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THE POLITICAL ECONOMY OF THE PREDATORY STATE

by

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## THE POLITICAL ECONOMY OF THE PREDATORY STATE

by

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### Abstract

This paper builds on the insight of Brennan and Buchanan that most states in the past and present are best viewed as predatory, seeking to maximise the profits of government, rather than as is usually assumed as being benevolent, seeking to maximise the welfare of their constituents. Part I explores the positive political economy of a predatory state by examining the macro historical record to answer four broad questions: are there likely to be differences among states in the extent of their predation? If so, what type of predatory state is likely to emerge and over what territorial area under different technical, economic and ecological conditions? When is a self-interested predatory state likely to institute an efficient set of property rights required for a market economy? The first part of the paper provides some speculations on the endogenous determination of the form and extent of predation and the type of economic organisation likely to emerge in a particular area by a simple application of the recent theory of "contestable markets" and industrial structures. The second part attempts an explanation of a particular form of predatory state that has existed in my view for millenia in India, whilst the final part of the paper draws some general conclusions on the feasibility of establishing market economies in areas where the "natural" instincts of the predatory state are inhibiting.

## The Political Economy of the Predatory State

### Introduction

The economic advice usually offered to developing countries is based on an implicit model of a state run by Platonic Guardians. Whatever the merits of this view (in a descriptive sense) of the rulers of many Western democracies--and that is questionable--it is particularly inappropriate if we consider their past or many of the present rulers of the Third World.

By contrast, the emerging 'new political economy' has begun to substitute the notion of a 'predatory' state which maximizes the profits of government for that of a benevolent state seeking to maximize the welfare--however defined--of its constituents. Many policy recommendations of the traditional analysis are overturned. Thus, the so-called Ramsey optimal tax rules for commodity taxation are no longer optimal for the constituents if a revenue maximizing Leviathan is sought to be controlled. Brennan and Buchanan have devised a public finance to control Leviathan through a constitution, in which behind a Rawlsian veil of ignorance the constitution makers decide on the base of taxation leaving the predatory state to decide the rates. The applicability of their model to modern day bureaucracies in western democracies has been questioned by Usher, as "the tyranny of the despot and the tyranny of the majority" are not identical. Behind a veil of ignorance citizens would limit the powers of a king more than that of majoritarian democracies, "if only because they are less likely to emerge as a king than as members of the majority coalition". (p.1022)

We do not know whether a predatory or contractarian origin of the State is historically more valid. 1/ But it is interesting to determine how groups "with a comparative advantage in coercion produced a state which on the one hand devised a set of property rights to maximize the returns to the

rulers and on the other hand, within that framework, developed a body of law and its enforcement aimed at promoting economic efficiency and hence, tax revenue." (North p.64).

Questions of positive political economy then arise: are there differences amongst states in the extent of their predation? If so, what type of predatory state is likely to emerge and over what territorial area in different technical, economic and ecological conditions? As these economic conditions are unlikely to be exogenous, the feasible forms of economic organization will also depend upon the type of property rights a particular predatory state finds it profitable to establish. Many economic historians (Hicks, North, Jones, Baechler, Braudel) emphasize the rise of the market, and its associated property rights as an essential element (historically) for sustained 'modern' economic growth (in Kuznet's terms). Hence, when is a self-interested predatory state likely to institute an efficient set of property rights required for a market economy?

North and associates have argued for the interconnection between the form and extent of predation and the type of economic organization likely to emerge in a particular territorial area. Part I presents some resulting speculations <sup>2/</sup> on the endogenous determination of these two aspects of economic development, by applying the recent theory of "contestable markets" and industrial structure (Baumol, Panzer and Willig). The second part attempts to provide an explanation for the particular form of predatory state that has existed for millenia in the developing country I know best--India. In the final part of the paper I draw some general conclusions on the feasibility of establishing market economies in areas where the 'natural' instincts of the predatory state are innibiting.

I.

1. The State as a Violence cum Justice Producing Natural Monopoly

There is one essential aspect of a State which makes it inherently prone to predation. This is its monopoly of the use of violence within its territory. Moreover this violence using and violence controlling "industry" is a natural monopoly. 3/

But as will come as no surprise in this city, the resulting state can range from the 'protection' provided by the Mafia "against a violence (it) itself threatens, and who actually supply a sort of 'black market' protection in return, suppressing rival gangsters "[Lane, p.403), to the modern day Western democracies which besides maintaining law and order also provide other public goods to their citizens. But even these democracies have evolved from nation states which were similar to the Mafia in their operation. 4/

The services of this natural monopoly were paid for by revenues extracted from the newly protected prey. The natural interest of the monopoly's controllers would be to maximize their net revenue. But this need not lead to the establishment of an efficient set of property rights. As Hicks as well as North emphasize: "efficient property rights may lead to a higher income in the state but lower tax revenues for the ruler because of the transaction costs ( monitoring, metering and collecting such taxes) as compared to those of a more inefficient set of property rights. A ruler therefore frequently found it in his interests to grant a monopoly rather than property rights which would lead to more competitive conditions" (North, p.29).

Most economic historians have noted the link between the rise of the market and mercantile economies. Geography was important for the rise of the first mercantile states and 'market' economies in Greece. In these city states and democracies, the state was under the control of its citizens and enforced the property rights required for the existence of a market economy--the need for protection of property and the need for protection of contracts (Hicks, p.33). When later, military technology made the Greek city state unviable it was Venice, controlled by its merchants, which took up the torch of the mercantile and market economy, which then passed subsequently to the Hansa towns of the North Sea and the Baltic and then to Holland and later to England. In all these cases the system of property rights required to sustain an efficient market system required for growth entailed the curbing of the inherent predatory power of the state by its citizens through various forms of taxation based on representation. By contrast, the 'revenue economies' of absolutist France and Spain did not create such rights. Why?

Relative barriers to entry in the national 'predation' monopoly is the answer usually given. This idea can be sharpened by applying the newly formalized theory of "contestable markets". The state at a minimum is a two good multiproduct natural monopoly, providing 'protection' and 'justice'. These goods are complementary, with substantial increasing returns to scale in their costs of production, and their joint cost function is likely to meet Baumol, Bailey and Willig's (BBW) criteria for a "sustainable equilibrium for a multi-product monopoly". This is defined as "a stationary equilibrium set of product quantities and prices which does not attract rivals into the industry" (p.350). 5/

BBW show that, for a multiproduct natural monopolist the sustainable equilibrium preventing entry involves pricing its services at the Ramsey

prices 6/ associated with the maximum profits allowed by barriers to entry, (see the notes to Fig. I for the heuristic argument), which are "the annual equivalent of the discounted present value of the entry costs or barriers to entry facing new firms in the market". Thus as they conclude "the same invisible hand that guarantees welfare--optimal pricing under perfect competition may guide the farsighted monopolist seeking protection from entry, to the Ramsey welfare optimum" (p.359). 7/

The farsightedness, of the incumbent predator is one of the determinants of the stability of any particular form of predatory state. But what are the relative barriers to entry which determine the stable long run 'rents' that different, farsighted predatory states can extract?

## 2. Barriers to Entry

We need to distinguish between internal and external competitors to the rulers of a State, though of course there are many historical examples of claimants of both sorts combining to overthrow the incumbent natural monopolist.

For potential external predators the geography of the particular region and "amalgamation costs" (Jones, p.106) are relevant in determining the barriers to entry. The early European city states which first established a market system could exist independently because of their geography. 8/ Later, with changes in military technology the feasible territorial size of a state grew. The "core areas" of the new European states were alluvial plains on which plough husbandry could be practiced to yield the tax base for military control. 9/ Though the intervening areas could be and were brought into politics linked to the core-areas as communications and military technology improved, there were a number of natural barriers like the sea which protected England, the Pyrrenes and the Alps and the northern marshes which defined the



'natural' defenses of Spain, France, the Netherlands and Italy. 10/ These raised the entry cost for external predators.

Also paradoxically, modern day countries such as Switzerland and the Netherlands (the old United Provinces) whose inherently poor soils or difficult terrain was an economic disadvantage, also proved to be their political strength as external predators found it too costly (in terms of net returns) to control them.

In addition there were the amalgamation costs faced by external predators. Given ethnic, linguistic, and religious differences between the external predator and the peoples in an incumbent's territory--differences in Europe "dating from early folk movements and settlement history" (Jones, p.106)--the incumbent could count on a form of 'loyalty' which the external predator could not. 11/

What of entry barriers to challenges from internal competitors? This depended upon military technology and the physical size of the 'naturally' defensible territory. Ceteris paribus a physically smaller territory would be easier to take over than a larger one, whilst the changing technology of warfare which made large scale an advantage in the violence industry would tend to favor the incumbent. For instance, the development of the cannon in the mid 15th century removed the security of baronial fortifications in Europe and shifted the balance of advantages to an incumbent centralizing predator who could build larger and more expensive castles. (Bean).

Thus the resource base for extracting revenue and the geographical area 'naturally' defensible with available military technology would determine the 'optimal' territorial size of the state in a particular region as well as the stable sustainable 'natural' rent that could be extracted by the predator. But, what shapes the system of property rights they will tend to enforce?

North and Thomas argue that this will depend upon the relative 'bargaining strengths' of the rulers and constituents. 12/ But this 'bargaining strength' has in effect been subsumed in the 'entry barriers' which determine the sustainable 'natural' rent the incumbent predator can extract.

The lower the entry barriers to internal rivals the more likely it is that the reduction in natural 'rents' represented by the property rights required for an open market will be instituted. However the effects of entry barriers facing external rivals may be more ambiguous. The higher these barriers the smaller the incentive for the incumbent predator to come to terms with his prey, something he might have to do to increase their 'loyalty' and hence the 'amalgamation costs' faced by external competitors if external barriers were lower. But equally to the extent the constituents fear amalgamation by an external predator, they are less likely to press their case against an incumbent predator the lower the entry barrier and vice versa.

The system of efficient property rights based on the relative bargaining strength of the prey is most likely to emerge in regions where geography, and military technology allow the 'natural' territorial size of the state to be such that, barriers to internal and external entry are high enough to prevent endemic political instability associated with internal baronial warfare or external invasions, but not so high as to make the incumbent secure enough to extract the maximum feasible revenue from his prey. It is the uniqueness of Europe, as Jones emphasizes, that it provided the ecological environment for the development of a 'states-system' after the Renaissance, which bucked the historical trend towards organizing large regional populations into empires. In Europe no empire was built after the fall of Rome--their overseas empires came later. Though Europe thereby lost some

economies of scale, the predatory power of the individual states was lowered compared with an imperial monopoly over the region. The environmental characteristic was "the scatter of regions of high arable potential set in a continent of wastes and forests" (Jones, p.105).

A second factor, perhaps of equal importance, is the structure of the economy which determines the feasible set of taxes--their relative structure, if the monopoly is to be sustainable, being determined by the Ramsey Rules a la BW. Here the important distinction (as Hicks notes) is the relative importance of internal versus external trade. As in pre-modern economies, this is likely to depend upon natural resource endowments, particularly the availability of rich arable land relative to the population, we would expect external trade to be more important for the relatively resource poor countries. The Greek city states, the Netherlands and England would successively classify as countries which fall in this category.

The self-interest of the predator in expanding the tax base of an economy dependent on external trade should induce him to set up the property rights for a mercantile economy. 13/ The economic history of Britain and the Netherlands vis a vis France and Spain can (as North & Thomas show) be written in terms of the different systems of property rights that were established after the Renaissance, and there were good ecological and economic reasons why this should have been so.

If the incumbent predator is far sighted he will charge Ramsey prices for the multiproduct natural monopoly he owns, extracting the 'natural' rent equal to the present discounted value of the internal and external entry costs. However, even if these costs do not change over time (which is unlikely) they cannot be ascertained with any exactitude. Their estimates will be probabilistic. Depending upon differences in subjective probabilities

and/or different degrees of risk aversion on the part of the incumbent and his rivals, what may "objectively" seem to be a sustainable equilibrium may or may not turn out to be one. There may thus be sustainable equilibria in practice which involve extracting more or less than the 'natural' rent than entailed by 'objective' entry barriers. There may then be long run 'predatory' cycles <sup>14/</sup> in which the long run sustainable equilibrium is undermined over time by predators beginning to charge more than the Ramsey prices which makes entry profitable. This leads in the medium run (which of course could be more than a century!) to the eventual overthrow of the incumbent and the establishment of a fresh sustainable equilibrium by a new group of predators.

## II.

### I. The Hindu Equilibrium

How do these speculations arising from the economic history of Europe relate to the form of predatory state that was established in India?

I have argued elsewhere (Lal (1981) that on the Indian subcontinent, by the early years of the Christian era a social, administrative and economic system had been established which has remained impervious to fundamental change for millenia. I label this cultural stability and economic stagnation for about 2000 years as the Hindu Equilibrium. <sup>15/</sup> It has provided a predatory state with a fairly high 'natural' rent. In explaining the determinant of this form of predatory state, and the associated property rights system we need to explain both the origins and resilience of the Hindu socio-economic system, as expressed in its twin pillars--the caste system and autarkic village 'communities'. This is the task of the following sections. I concentrate upon the North and particularly the Indo Gangetic plain--the crucible of Hinduism and its social expression in the caste system.

## 1. Some Empirical Hypotheses

There are some crucial empirical assumptions underlying the following speculations, one of which can be thoroughly documented from India's history, but the evidence on the others is still largely speculative.

### a) Political Instability

The political history of the sub-continent particularly of the Indo-Gangetic plain has been largely determined by its geography. The Himalayas to the North have (until recently) provided a natural barrier against external predation from the North. The success of external predation through the Northern passes and more recently by sea has thus depended upon changes in military technology and political anarchy within the sub-continent.

The large rich alluvial and geographically homogenous Indo-Gangetic plain has formed a natural 'core-area' in Jones' terms for an Indian state. But given its size, its domination by a single state, with the available military and transport technologies has been episodic. Nor have there been geographical barriers within the area to provide a 'natural' states system as in Europe. The history of Northern India is one of the rise and fall of Indo-Gangetic empires, which when they were enduring also extended to the South. The resulting endemic political instability and the periodic breakdown of any centrally imposed law and order accompanied by cultural and (more contentiously) economic stability has been remarked upon by historians (see Thapar, p.46).

Since the establishment of numerous feuding Aryan monarchies in the Indo-Gangetic plain, the lodestone of every petty Indian chieftan has been the establishment of a pan North Indian or sub-continental empire based on the exploitation of the large revenue base provided by the relatively productive agrarian system which was gradually established in the region. 16/ This is the first ecological-empirical assumption we make.

b) Stability of Population Size

The second, concerns the size of the population at the time of the evolution of the caste system in the monarchies of the Indo-Gangetic plain. India today, is considered to be a heavily populated country. However, till the early part of the 20th century, the land-man ratio in the country was very favorable.

More surprisingly perhaps, there is some uncertain and tentative evidence (admittedly little better than guess estimates for antiquity) which suggests that the size of the population and thence the land-man ratio in times of peace and political stability (which could be termed the 'equilibrium' level) remained relatively constant from the time of the Mauryas (c320BC) till the late 18th century. <sup>17/</sup> Though there were likely to have been large deviations around this "equilibrium" level over the centuries, due to famine, disease and war.

c) Unchanging levels of living

The final empirical assumption we make concerns levels of living. Some quantitative evidence is available for medieval India (16th century) <sup>18/</sup> It suggests that, there has not been any marked improvement in levels of living between 1595 and 1960, though equally there has probably been no marked worsening. Maddison's guess estimate is that "India's per capita income in 1750 was probably similar to that in 1960, at about \$150 at 1965 U.S. prices". <sup>19/</sup>

We lack even the meagre and speculative estimates of levels of living during Akbar's reign for the earlier periods, but there is some meagre evidence <sup>20/</sup> which suggest that the levels of living were about the same in 320 BC as they were in 1595 AD.

Taking the last three of the empirical assumptions together suggests that by about the 3rd century BC India had evolved an economic system which

maintained living standards (as least at times of political stability) which, though not much above subsistence by modern standards, were comparable to those in India in about 1960. The caste system and the village economy as it had evolved by the 3rd or 4th century BC were, we would hypothesize, an essential ingredient in maintaining this "equilibrium", albeit at a relatively low level, by present, though not necessarily by the standards of contemporaneous countries and civilizations in ancient times.

## 2. The Boserup Theory and the Aryan Economic Problem

The danger of a shortage of labor was the major problem faced by the expanding Aryan settlements in the Indo-Gangetic plain. The Dasas, who were the peoples vanquished by the Aryans in their march across the Indo-Gangetic plains and who were initially used to clear the forest, augmented the supply of labor available to the Aryans for agriculture from their own tribes. This both enabled and impelled them to move from their traditional form of nomadic pastoralism towards a form of settled agriculture. The role of increasing population pressure on land in both inducing and facilitating the adoption of more extensive forms of agriculture has been persuasively argued by Boserup. 21/

Once the Aryans had established monarchies based on the revenue from agricultural settlements in the Indo-Gangetic plain, any drastic decrease in labor supply was likely to threaten their new found way of life, with its high demand for labor. Given the relative abundance of land there must always have been the danger that part of the labor supply on the new settlements might melt into the remaining forests to start their own settlements, or else, and more likely, take to more primitive forms of agriculture. The control and maintenance of an adequate supply of labor is likely, therefore, to have been an important consideration underlying the socio-economic system set up in the Indo-Gangetic plain. The caste system we hypothesize was the result.

### 3. Labor supply, Slavery and Caste

India has never been economically dependent on slavery. Why?

The 'shudra' cultivators in Hindu caste society were the descendants of the earlier Aryan enemies, the Dasas.<sup>22/</sup> In the absence of a centralized administrative system to register and enforce slave "contracts", a necessary condition for slavery to persist is the ease with which slaves can be distinguished from free men by some attribute such as pigmentation or language--the former being more inescapable than the latter. The Dasas were distinct in their appearance from the Aryans, and spoke a different language. Thus it would have been possible for the Aryans to have enforced their enslavement even without the centralized political system they lacked to enforce a more colorblind type of slave system. It is likely, that in the original development of the caste system, the Dasas were enslaved in some form and put beyond the Aryan social pale. However, gradually, though not accorded the twice born status of the Aryans, they were incorporated into the Hindu caste system, as the Shudras who were permitted to cultivate land. Though some slavery continued, it was now more in the nature of debt peonage. It was often contractual, with free men selling themselves and their families into slavery in times of distress. <sup>23/</sup>

Unlike the nomadic pastoralist Aryans, the Dasas were probably acquainted with the technology of settled agriculture, a technology which from the remains of the Harappan civilization (see Allchin & Allchin) appears was known in India before the Aryan invasions. It was this technology or various extensions of it, which was probably the basis of the settled agriculture of the Aryan settlements in the Indo-Gangetic plain. This might explain why the Dasas who might initially have been enslaved (during the period they were used to clear the forests) were later incorporated into Hindu society, albeit with a lowly status. There could be three reasons for this.



First, the cultivation skills which the Dasas needed to pass on to the Aryans to make settled agriculture viable, could presumably only be demonstrated by doing, which of course implies the willingness of the Dasas to demonstrate these skills. Secondly, if the Dasas had practised these skills in the past, they were likely to have had a comparative advantage in the exercise of these skills (at least initially) as compared with the Aryans. Thirdly, as is well known from the experience of various forms of collectivised agriculture, as agricultural technology (even of the subsistence type) cannot be described in terms of any precise set of input-output co-efficients, it is very difficult to monitor the effort of peasants, and to coerce them to perform according to an efficiency norm, as there are no unambiguous indicators of this norm. Thus, it would have been more efficient for the above incentive and informational reasons to have emancipated the Dasa slaves and given them autonomy in decision making and control over agricultural operations.

Various other means of maintaining the rural labor supply in the Indo-Gangetic plains besides slavery, such as polltaxation, 24/ limitations on migration, and various forms of indenture, would also have been infeasible as they all require the power of a centralized state and its attendant bureaucracy for their enforcement. However, given the endemic political instability during this period (our first stylized fact), any such alternative would have been built on sand. With plentiful land, and the waxing and waning of political authority over a particular region there would always have been the danger that directly coerced peasants would have fled the settlements (as they nevertheless did off and on, for instance in later Moghul times) whenever the political authority was weakened from internecine conflict amongst the monarchies.

The caste system provided a more subtle and enduring answer to the Aryan problem of maintaining their rural labor supply. It took account of the need for a decentralized system which did not require any overall (and larger) political community to exist for its survival, and ensured that, any attempt to start new settlements outside the framework of Hindu society would be difficult if not impossible. The division of labor by caste, and its enforcement by local social ostracism was central to the schema. There were two aspects of the caste system which are relevant.

The first is the endogamous specialization of the complementary services required as inputs into the functioning of a viable settlement. Any single oppressed group planning to leave a particular village to set up on its own, would find that, if the group was confined to one caste group, they would lack the necessary complementary skills confined to other castes, to start a new settlement. They would therefore have to recruit members of other castes to join them in fleeing the Aryan settlement. The likelihood of that would be remote, as some of these other complementary castes would have a high ritual and economic status, and would not have an incentive to move to the more uncertain environment of the new settlement.

The castewise division of labor could also be maintained purely through the instrument of social ostracism without a central church, or political coercion.

The ostracism involved in breaking the caste code, either as a consumer or producer (at each level of the caste hierarchy) would entail higher costs than any gains from performing any profitable arbitrage in the labor market (including imparting knowledge of complementary skills) that the casteist segmentation of labor might entail. This can be shown more rigorously, in terms of a model of a caste society developed by Akerlof.

As the casteist segmentation of labor inhibited labor mobility between occupations, but did not completely prevent it, overpopulated castes who would suffer a cut in earnings if all their members crowded the occupation could and did, (both in theory and practice), take up other occupations. 25/ There was thus both occupational and status (social) group mobility within the caste system.

#### 4. Village Autarky

The endemic political instability would also explain the relatively autarkic nature of the Aryan village communities. A viable socio-economic system would have had to overcome the periodic interruption of inter-regional trade and commerce. Even after taking account of the primitive systems of transport and communications in ancient India, which by imposing high transport costs could have made many goods in the regional or sub-regional economies non-tradeables, the uncertainty induced by the continual political instability must have made a further move towards sub-regional or village autarky economically rational. 26/

## II. The 'Hindu' Revenue State

The centripetal tendencies towards an Indian Empire have been counterbalanced by the endemic centrifugal forces flowing from geography, and the associated difficulties of communications in holding the sub-continent together. Though the most prosperous and glorious periods of Indian history have been the periods of stability under dynastic Imperial rule, the difficulty of maintaining the imperial unity of India, has in its long history made such periods relatively infrequent. The great strength of the social and economic system set up by the ancient Hindus, therefore, was its highly decentralized nature which provided specific incentives to warring chieftains

to disturb the ongoing life of the relatively autarkhic village communities as little as possible. This was done in part by making war the trade of professionals and thus saving the mass of the populace from being inducted into the deadly disputes of India's changing rulers. Equally important, however, was the creation of a local administrative and revenue structure, and a tradition of paying a certain customary share of the village output as revenue to the current overlord, which meant that any new political victor had a ready and willing source of tribute in place. It would be a foolhardy monarch who would seek to change these local arrangements which greatly reduced the effort required on his part to finance his armies and court. The village communities in turn bought relative peace and quiet and could carry on their daily business relatively undisturbed beneath the hurly burly of continuing aristocratic conflict over the tax base. This explains both the continuity of the village communities, and the prima facie surprising supineness Indians have shown in quickly buckling under the heel of any new ruler.

### III. The Origins of Indian Revenue Administration

The beginnings of an administrative structure are discernible in the ancient Hindu monarchies from the 6th century BC but the ancient Indian administrative system was only fully developed under the Imperial Mauryas in the third century BC. Its basis, as that of the empire, was land revenue.

Officials were appointed to measure the land under cultivation and to evaluate the crop. Regular assessments were made to increase the revenues from an expanding economy. Each village was under the jurisdiction of a headman who was responsible for collecting taxes, 27/ and these were shipped

to the royal treasury by yet other officials. The government was also responsible for the construction and maintenance of various irrigation facilities and, it seems, a water tax was levied on those using these facilities.

The Mauryas established the first centralized bureaucracy in India. Ashoka's empire was divided into four provinces, under vice-regal royal princes. Each province was subdivided into districts, which, in turn, were divided into groups of villages. The village was the lowest unit of administration. 23/ This is a pattern for administering the Indian Empire which has remained virtually unchanged over the intervening centuries.

#### IV. Cycles in Fiscal Predation

Military technology has obviously been important in determining the degree to which the natural monopoly that has been periodically established in the Indo-Gangetic plain is contestable by internal rivals. Once a new entrant established his dominance, the sustainability on a dynastic basis of the newly established monopoly depended upon his heirs being farsighted enough not to extract more than the natural rent. If they did then there would be an incentive for internal competitors to arise and attempt to provide a competitive supply. The rebellions at the edges of the Empire (where because of costs of transport and communication rival entry would be easier) which have (as they still do) 29/ plagued India's imperial rulers, would then become endemic. The ensuing breakdown of the Empire would be followed by another period of chaos until one or other of the feuding chiefs succeeded in establishing his hegemony but refrained from overcharging for the natural monopoly he had acquired. If the underlying ecological, demographic and

economic conditions did not alter markedly--as they did not (till very recently)--there would be cycles of growth and decay of empires linked to cycles in 'rents' that the predatory state sought to exact, with the 'stable' equilibrium corresponding to the sustainable 'natural' rents extractable under the rules of BBW!

We have little to go on in documenting the changing fiscal exaction of India's predators till about 1000AD. But the simple theory outlined in Part I does seem to fit the case of at least two of the major Indian empires that have risen and fallen since then--the medieval Moghul empire, and the British Raj of the 18th to 20th centuries.

The theory suggests that given the large alluvial "core area" of the Indo-Gangetic plain and the considerable entry barriers facing external rivals, the 'natural' rent that a stable predatory state could extract would be relatively high. Secondly, given the importance of internal relative to external trade, there would be little incentive for the predatory state to create the property rights required to establish a mercantile and thereby a market economy. These predictions are borne out by the relatively detailed account now available of the 'Revenue Economy' (Hicks) established by first the Sultanate and then the Moghuls in the Indo-Gangetic plain (see Ray Chaudhri and Habib).

"There now seems to be a consensus that the Moghul State claimed at least one third to half or more of the agricultural produce in cash" (Bhattacharya, p.1708). Maddison has estimated that "the total revenue (of which land revenue was the major part) of the Moghul State and autonomous princelings and chiefs was probably about 15-18% of national income" (p.22). This can be compared with the estimate of Deane & Cole that in 1688, tax

revenue amounted to 6.3% of national income in England (a country which would have a lower threshold of internal 'entry' costs and hence lower 'natural' rents). This tax burden was increased under Aurangzeb and his successors and contributed to the decline of the Moghuls (in line with the cyclical model of fiscal excess). The internal chaos and breakdown only came to an end with the gradual establishment and extension of British power over the subcontinent.

The British Raj, was relatively benign in its fiscal exactions. Maddison estimates that, by the end of the colonial period "the total tax burden was only 6%" of national income (Maddison p.45). But as a result, the Raj's finances were always precarious. Moreover, unlike its predecessors the Raj could not extract the 'natural' rent that past predatory states had extracted for two important reasons. First, unlike most of India's other invaders, the British, after a brief initial period (which ended with the 1857 mutiny) in which they attempted to become a traditional Indian power, set themselves apart and above their subjects. This meant that, unlike any of India's previous rulers there was a possibility of a nationalist revolt of the populace as a whole against its rulers. This meant that the entry costs for internal rivals had been considerably reduced, and the British found that, the "secret of successful Indian government was low taxation", (Tomlinson (1975) p.338) whilst providing law and order more cheaply than had historically been possible.

On the other hand, the value of India to the Empire was in providing a large reservoir of armed manpower for use in Asia and Africa paid out of Indian revenues (Tomlinson, p. 339). The constitutional history of the British Raj has been recently reworked as a history of various expedients to squeeze more revenues for Imperial purposes (see Seal). Co-opting Indian

collaborators by granting them systems of representation, nomination and election became an essential expedient in squeezing more revenues without incurring the accompanying political and administrative costs. The system of representative government that emerged was however to be used in the post 1947 period by people less moved by the spirit of John Stuart Mill than the ancient Indian political tradition of feuding faction leaders fighting for a share of the regional or national spoils of a potentially Imperial Revenue economy. A new institutional structure (admittedly less bloody than in the past) for ambitious politicians to fight for and wield Imperial authority had been created but the ancient Indian notion that the state is the personal (possibly hereditary) jagir (fief) of those who control its central levers had not been eradicated from the minds of either the rulers or the ruled.

Worse, with the ending of alien rule and the accompanying reduction of the danger of an internal nationalist revolt, the 'natural' rent to be extracted had once again risen to its historical levels. India's rulers did not miss this opportunity, and the economic history of India since Independence can be looked upon as a vast extension of India's historical Revenue Economy that these changed circumstances have permitted. The overt revenues extracted by the State in the late 1970s were running at over 20% of national income, but this does not begin to take account of the rents that various public officials were extracting from the mercantilist system of trade, industrial and price controls that the post Independence predatory state has established in India.

#### V. The Failure to Develop a Market Economy

There has been a thriving merchant class in India since at least the 6th century B.C. which has benefitted from the development of urban centres



from about the same date. However, the flowering of a form of mercantile capitalism has been repeatedly prevented by various constraints on commerce imposed by officialdom as well as the social restrictions of the caste system.

There was a period in ancient Indian history when the development of a mercantile economy in the subcontinent was at least a possibility. It was however decisively (and in our view inevitably) settled by the conflict between Brahminism--which upheld the caste system--and the non-casteist religious sects--Buddhism and Jainism--which had grown in the 6th century BC. 30/ The mercantile classes had prospered with the growth of trade and commerce in the 4th - 6th centuries BC, but their economic power was not matched by political power which was held by the two upper castes. The mercantile castes supported the new non-casteist sects and the outcome of their conflict with the Brahmins can be traced in the relative growth and decline in Buddhism--whose decline in turn was associated with the decline in the political fortunes of the mercantile class. The latter decline was in part caused by the increasing internecine warfare in Northern India after the Gupta period (4th-5th centuries AD) and the beginning of a series of invasions from the northwest which must have disrupted the inland and overseas trade which was the source of the mercantile class' economic power. By the time of the advent of the Crescent in India (c 1000 ACD) Brahminism had triumphed.

Though under the Moghuls and the restoration of law and order for substantial periods over a large part of the subcontinent, the merchants prospered, their economic power was not matched by their political power (Spear, p.47).

Nor did the British succeed in establishing a mercantile economy, even though the late 19th century with its commitment to liberal economic

policies did see the rise of various indigenous industrial groups from the merchant castes. The traditional literary castes--particularly the Brahmins--were the first (given their historical penchant for parasitical government service) to convert to the new Western ways and take the opportunities for legal and clerical jobs the new system offered. They were the first to penetrate the higher reaches of the bureaucratic 'steel frame', the Indian Civil Service. As the major historian of the Indian middle classes notes:

"Since India's tradition of caste authoritarianism fitted in well with the Imperial scheme of things, Indian bureaucrats, who usually belonged to higher castes, were quick to step into the shoes of the British who left India in 1947. Bureaucracy thus continued to retain its hold over business in India and is increasing its hold with the extension of the state's economic function. This may be beneficial to the educated middle classes, since as officers of Government they step in as controllers of nationalized industries without any personal stake in them. But it is no gain to the country as a whole. The system of state control in fact stifles growth of entrepreneurial elements which India has in the past badly needed to speed up production. Traditionally recruited from the literary classes, with no business acumen, civil servants are most unsuited to accelerate production in Indian conditions", (Mishra, p.340).

I hope this is enough to suggest how there have been long run propensities which have shaped a particular form of predatory state in India, which though recently garbed in representative clothes has not changed its nature or essential purpose. In fact the advances in what Hicks terms the 'administrative revolution' of the last 100 years, have led to a huge expansion of the traditional Indian form of a Revenue economy with dire consequences for its economic development.

III.

Precommitment and Efficiency

Can these natural proclivities of large 'natural' rent rich states to establish an inefficient set of property rights be stemmed? There is one important historical case where this has happened--the United States. It has been done by a form of precommitment 31--a constitution--which tied the State, Ulysses like to the mast, so that it was not ensnared by the Sirens of its 'natural' rent seeking proclivities. This was possible because as North notes: "The American colonies were in the extraordinary position of taking over from England not only the body of property rights (and common law) that had been evolving there, but also the deep distrust of a powerful state that emerged from the English Revolution". (North p.187). But as he goes on to show, under populist pressure the controls that the framers of the constitution had instituted to control the State broke down. The reasons were concerns about the distributional justice of an unregulated market and demands for fundamental political and economic structural change to alter the distribution of income (North p.192). The resulting politicization of economic life and its consequences for the attenuation of the market system is another story.

But for my purpose it is important to note the hold of a similar public ideology--Fabian socialism--in modern India. Thus when India got a constitution at Independence it legitimized the continuation of a grossly expanded version of the Revenue economy in the name of "social justice". 32/

Thus precommitment in the form of a constitution is not enough if the ideology of the constitution makers is not conducive to chaining Leviathan. Most inefficient predatory states need to be saved from themselves by some form of precommitment, but in devising and recommending the form of that precommitment we must be clearheaded. The optimal Ramsey tax rules that economists are taught to recommend are also the appropriate ones for Leviathan. As the BBW theory suggests, advising a predatory state to levy these would be redundant if the state was intertemporally rational (farsighted). Given the self-interest predatory states have in their net revenues as well as survival, if the optimal tax experts' advice is not heeded it will usually mean that he/she has not recognized some of the political constraints which determine which set of commodities can be taxed, and over which the tax structure should be Ramsey optimal.

But even though the levying of Ramsey taxes is compatible with a whole host of alternative property rights systems and the associated 'natural' rents extracted by the predatory state, there maybe a secondbest argument from the viewpoint of its constituents for some form of precommitment by the State not to levy the Ramsey optimal taxes in a territory where its natural proclivity is towards the assignment of inefficient property rights. If such a precommitment can be obtained it could lead towards a welfare optimal dynamic adjustment to a more developmentally and market oriented set of property rights. This brings us straight back to Brennan and Buchanan's fiscal constitutionalism--which is where we came in. How we get a reluctant Ulysses to tie him (or her) self to the mast, then becomes the really important question for political economy--on which of course I have (as yet) nothing to say!

#### FOOTNOTES

1. As North notes: "whether the state originated as a predatory group attacking and exploiting a peasant village (a predatory origin of the state) or developed out of the communal needs for organisation of the peasant village (a contract origin of the state) cannot be resolved."

2. These speculations are 'macro-historical' in that they concentrate on very broad general trends rather than the details of history. They are akin to those of McNeill, Jones and Barrington-Moore for instance.

3. "There have been times when violence-using enterprises competed in demanding payments for protection in almost the same territory, for example, during the Thirty Years' war in Germany. But such a situation was even more uneconomic than would be competition in the same territories between rival telephone systems. Competing police forces were even more inefficient than competing fire companies. A monopoly of the use of force within a contiguous territory enabled a protection-producing enterprise to improve its product and reduce its costs." (Lane, p.402).

4. North & Thomas (p.87) note of the emergence of European nation states in the 15th and 16th centuries: "Born in expanding warfare, created by intrigue and treachery, the crowned heads appeared to have more the characteristics of Mafia bosses than the characteristics of kings envisioned a century later by John Locke".

5. These are that (a) the total cost function for the two products produced jointly by the firm have "strictly decreasing ray average cost, that is, if a proportionate increase in all of the firm's outputs produces a less than proportionate increase in its total cost," (p.354) and (ii) the cost function is trans ray convex, which "requires, in essence that complementarities in production outweigh scale effects along the relevant cross section". (p.354). The total cost function therefore looks as in Fig. 1.

6. If the vector of optimal outputs is denoted by  $y^*$ ,  $C(y)$  is the cost of producing the outputs (excluding entry costs) and  $MR_i$  and  $P^i$  the marginal revenue and price respectively of the  $i^{th}$  product. the Ramsey conditions require for the 2 good case

$$\frac{MR_1(y^*) - C_1(y^*)}{MR_2(y^*) - C_2(y^*)} = \frac{P^1(y^*) - C_1(y^*)}{P^2(y^*) - C_2(y^*)}$$

7. It should be noted however that: "Ramsey pricing is sufficient but not necessary for sustainability. Consequently, there may exist sustainable price vectors, perhaps even many of them that do not satisfy the Ramsey conditions" [Baumol, Panzer, Willig, p.2].

8. See Hicks, p. 39.

9. See Jones, p.105-6.

10. Jones, *ibid*.

11. However, as McNeill emphasizes, in the Old World (from about 800BC to 14th century AD), there was a chronic conflict between the nomads of the steppes and settled agriculturalists. The nomadic pastoralists' "rapidity of movement and superior diet, gave them a clear military advantage over more sessile and (often) protein-deficient cultivators" [McNeill (1984) p.2] From the time when pastoral nomads first learned to shoot arrows from horseback till the Mughal and Manchu conquests of India and China in the 16th and 17th centuries, "the political history of civilized Eurasia and Africa consists largely of intermittent conquest by invaders from the grasslands, punctuated by recurrent rebellions of agricultural populations against subjugation to the heirs of such conquerors". (McNeill (1983) p.12).

12. See North and Thomas, p.98.

13. A fact which maybe of importance in explaining the development of the mercantile economies amongst the contemporary South East Asia NICs-- the 'Gang of Four'--Korea, Taiwan, HongKong and Singapore.

14. The growth cycle model of Goodwin which is explicitly based on the biological predator-prey model of Volterra would seem to be applicable.

15. The term Hindu is used in its ancient geographical sense as referring to the inhabitants in the land of the Indus. Various other attempts which are meagre and in my view unsuccessful in explaining the origins of the caste system are reviewed in Lal.

16. "Megasthenes in the 4th century B.C. heard of 113 kingdoms, and the actual number may well have been more. From time to time a strong paramount power has arisen and succeeded for a few years in introducing a certain amount of political unity, but such occasions were rare. When no such power existed, the states, hundreds in number, might be likened to a swarm of powerful, mutually repellant molecules in a state of incessant movement, now flying apart, and again coalescing" (Smith (1981), p.5).

17. See Raychaudri; Raychaudri & Habib; Datta; Durand; Basham; Thapar; Davis; Maddison.

18. See Raychaudri & Habib chp. VII; Bhattacharya, for a review of the evidence.

19. Maddison, p.13.

20. See Lal for a review of this aspect.

21. Also see Clark and Haswell chapter 3. Dairty provides a formalization of the Boserup 'growth model'.

22. Thapar, pp.34, 38.

23. Basham p.153.

24. As in Keyna, to provide a cheap labor supply to the white settler farms. See Collier and Lal.

25. See Basham; Srinivas.

26. Thus in Lal we estimate that with the benefit of hindsight between the 4th century BC and 19th century AD assuming that each generation's time horizon is roughly a century, the probability that there would be political stability and pan North Indian law and order was 0.19. Assuming that the elasticity of marginal utility is 2, and that the trading alternative doubled per capita incomes above the autarkic levels during periods of political stability, the trading alternative would only be superior if at times of trade disruption, incomes did not fall to less than 30-90% of the autarkic levels. For more realistic gains from trade, the levels of income at times of disruption under trade should not fall below 95% of the autarkic levels if the trading alternative were to be expected utility maximizing.

27. Thapar, p.55.

28. *ibid.*, p.34.

29. Consider recent events in Assam and Punjab for instance, and the long-standing separatist movement in Tamil Nadu.

30. Inevitably, because as we have argued above the caste system was not dysfunctional and provided the basis for a viable and relatively prosperous economic and social order. The conflict was also between the republican foothills and the monarchical plains. The latter with their larger tax base were bound to win out in the long run as they did. See Lal for a fuller development of the argument.

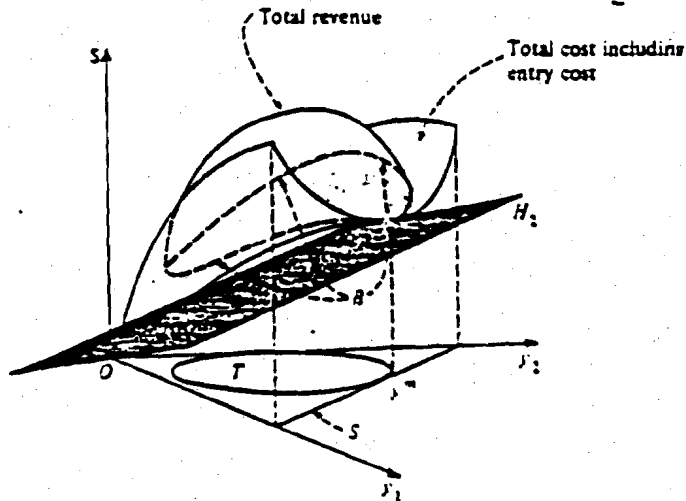
31. The importance of "precommitment" as an essential element in human rationality goes back to the discussion of 'akrasia' by Aristotle, and appears in various modern guises in economics such as the 'isolation paradox'



(Sen), inconsistent time preferences (Strotz), and endogenous changes in tastes (von Weiszacker). Elster provides a splendid discussion and elucidation of this important facet of 'imperfect rationality'. Schelling's is a recent economist's view of the subject.

32. This is argued in Lal.

Figure I.



Source: Bammol, Panzer & Willig, op.cit. p.212.

Fig. 1 shows the total cusped cost surface for the two outputs  $y_1$  and  $y_2$  and a total revenue surface  $B$ . The hyperplane  $H_2$  defines the set of Ramsey optimal prices which are sustainable, as any competitor cannot cover costs if he charges a set of prices with a flatter  $H_2$ .

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