the financial autarchy necessary to prevent capital flight. Liberalisation sharpened the trade off between inflation and growth because financial liberalisation reduced government-captured borrowing [29]. A given monetary expansion henceforth resulted in both a higher interest rate and a greater sensitivity of that interest rate to changes in the fiscal deficit. The marginal real interest rate on government funds rose steadily. In 1993-4 and 1994-5 interest rates were moderate, despite high fiscal deficits, because of large inflows of capital. In

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[28] Principally short term capital flows not FDI.

[29] In 1991, the government and RBI captured 63.5% of bank deposits.

1995-6 monetary policy was tightened to control inflation; and, because of the loose fiscal stance, interest rates rose sharply. The state became increasingly formally enmeshed in markets rather than seeking to dominate them from the 'commanding heights' of the economy.

4) Employment Creation. The Indian state progressively withdrew from its role in creating employment for the educated, lower-middle class. Employment in the government sector grew by 15% p.a. between 1950-60, by 1.7% p.a. between 1985-90 and by only 0.5% p.a. in the next five years. A declining share of marginal employment growth was thus subjected to reservation (positive discrimination for the scheduled caste and low caste fractions of the population).

5) Reform of External Accounts. External accounts were structured so as to be more favourable to international capital and exporters. In 1991 the Rupee was devalued by 20% despite a merchandise trade balance. It was necessary specifically to attract a larger capital inflow to balance the deficit on portfolio flows, consequent upon a large discrepancy in stocks of external debt relative to domestic reserves of foreign exchange. Restrictions on FDI and portfolio investment were progressively removed. Interventions in resource allocation and trade controls were relaxed better to enable resources to flow into areas of comparative advantage. Export subsidies were abolished. An import entitlement scheme for exporters introduced to provide duty free materials and components for exporters. Quantitative controls on capital and intermediate goods were abolished.

Yet, in the year and a half from 1993, out of $13.6bn of gross capital inflow, direct foreign investment made up only $1.1bn and concessional overseas development assistance only $2bn. The recovery of international confidence had only restored the “normalcy” of the previous decade. External debt rose by $3.5bn in the first six months of 1992-3. In the entire period March 1989 to March 1992 it rose by $4.5bn. Domestic policy was being subordinated to the dictates of 'hot' money.

6) Directed Credit. After bank nationalisation in 1969, lending was directed to “priority areas”. By 1974, thirty three percent of bank advances were directed to “agriculture, small scale industry, small transport operators, small business and professional and self employed persons" (Joshi and Little, 1994, p134). These categories are almost identical to the intermediate classes' described by Jha. By 1985, this had been raised to 40%. The beneficiaries of directed credit enjoyed subsidised interest, easy recourse to default and periodic, election-inspired loan-write-offs, to such an extent that by 1994 three quarters of regional banks had negative net worth. The liberalisation and commercialisation proposed for the financial sector directly undermined these classes.

7) Presumptive Taxation. Presumptive direct taxation was introduced to target non-compliance and combat the high costs of verification and detection among small business and the self employed [30]. This was indeed a direct assault on the intermediate classes. In other countries it has yielded dramatic results: used by Bolivia for example to increase tax revenue from 1% to 7.5% of GDP between 1986-90. It was first introduced (a flat tax of Rs1400) in the 1992-3 budget on small shopkeepers with turnover of less than Rs5,00,000.

8) Investment in Agriculture. Private agricultural investment depends crucially on complementary inputs of power, irrigation, fertiliser, extension services and other rural infrastructure. Simultaneous cuts in public capital investment combined with the scaling down of rates directed credit and declines in key wholesale prices squeezed the rates of return of the agricultural capitalist class (an important constituent of the intermediate classes). The compensatory rise in public procurement prices after 1991-2 only benefited larger farmers who dominate the marketed surplus. Agriculture is far from liberalised. But the benefits of intervention became more polarised. A regime of regulation deemed 'excessive' by the world Bank and protecting domestic agro-industry [31] provides cover for millions of small capitalist family firms.

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[30] Taxing on the basis of norms specific to each sector or occupation e.g. what is possible to earn on the basis of average effort by using a proxy such as education or experience or via the average income across enterprises and charging a flat fee.

[31] Unpublished internal World Bank paper referred to on p. 24 of Bhalla et al (1999).

Having unwound the structure of policy generated by the intermediate regime, the social toleration of inflation increased. By 1994-5, prices were still rising at about ten percent per annum, despite a run of average to good monsoons and despite nearly thirty million tonnes of foodgrains in reserve.

7. Hindutva

On the 6th December 1992 the Babri mosque at Ayodhya was demolished. Perhaps more than any other, this incident illustrated the widely chronicled crisis of the Indian state. The BJP at Lucknow would "brook no use of force whatsoever on the sadus and saints gathered in their thousands at Ayodhya with the express purpose of violating a court injunction" (Balagopal, 1992, p 1959). Bose (1997) argued the crisis of the state was systemic, with deep structural roots that would generate the chronic social and political instability of the 1990s. There are two main strands in his explanation. The first orthodox strand stresses political forces as being significant and independent variables [32].

1) Political Decay. Before 1967 the Congress Party was able to co-opt local elites through a network of patronage and organisation. Local 'Big Men' controlled economic resources in their own right. They could use their high caste status to deliver blocks of lower caste votes. The Congress split in 1969. The organised structure passed largely to Congress (O) (before gradually departing the scene). Indira Gandhi turned instead to a personal dynastic appeal and to populist measures. Initially the high castes remained loyal to Congress (O). In Gujarat, which can be taken as representative, the Patidars had both high caste status and a significant stake in the local capitalist class. With universal suffrage, Congress (R) sought to consolidate power by appealing first to lower status but numerically powerful Kshatriyas, and then to lower castes, Dalits and Muslims. By the early 1980s, this cleavage was complete. The Kshatriyas had largely removed the Patels from the state apparatus despite the latter still controlling agriculture, the press and commerce. Political and economic power diverged. The

[32] See Kohli (1990).

increasing reservation [33] of state employment and legislative seats for low and scheduled castes brewed a heady cocktail of resentment among the economically dominant Patels. By 1985, the privileged minority were refusing to accept the verdict of the ballot box and participated in both anti-Muslim and anti-reservation rioting. The rise of lower castes, labeled 'political awakening' weakened the traditional authority patterns of local 'Big Men'. This 'political awakening' is reflected both in a steady rise in national turnout of voters, from 45% of the electorate in 1952 to 64% in 1993-5 and in the number of contestants per seat, rising from an average of 4.7 in 1952 to 14.7 in 1993-5.

In 1989-90 for the first time in India's postcolonial history in Uttar Pradesh and Bihar, both elected governments came under the leadership of members of backward castes. In 1947 nationally, most Chief Ministers had been Brahmins, by 1997 there were none. The title of Narasima Rao's biography was, perhaps appropriately, *'The Last Brahmin Prime Minister'*.

After the split in Congress, local leaders derived their power from their personal association with the leader, such loyalty replaced the local power base. Without local legitimacy, it became harder to organise locally for anything other than elections, and harder to translate populist-personalistic support into the political ability to accomplish policy goals. Policy ineffectuality was compounded by the absence of enduring coalitions: "All pre-existing cleavages in society around which political mobilisation is possible become a fair game for competing politicians. Linguistic, religious and ethnic divisions clearly offer attractive opportunities for political mobilisation" (Kohli, 1990, p107).

Thus the formal institutions of Indian democracy suffered a process of 'political decay'. The breakdown of the state is thus traced back to the simple desire of those in power to retain it and those outside to gain it. Populism, regionalism, ethnic and communal politics work identity into votes in a fragmented society (Bengali nationalism for the CPM for example or Reservations for the Gujarati Congress). Political conflict was increasingly hard to contain without physical force.

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[33] In 1980 40% of legislative seats were reserved for Muslims, scheduled tribes and castes.

The developmental state in India controlled a significant proportion of the resource base. The legitimacy of claims on such public resources are the result of political negotiation and struggle. Conflicts over the spoils of patronage sharpened into political violence, the economic implications of which are traced by Bardhan (1984, 1988). As the legitimacy of Congress faded in this heterogeneous society where an uneasy coalition of dominant proprietary classes tusseled in different directions, none strong enough to dominate the process of resource allocation, "one predictable outcome is the proliferation of subsidies and grants to placate all of them" (Bardhan, 1988, p218). So stagnation before the late 1980s is argued to be connected with the decline of state capital formation as increasingly "the bulk of public resources are being frittered away in non-developmental expenditures" (Bardhan 1988, p218).

In this explanation political forces are significant and independent variables (Kohli, 1990). Liberalisation and the consequent retreat of the state from the regulation of the economy can be interpreted as a reduction in the premium available from political power. If the functions of development and patronage are replaced by a technocratic and administrative state the incentive to gain control of such a state diminishes and competitive energy should flow to “the market place”. Conflict over the benefits of public largesse due to the lack of clear property rights should be replaced by efficient, private contracting, and anonymous impersonal private exchange with the state implementing its classic nightwatchman roles, involving law and order, the standardisation of weights and measures etc.. Liberalisation is thus an attempt to remove the economy from politics, so as to stop the state being used as a means of accumulation.

2) Economic Dynamism. There is more than one argument to this second strand of explanation. Marxist thought focussed on the failure of prevailing values and ideologies to legitimise the existing division of labour. India is in a transition to capitalism in which most political parties have failed to align themselves with the social classes generated by its economic development (Mukajan et al, 1994, p1112).

The further group of unorthodox explanations for the crisis of the state is rooted in the dynamics of social and economic change [34]. The massacre of twenty-one dalits by members of the Reddy caste in the Chinduru region of Andhra Pradesh in 1991 reveals the impact that modernisation may have on a rural community. Dalits own a tiny proportion of the land, only 78 acres out of 2,420. However the equation of class and caste has been thoroughly undermined by the dynamics of development. Eighty percent of Reddy land is cultivated by non-dalit tenants. Five hundred local dalits are employed on the local railway which had generated an alternative economic base to that of Reddy controlled land. However, the most striking divergence is in relative levels of education in which "the dalits have moved far ahead" (Kannabiran and Kannabiran, 1991, p2131). No Reddis had a university education whereas there were ten dalit postgraduates, dozens of graduates and several hundred matriculates: a legacy from a long history of Christian missionary schools and colleges. Dalits and Reddis tended to mix freely in the local town Tenali, connected to Chunduru by the train link which had enabled dalits to travel to work. The violence was eventually precipitated by a dalit buying a ticket for the Reddy section of a local cinema.

"The process of change is what has boiled over, precipitating the carnage in Chunduru. The violence of the upper caste reaction must be seen as one extreme outcome of the tremendous insecurity of a section of the ruling class, saddled with a cultural apparatus which has outlived its function, under the onslaught of a stormy modernisation" (Commentary, EPW 1991, Sep 7th). These examples could be multiplied, the point being the political “disenfranchisement” of local economic elites.

7.1 Liberalisation and Intermediate Classes.

The concept of the Intermediate Regime has not hitherto been applied to the context of liberalisation. It does, however, offer an alternative framework to that of the orthodox 'political' explanation. The growth of a radical Hindu nationalism in the late 1980s coincided

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[34] By contrast Kohli (1990) found no correlation between political breakdown and development.He argued that both modernising Gujarat and backward Bihar experienced chronic problems of governability in the 1980's.

with the increasing integration of India into global consumption and culture. Globalisation prompted an anti-modern fundamentalist reaction by the most threatened groups, a reaction which led to the rise of the BJP, in 1990 to victory in four state elections. By 1991 it had become the largest national party and in 1998 it formed the central government. In the 1995 Assembly elections for Gujarat [35], the BJP captured 122 out of 182 seats but based on 42% of the vote. The concentration of BJP support among the groups constituting the old Intermediate Classes has been noted by many commentators (Hansen, 1998). Among college graduates the BJP secured 73% of the vote, with Congress on 12%. Among the business class 56% and 22% respectively and among upper castes 67% and 20%. Congress retreated into a withering stronghold of Muslims and scheduled castes where the voting patterns were equally striking. The BJP is an alliance of the intermediate classes, threatened by liberalisation with capitalist advocates of it. Hindutva is the ideological response of part of this alliance to “genuine secularism” (Balagopal, 1993, p790), a secularism intensified by liberalisation and marketisation.

Hindutva is anti-democratic, a "veiled attempt to prevent the minimal change that is taking place, to strengthen the upper caste dominance within the traditional ideological framework and to undercut the upward thrust of the hitherto underprivileged" (Aloysius, 1994, p1451). The 1990s have seen an intensified conflict between the forces of neo- Swadeshi (national self reliance), led by certain BJP ideology and the increasing pressures of globalisation and consumerism. An example is the "rise to prominence of mass mediated images as a centralised locus of social and political discourse indexed by the recent establishment of national television" (Rajagopal, 1994, p1659). Swadeshi can be scaled to encompass nation, state, village or even caste and linguistic groups. Globalisation and Swadeshi are mutually contradictory. The globalisation of trade and culture is said to undermine the particularity of place and social relations, subordinating them to a universalising logic. "In place of the old wants, satisfied by the productions of the country, we find new wants, requiring for their satisfaction the products of distant lands and climes. In place of the old local and national seclusion and self-sufficiency, we have intercourse in every direction, universal interdependence of nations" (Marx, 1967, p84).

[35] See Shah (1996)

The rise of the BJP parallels the growth of globalisation, the homogenising influence of middle-class, consumer culture and the strengthening of international influences via imported consumer goods, capital and supra-national attitudes. Swadeshi is consistent with the interests of Intermediate Classes, fragmented into their various constituents. This process was sharpened by liberalisation after 1991 and associated policy changes that undermined their economic power. "This intermediate regime enjoyed its heyday in the 1950s and 1960s, and since then has been gradually but steadily undermined by changing class relations and attendant socio-political conflict"(Bose, 1997, p133). The mass supporters of the BJP are “the small industrialists and businessmen, traders and employees in the lower ranks of the professions and civil service, i.e. the petty bourgeoisie” (Bose, 1997, p118).

Hindutva is an ideological cover behind which the classes of a former Intermediate Regime are challenged by strains imposed by national development and globalisation. A national capitalist economic structure is being consolidated. The composite but numerically significant intermediate classes show signs of mobilisation, this time not so as to benefit from 'shortages' and stagnation (although they still do this whenever they can) but instead in support of the casteist project of Hindutva and the nationalist project of neo-Swadeshi. They are aligned against the forces of globalisation, international capital and unorganised or poorly organised domestic wage labour and ambivalently against national corporate capital [36]. In the Indian economy , space is continually and persistently created and tolerated for this huge fraction of petty commodity producing firms and family-based capital. There are two ‘big pictures’ of the Indian economy. Corporate capital, topping the economic peaks and pinnacles makes the first. Intermediate capital, the extensive foothills which span the vast bulk of Indian territory, population and society, is the second.

"The lower middle class, the small manufacturer, the shopkeeper, the artisan, the peasant, all these fight against the bourgeoisie, to save from extinction their existence as fractions of the

[36] Further discussion is outside the scope of this paper but, see Basile and Harriss-White (1999) for a detailed analysis of the distinctive regulative role of a pervasive corporatist associative order (in which caste plays the ideological role often supplied by the state elsewhere) and of the tensions between this evolving order on the one hand and national corporate capital on the other.

middle class..they are reactionary, for they try to roll back the wheel of history" (Marx,1967, p91).

Let us see.

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