Politics of Economic Growth in India, 1980-2005

Part II: The 1990s and Beyond

India's economic growth has not accelerated dramatically. What aggregate change is noticeable predates the liberalising reforms by a whole decade and industrial growth in the post-reform period did not pick up. Moreover, the problems posed by India's current pro-business model of development include disquieting implications for the quality of India's democracy. Why should the common people in a democracy accept a narrow ruling alliance at the helm? Is ethnic and nationalistic mobilisation a substitute for pro-poor politics? And, is India increasingly stuck with a two track democracy, in which common people are only needed at the time of elections, and then it is best that they all go home, forget politics, and let the "rational" elite quietly run a pro-business show?

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Having analysed the political economy of the growth experience in the 1980s, the second empirical puzzle for the paper emerges by juxtaposing economic performance – especially performance of the manufacturing sector in specific and of industry in general – during the 1980s against that in the 1990s and beyond. A number of scholars have in recent years demonstrated that, though growth in manufacturing in the 1990s was somewhat lower than in the 1980s, the shift in growth trend since 1991-92 was not statistically significant [see e g, Nagaraj 2003, and Table 3 in Part I of this paper]. The stunning fact is then this: in spite of all the noise about reforms – for and against – the growth rate of India's manufacturing industry was not influenced all that greatly by the reforms (Figure 2 in Part I). The real break in growth occurred around 1980. Since then nothing dramatic has changed in terms of the aggregate outcomes. The growth data is further supported by employment data: employment in manufacturing remained constant around 12 per cent of the workforce during the 1980s and the 1990s [Nagaraj 2003, p 3708]. The reforms have thus neither helped nor hurt growth and employment by much.[1] Why?

Once again, observing the more proximate economic determinants of these trends helps set up the puzzle for a deeper political economy analysis. It is clear from Table 2 (Part I) that the overall rates of capital formation in the Indian economy did not alter significantly between the 1980s and the 1990s. What did alter, however, was the composition of this investment (Figure 3 in Part I); public investments declined in the 1990s and the balance was filled by a variety of private investors. As already noted, there might have been a slight decline in the growth rate of productivity of the economy, but not by much (Figure 4 in Part I). So, the second empirical puzzle concerns the impact of reforms on investment – overall stability but changing composition – and on the rate of growth of productivity of labour and capital, where very few gains are evident.

That India in 1991 adopted a fairly significant set of economic policy reforms is well known. A list of reforms undertaken is also readily available elsewhere [Jenkins 1999, pp 16-28; Kumar 2000; Frankel 2005]. The important issues deserving our attention instead are two: why were the reforms undertaken and how have they evolved; and why has the impact of reforms on aggregate economic growth, especially on industrial growth, been negligible. Before tackling these issues, a few interpretive comments on the nature and the scope of the reforms are in order.

The economic reforms undertaken since 1991 have influenced both India's industrial policy and external economic relations. The variety of industrial policy reforms – further delicensing, removal of MRTP constraints, tax concessions, opening of yet newer areas hitherto reserved for the public sector, and taming labour – are best viewed as continuation of reforms well underway during the 1980s. These reforms also ought to be judged mainly as pro-indigenous business, enabling well established businesses to grow and allowing some new ones to emerge and flourish. In light of the discussion above, none of these reforms should be all that surprising. Where there was a significant element of discontinuity, and thus of surprise, was in the area of India's external economic relations, including, the trade, foreign investment and financial relations. As is also well known, starting in 1991, import quotas were removed (fully only in 2001), tariffs came down slowly but surely, currency was devalued, the foreign investment regime was liberalised, and various restrictions on external financial transactions were eased. Some of these reforms helped Indian business; others put enormous competitive pressure on them. In adopting these external economic reforms, the Indian state was responding to a sharply changed world and, in the process, attempting to establish a new social contract with Indian business: we will continue to put our full weight behind you, but you, in turn, must become more competitive.

The scope of India's external economic reforms must be kept in perspective. By India's own past standards, the changes were quite dramatic. In a comparative and global perspective, however, India's opening to the world remains relatively modest. In a useful essay, Baldev Raj Nayar (2001) has documented this "modesty".

On the trade front, for example, tariffs did come down significantly, but the decline began in 1987, during the Rajiv Gandhi years, and towards the end of the millennium, still averaged some 30 per cent, among the highest in the world. India's share of foreign trade at some 25 per cent of the GDP was also among the lowest in the world in the early 21st century (Table 3). The story on foreign investment is not all that different. While the inflows in the 1990s were huge compared to the past – averaging nearly $ 4 billion, including both direct and portfolio investments – on a per capita basis India remained one of the least exposed countries to foreign investment in the world. And finally, it is well known that capital movements in India remain relatively restricted.

Now, let us first briefly visit the issue of politics of reforms. Why did the same set of reforms that proved difficult to pursue during the 1980s become more likely in the early 1990s? A superficial answer would point to the economic "crisis" of 1991. As already indicated above, however, the "crisis" mainly provided an opportunity for policy reform; the real causes were deeper. A number of political analysts have drawn our attention to these deeper causes [Jenkins 1999; Pederson 2000; Nayar 2001; Harriss and Corbridge 2000]. Building on their work, it makes sense to separate the underlying structural variables from the political process, and then to think of the underlying structural changes as both external to India and within India, especially in India's business community. The reforms became more acceptable during the 1990s then because the world in which India operated changed and because Indian capital split politically, with a significant faction at least willing to experiment with a more open economy. Let us elaborate:

Foremost among the significant external changes was the decline and the disintegration of the Soviet Union. This change was profoundly consequential for India. What I have in mind here is not only the diffuse and the oft cited issue of the decline of a model of development. The resulting pressures were instead more concrete and more serious. First, the Soviet Union was an important trading partner (India-Soviet Union trade was close to $ 6 billion towards the end of the 1980s**)** which provided India, in exchange for a variety of goods, oil, armaments and defence materials. Much of this exchange did not involve use of hard currencies. With a sharp decline in exports to Russia, the issue of maintaining and upgrading defence forces became intimately related to the availability of hard foreign exchange. Improving export earnings and maximising other sources of foreign exchange thus became issues of national security. While never publicised as such, these issues must have created a new sense of urgency for "liberalisation". Closely related to this, the disintegration of the Soviet Union also meant the loss of a military and political ally, creating pressures to shore up relations with the US. As most developing country leaders understand, improved political relations with the US, in turn, often involve closer economic relations, especially the opening of an economy to American goods and capital.

A second important global change that developed over the 1980s was the growing availability of investible resources – in foreign exchange, to boot – in the form of portfolio investments. While a Faustian bargain – mainly because of their volatile nature – they might have appeared attractive to foreign exchange starved Indian decision-makers. Even to Indian businessmen, portfolio investment must have appeared less threatening – it is in some ways more akin to selling your shares in public, over which one has some control – than greenfield foreign investment, not to mention acquisitions and mergers.

And, finally, it must have been clear to Indian decision-makers that WTO was going to happen (it actually came into being in 1994), and that India would be a signatory to WTO agreement. Given WTO's requirements, it must also have been clear that import quotas would have to go and that tariffs would have to come down within some time bound period. Mitu Sengupta during her researches thus found a number of decision-makers, including Manmohan Singh and Amar Nath Varma, arguing that these external considerations were important considerations in why India had to liberalise in the early 1990s.[2]

While India's "world" thus indeed change over the 1980s, some very important changes within India also must be taken into account. Most important, the reluctance of Indian business group towards external opening softened, though within limits. During the 1980s, segments of Indian capital became more efficient and business lobbying underwent some significant changes. We have already discussed above the steady gains in productivity of Indian industry throughout the 1980s. One can then suggest that some Indian business groups were probably more ready to deal with foreign competition in the 1990s than in the 1980s. The clearest evidence for this claim is available in the changing patterns of how Indian capital organised itself politically and in the demands it then made on the state during this period.

Stanley Kochanek (1996A; 1996B) has ably documented some of these changes in business organisation and lobbying. Very briefly, during the 1980s, India's two main national chambers of commerce – the Federation of Indian Chambers of Commerce and Industry (FICCI) and the Associated Chambers of Commerce and Industry (Assocham) – reorganised. They increasingly became mirror images of each other (with differing regional base), but they also slowly lost ground to the newly constituted Confederation of Indian Industry (CII) in terms of political influence. The CII increasingly came to represent India's more "modern" industries – especially engineering firms, often located in the south of India – who were more interested in exports. The CII was also run professionally and developed such close ties with Indian bureaucracy that it came to be dubbed as the "junior partner" of the government; so much so that the 1993-94 budget came to be called the "Tarun Das" budget, referring to Tarun Das, the director of CII [Kochanek 1996A, p 167]. Over the next decade, these patterns became nearly institutionalised; for example, Montek Singh Ahluwalia in 2004 was openly discussing the need for "public-private partnership" in industry and inviting the private sector "to be part of the decision-making" (*Indian Express*, December 29, 2004). While not quite "India Incorporated", there is more than a shade of a move towards "Korea or Taiwan Incorporated" in these changes.

Though somewhat of an oversimplification, Indian capital basically split during the 1980s in its political and policy preferences. On the one side were the more "modern", export-oriented businesses, represented by the CII. They favoured a more open, competitive economy. And on the other side were the older business houses that matured during the import substitution regime. They were represented by both FICCI and Assocham; they were also considerably more wary of external opening. As will become clear below, the actual political process surrounding economic liberalisation was more complex than this characterisation might suggest. Nevertheless, with some significant business names and organisations willing to support the opening of the economy, India's pro-liberalisation policy-makers must have felt emboldened. Changing global conditions and splits within the ranks of Indian capital thus provided the new structural conditions within which India's technocratic elite pushed through some significant policy changes in the early 1990s.

Beyond the structural changes, the political process of economic liberalisation was also revealing of the underlying power dynamics. As I analyse this, the basic picture that emerges is one of the political and economic elite attempting to accommodate each other, but within the context of considerable fragmentation of political power; this political dynamics, I will suggest, was economically consequential. To highlight only some of the main events, as the balance of payments situation deteriorated throughout 1990, the issue of India approaching the IMF for a "structural adjustment" type of a loan was again at the forefront; India accepted such a loan in 1990 with a caretaker government in charge. In early 1991 then, just a couple of months before the "big bang" announcement of new liberal economic policies, the CII floated a "theme paper" in April 1991, arguing for radical shifts in India's economic policies towards a more open and competitive economy [Kochanek 1996B: 538]. When the Congress government, with Manmohan Singh as the finance minister, actually announced the policy shift, the main forces supporting such a shift included the narrow political leadership, the technocratic policy elite, a segment of Indian capital, and external actors, expressing their preferences mainly in the form of policy conditionalities set by the IMF.

In spite of India being a fairly mobilised democracy, it was then the case that major economic policy changes arrived in India with a narrow support base. If further evidence was needed to support this claim, notice, for example, that critical reforms in industrial policy in 1991 were made as executive decisions. Anticipating nationalist opposition to global opening, the government used legal technicalities – they included the policy changes in a "statement" rather than in a "resolution" – to avoid any discussion and a vote in the parliament. Similarly, the efforts to reduce fiscal deficits over the next few years encountered opposition. Once gain, as yet another example, the government reduced some fertiliser subsidies and increased petroleum prices (in September 1992) only after Parliament went into recess. Other such examples could be readily multiplied. The simple point, however, is that liberalising reforms were pushed forward by a narrow coalition, and that an element of "stealth" clearly characterised the politics of economic liberalisation [see Jenkins 1999], aimed at circumventing nationalist and popular opposition.

The "big bang" rhetoric of a dramatic policy shift aside, India's economic policies during the 1990s altered only incrementally, responding to objective changes, the evolving views of key policy makers, and to a variety of political pressures. Early reforms included internal deregulation of industry, attempts to tame the deficit, and slow but steady external opening. The industrial policy reform included further delicensing of the private sector, removal of MRTP restrictions, tax concessions to business, and some further efforts to tame India's well entrenched and activist labour. India's private sector rightly interpreted these policy changes as creating "operational freedom it has never enjoyed before" (*Economic Times*, November 9, 1991). The stock market boom that followed was probably not unrelated to what was interpreted as a sharply pro-business policy shift.

In line with the IMF's "structural adjustment" prescriptions, a second important element of early reforms included efforts to cut the budget deficit. Since it was difficult to increase revenues – especially in light of tax concessions to the corporate sector – the burden of these efforts fell on reducing expenditures. After some early success, say, the first three years, these soon ran into numerous problems. For example, cutbacks in subsidies were resisted by such politically consequential groups as farmers and exporters, further cuts in social expenditures were likely to cost popular electoral support, and decline in public investments was being widely associated with the continuing industrial recession. Even big capital started arguing for greater public investments in such areas as infrastructure. Concerned about economic growth then, the Indian government by 1994 chose not to accept further IMF loans, started arguing that further cuts in budget deficits were neither possible nor desirable, and the decline in current expenditures came to a halt; the reduction in budget deficits that was actually achieved unfortunately came at the expense of social spending and public investment [Kumar 2000: 807-8].

The attempt to integrate the Indian economy with the global economy was, of course, the third major component of the reform initiative. As already noted, during the 1990s most import quotas were removed, tariff levels came down, and laws governing the inflow of foreign capital were liberalised. However, the political process of India's global opening turned out to be quite contentious and, in the end, a variety of pressures, especially business lobbying, limited the speed and scope of such an opening. For example, as also discussed above, India's major chamber of commerce, the CII, supported the opening of India's economy in the early 1990s. By contrast, the other two chambers, FICCI and Assocham, argued throughout the 1980s for internal deregulation but for "going slow" on the external front. Within two-three years of the "big bang" opening, as the balance of payment crisis eased, a variety of Indian business houses came together – in a group the Indian press dubbed as the "Bombay Club" – to oppose India's external opening [Kochanek 1996A: 168-70]. They argued that rapid liberalisation will destroy India's indigenous industry, especially capital goods industry; according to them, tariffs should be brought down very slowly, and the inflow of foreign investment should be limited. Citing Korea as their model, they asked for more government help and for a more selective integration with the global economy. Along with FICCI and Assocham members, the prominent spokesmen of the Bombay Club included senior officials of the CII, underlining the point that, as far as external opening is concerned, Indian capital is not as factionalised as the organisational politics of competing chambers might suggest.

The nationalist element in Indian business's protests found a strong echo in the swadeshi politics of India's main opposition party at the time, the BJP. A variety of more diffuse issues – such as intellectual property rights and rapid opening of trade in commodities and services – also fed the nationalist wrath of India's political class. The BJP mobilised these sentiments effectively in the mid-1990s, putting the ruling Congress government on the defensive. The early momentum of reforms thus got bogged down in the nearly normal complexities of India's democratic politics. The results included a steady but relatively slow-paced integration of Indian economy with the global economy, a trend that has pretty well continued into the present period.

Of the major policy reforms initiated in 1991 then, internal deregulation has proceeded the furthest, global opening has been real but slow and modest, and the attempts to trim current public expenditures have not made much headway. Two other reform areas – privatisation of public enterprises and labour reforms – were also discussed at the early stages, and have been periodically rediscussed. Anticipating serious political opposition, however, various governments have mostly left these policy reform areas alone. A pattern thus emerges. Internal deregulation and the modest global opening were changes that were either demanded by Indian business groups, especially big business, or something a significant faction of Indian business could live with. The unwillingness or the inability to privatise public enterprises and/or to tame India's organised labour in turn underline the "soft" or fragmented nature of state power in democratic India. The politics of continuing budget deficits is in part a result of similar democratic pressures, but it also highlights the commitment of Indian policy-makers to economic growth, and the related willingness to use public expenditures to facilitate this outcome. In spite of the much pro- and anti-reform rhetoric about India going neo-liberal, therefore, both the political process and the process of policy reform reflect a much more complex pattern of state intervention in the economy: while some liberalisation is real, Indian state remains activist, willing to support and to work closely with Indian business, but at the same time state actors remain hemmed in by a variety of democratic political pressures.

Now, leaving aside the issue of politics and policies of reform, the second major vexing issue concerns their limited economic impact. In the words of Montek Ahluwalia, the reforms "were expected to generate faster industrial growth and greater penetration of world markets in industrial products, but performance in this respect has been disappointing" [Ahluwalia 2002: 75]. With reform advocates themselves expressing disappointment, the real debate in the literature is about explaining the disappointing performance. The "disappointment" of course has to be kept in perspective: at some six per cent annual growth, India is still among the world's fastest growers; exports have grown steadily; and the balance of payment situation has improved considerably since the reforms. And yet, it is the case that industrial growth in the 1990s and beyond did not improve over the 1980s (Figure 2 in Part I), growth in total factor productivity in the post-reform period was somewhat lower than in the 1980s (Figure 4 in Part I), the modest export growth continued to be surpassed by growing imports, and public investment declined while the share of public debt in the GDP continued to grow. Contending explanations, as one might expect, tend to suggest either that reforms have not gone far enough [e g, Ahluwalia 2002], or that they have already gone too far, too quick [Patnaik 1999; Chaudhuri 2002].[3]

Focusing mainly on the political economy of growth, what is surprising is that, at least at the aggregate level, India's reforms seemed to have neither helped nor hurt economic growth by much. How does one best understand this outcome? As before, one needs to focus both on issues of rates of investment and of productivity, neither of which improved much in the post-reform period.

Some of the post-reform economic indicators are presented in Table 3. Along with the data presented above, they underline the point relatively well known to observers of India, namely, that private investments, including corporate investments, have for the most part remained buoyant in the post-reform period but public investments have declined (see Table 2 and Figure 3 in Part I and Table 3 here). Private corporate investment shot up rapidly after the reforms but peaked in the mid-1990s. Since then the rate of growth of corporate investments has declined but still remained at a level generally higher than in the earlier periods. Capital formation in the household sector by contrast has grown rapidly since the mid-1990s.

One must attribute the continued buoyancy of private sector investments to the variety of pro-business industrial policy changes introduced in the post-1991 period. The fact that the investment boom originated mainly in the "registered sector," especially in the first-half of the 1990s [see Nagaraj 2003: 3711], further suggests two observations: reform policies initially helped big business more than small business; and that big business felt relatively comfortable with the slow pace of external opening of the economy, at least until later in the 1990s, when continued imports and foreign investor produced goods brought forward protests and discouraged further investments. The relatively high rates of private investment are also one of the main forces propelling steady growth of industry (though not at a very high rate) in the post-reform period. The pro-growth and the pro-business drift of the Indian state – that began in the 1980s and continued into the 1990s and beyond – are thus mainly responsible for the respectable performance of the Indian economy.

Several related observations further support the point that the main dynamics underlying sustained growth is not so much liberalisation as it is the state's continuing pro-business orientation. First, contrary to what one might expect from further liberalisation, the labour intensity of Indian industry decreased steadily during the 1990s [Chaudhuri 2002: 160]. Second, the unregistered sector of Indian industry – which one presumes to be more export-oriented and less capital intensive – did not attract much new investment in the post-reform period [Nagaraj 2003: 3711]. Relatedly, there is no clear evidence that exports of labour-intensive goods grew sharply. Fourth, and this is quite important, the level of concentration in private industry has increased since 1991: for example, market capitalisation of the top 10 private companies increased from 2.2 per cent of the GDP in 1990 to 12.9 per cent in 2004 and sales of the top 10 companies during the same period grew from 2.3 to 9.3 per cent of the GDP.[4] And finally, the share of employment generated by the manufacturing sector has remained largely unaltered over the last decade and a half.

Leaving aside the issue of private industry, public investments in India as a proportion of total economic activity declined

Table 3: Some Post-Reform Economic Indicators

Year	GDP Growth (Per Cent)	Industrial Growth (Per Cent)	Capital Formation (Per Cent GDP)		Electricity Generated Growth (Per Cent)	International Trade Per Cent GDP	
			Private Sector	Public Sector		Exports	Imports
1990-1991	5.6	7.0	13.9	9.0	9.6	6.2	9.4
1991-1992	1.3	-1.0	12.9	9.2	4.0	7.3	8.3
1992-1993	5.1	4.3	14.2	8.2	4.8	7.8	10.2
1993-1994	5.9	5.6	13.4	8.0	5.0	8.1	9.6
1994-1995	7.3	10.3	13.2	8.8	6.1	8.1	10.9
1995-1996	7.3	12.3	16.7	7.7	5.8	8.9	12.0
1996-1997	7.8	7.7	15.9	6.9	3.5	8.6	12.3
1997-1998	4.8	3.8	15.3	6.4	3.4	8.5	12.2
1998-1999	6.5	3.8	15.1	6.5	4.6	8.3	11.5
1999-2000	6.1	4.9	15.6	6.2	5.0	8.4	12.4
2000-2001	4.0	7.0	15.9	6.0	4.6	9.9	12.7
2001-2002	4.4	3.7	16.2	5.9	4.0	9.4	11.8
2002-2003	5.8	6.3	16.6	5.6	5.0	10.6	12.7
2003-2004	8.5	6.6	16.8	6.0	6.5	10.8	13.3
Average	5.7	5.9	15.1	7.2	5.1	8.6	11.4

Source: Author's estimates based on, *Economic Survey*, Government of India, various issues, http://indiabudget.nic noticeably during the 1990s (Table 2 and Figure 3 in Part I and Table 3 here). The underlying dynamics are not hard to understand. Given the fragmented nature of state power in India, public authorities find it hard to raise taxes and revenues. A variety of tax concessions to the rich and middle classes have also cut into the revenue pie, as has the decline of import duties. The service and agricultural sectors remain largely untaxed. The pressure on the expenditure side is merciless, especially paying interest on the growing public debt, and defence expenditures. Faced with severe fiscal pressures in 1991, along with a loan and associated conditions of the IMF, the Indian government sought to trim the deficit. While the successive governments have made some headway, they have been unable to control current expenditures. The budget deficit has thus been reduced mainly by cutting public investments, including in infrastructure. Among the various consequences, notice the sluggish growth of such vital inputs to industrial growth as the supply of electricity (see Table 1); the rate of growth of electricity generating capacity in the 1980s was nearly double that of the 1990s [see Nagaraj 2003: 3713]. Can anyone doubt that such state shrinkage is hurting India's economic growth? It is no wonder that various analysts, of a variety of persuasions, seem to agree that public investments in India now need to be stepped up (Ahluwalia 2002; Mohan 2002; Nagaraj 2003; and Chaudhuri 2002).

The continued buoyancy of private investment and the decline of public investment in India constitute key elements of India's economic growth "story" in the 1990s. An additional issue that deserves further attention is that the rate of growth of productivity of the industrial economy in the 1990s did not improve over the 1980s [Kumar 2000: 806-07]. While the international opening of the economy has led to a fair amount of restructuring and consolidation of Indian industry [Basant 2000], as well as to increase in technology imports, somehow none of this is adding up to any sharp improvement in efficiency. Why? The answer of reform advocates seems to be that tariffs are still too high and that the labour regime remains rigid. While this may be the case, it is also possible that one should not expect too much from mere international opening, especially in a large economy, with a relatively small role for international trade and investment. Moreover, the claim that trade opening will enhance economic efficiency may also have the causal sequence backwards, at least for late-late-industrialisers. If east Asian countries like South Korea are to be a model, note that state supported improvements in industrial efficiency came first, and export success only second [Amsden 1989; Kohli 2004].

While the Indian state indeed recommitted itself to private sector led growth around 1980, India is no South Korea or Taiwan. The fact is that the Indian state has neither done enough to help improve the efficiency of the private industrial economy, nor has it done much at all to improve the life-chances of its poor. First, India's dismal infrastructure continues to add to the cost of private industry. Second, while there is much talk of improving the labour situation, not only is the action limited, but even the underlying model of change is mispecified. Once again, if east Asia is to be the model, labour regimes in such rapid growers as South Korea combined job security, training on the job, continuing skill improvements, and strict discipline, involving repression; the "model" is thus neither fully desirable nor likely to be replicated in India. Third, the state has done not nearly enough to help improve the technological efficiency of the Indian economy. Imports of foreign technology have helped somewhat. However, with the declining R&D investment in the private sector, and with the continuing cuts in the role of the public sector, the trend is nearly in the opposite direction. Fourth, the efforts to improve India's human capital have been minimal. And lastly, both the incentives and pressures on the private sector to boost exports have remained insufficient. These series of inactions – some as a result of political incapacities and others due to the lack of imagination – may cumulatively help us understand why productivity growth of India's industrial economy has not improved in the post-reform period.

Politics of Economic Growth in the States

Finally, there is a third puzzle, namely, of considerable variation in growth performance across Indian states in the post-reform period. The basic growth data for Indian states during the 1980s and in the post-reform period (1990-2004) is provided in Table 4. The main thing to note is that the rates of economic growth across Indian states started diverging more in the 1990s than in the 1980s; for example, the coefficient of variation in the 1980s was 0.14 and in the 1990s, 0.29 [see Bhattacharya and Sakthivel 2004, Table 1]. Those who have used alternate measurements, such as gini coefficients, have found a similar pattern of divergence in the 1990s [Shetty 2003, Table 6: 5197], and even those sympathetic to reforms seem to agree [Ahluwalia 2000]. The analytical issue raised by this trend then is, how to make sense of the diverging growth performance. One strand of market logic would expect capital to move to capital-scarce areas where it might command higher returns, leading to some convergence following liberalisation. While a dozen years may be too short a time period to judge, the issue does arise: why are Indian states diverging instead?

Of the 16 major states listed in Table 2, notice that, when compared to the 1980s, economic growth rate in the post-reform period altered significantly in only half the states (i e, increased or decreased by one percentage point or more). Economic growth increased notably in Gujarat, Kerala and West Bengal; by contrast, following reforms, economic growth declined by more than

Table 4: Economic Growth in Major Indian States, 1980-2004

States	1980-1990	1990-2004	1980-2004
Andhra Pradesh	4.81	5.33	5.1
Assam	3.91	3.00	3.4
Bihar	5.20	4.2	4.6
Gujarat	5.71	8.11	7.1
Haryana	6.68	6.63	6.65
Himachal Pradesh	6.10	6.44	6.3
Karnataka	6.10	6.38	6.3
Kerala	4.50	5.69	5.2
Madhya Pradesh	5.18	4.74	4.9
Maharashtra	5.98	5.92	5.95
Orissa	5.85	3.94	4.7
Punjab	5.14	4.14	4.6
Rajasthan	7.17	5.68	6.3
Tamil Nadu	6.35	5.70	5.97
Uttar Pradesh	5.88	3.76	4.64
West Bengal	5.20	7.12	6.32
All-India	5.60	5.90	5.8

Source: Rajya Sabha Unstarred Question No 1285, dated March 14, 2002 and Lok Sabha Unstarred Question No 3170, dated March 22, 2002 and Central Statistical Organisation (www.indiastat.com). The figures for Bihar, Madhya Pradesh and Uttar Pradesh are not strictly comparable across years because, following 1994-1995, they do not include the regions that have come to constitute the states of Jharkhand, Chhattisgarh and Uttaranchal respectively.

a point in Bihar, Orissa, UP, Punjab and Rajasthan. Those working with more specific state-level data on manufacturing in the registered sector have established that the decline in growth in select states was more statistically robust than the growth pick-up [Nagaraj 2002, Table 3]. Somewhat broader data on growth rates in the secondary sector as a whole, however, are broadly consistent with the overall growth trends in Table 4, at least in terms of the eight states in which growth rates increased or decreased by a percentage point or more.[5] Given the problems of data quality and availability at the state level, I will focus my comments below on the divergence in the overall economic growth rates across states; moreover, given that only a small number of states are being analysed, where statistical findings are not likely to be robust, the discussion should be treated as rough and ready.

Within these constraints, how does one best explain that economic growth picked up significantly in the post-reform period in Gujarat, Kerala, and West Bengal and declined as significantly in Bihar, UP, Orissa, Punjab and Rajasthan? Figures 1 (A, B, C, D and E) provide some preliminary insights. First, let us set aside some plausible explanations. One might be tempted to hold that liberalisation enabled less well-off states to attract capital due to higher marginal productivity of capital and thus to grow more rapidly; this is not true (see Figure 1A). One might also be tempted to hold that growth patterns exhibit continuity, that states that grew rapidly in the 1980s also continued to grow rapidly in the post-reform period; again, this is not true (see Figure 1D). And finally, though the data on this is not presented here, there is little association between rates of literacy and the rate of growth across Indian states [Ahluwalia 2000: 1664].

What then is the most likely explanation for growth acceleration in some states and deceleration in others? Let us assume as before that growth rates reflect both shifts in levels of investment and in productivity. Unfortunately, unlike the national level, investment and productivity data for individual states are not readily available. On the issue of investment patterns, what we do know instead is that, following reforms, public investments declined across India and that this was also the case for most Indian states [Ahluwalia 2000, Table 8: 1642]. One may propose then that this decline hurt growth prospects of those states most who are unable to readily attract new private investment. By contrast, the states that have done better are probably those that have attracted new private investment, both domestic and foreign. While direct data to support this claim are not available, the numbers of "private projects under implementation" collected by the Centre for Monitoring the Indian Economy is broadly supportive, especially at the two extremes. One central component of the larger puzzle of varying growth rates across states is then this: why are some states better able to attract new private investment than others?

Data in Figure 1A again provides some clues. The states in which growth decelerated by more than a point – presumably because they failed to attract new private investment – are mostly India's poor states (Figure 1A): Bihar, UP, Orissa and Rajasthan. The only exception – Punjab – is really not an exception because growth deceleration in that state was more a function of decline in the agricultural growth rate and quite probably unrelated to the issue of policy reforms; industrial growth in Punjab in both the 1980s and in the post-reform period remained in the six per cent range. Whether a direct function of their poverty or not, the poor states then may fail to attract new private investment because of poor infrastructure (Figure 1E) or more broadly, an unfavourable investment climate (Figure 1B). Moreover, India's two other major and very poor states – Assam and Madhya Pradesh – also fit this pattern, though economic growth in them declined by less than one percentage point (Table 4). So, one pattern seems fairly clear: following policy reforms in 1991, India's poor states have not done very well. Growth deceleration in them probably reflects a decline in public investments and a concomitant failure of private investment to fill the gap. Instead of seeking a higher rate of return in capital-scarce areas – a trend that may still unfold over the longer term – private capital in India for now seems to be shirking India's poor states with poor infrastructure and unfavourable investment climate. That public action will be needed to reverse this trend ought to be clear.

The issue of why post-reform economic growth accelerated in yet other states is more muddled. As already noted, the three states where growth accelerated by more than one percentage point are Gujarat, West Bengal and Kerala; economic growth in the secondary sector in these three states also followed this trend [see Bhattacharya and Sakhtivel 2004, Table 6]. The underlying determinants, however, are not obvious. While Gujarat is clearly one of India's richest states, both West Bengal and Kerala are closer to the national average in terms of per capita income; investment climate in both Kerala and West Bengal is also considered to be not all that favourable (Figure 1B). The pattern of post-reform industrial growth in India's other rich states during the 1990s also ought to be noted: it picked up significantly in Tamil Nadu, somewhat in Maharashtra, stayed about the same in Karnataka and Punjab, and declined significantly in Haryana [Bhattacharya and Sakthivel 2004, Table 6]. What conclusions, if any, might one draw about the underlying determinants?

Figure 1A: Economic Growth in Rich and Poor States

		Post-reform Growth Rate (1990-2004)	
		Accelerated	Decelerated
State Per Capita Income	High	Gujarat, West Bengal	Punjab
	Low	Kerala	Rajasthan, Bihar, Orissa, UP

Notes: 1 Growth acceleration and deceleration in all the five figures (1A, 1B, 1C, 1D and 1E) is judged by a movement of at least one percentage point over the 1980s.

2 High and low state per capita incomes (or rich and poor) are simply defined as above and below the national income average in 1991.

Figure 1B: Economic Growth in States with Varying Investment Climate

		Post-reform Growth Rate (1990-2004)	
		Accelerated	Decelerated
Investment Climate	Favourable	Gujarat	Punjab
	Not favourable	West Bengal, Kerala	Rajasthan, Bihar, Orissa, UP

Notes: 1 The data of investment climate is from *India Today*, August 16, 2004, p 21. The factors they included were per cent of state GDP spent on administration, capital expenditure, per capita bank credit, industrial disputes, per cent of sick public enterprises, gross capital formation, and industrial workers in 15-59 population. There are clearly some problems of endogeniety here. The resulting categorisation should thus be treated only as rough and ready. A more systematic analysis of investment climate in a subset of these states is broadly consistent with this categorisation. See, World Bank, *Improving the Investment Climate in India,* Washington DC, 2001, Table 3.1, p 47.

Except for Haryana, one pattern that does seem to stand out is that post-reform industrial growth in India's better-off states either accelerated (Gujarat and Tamil Nadu) or stayed about the same as in the 1980s (Maharashtra, Karnataka and Punjab). These states are generally blessed with good infrastructure and more desirable investment climates (see *India Today*, August 16, 2004, pp 20-21). When juxtaposed against India's poorest states – where economic growth declined across the board in the post-reform period – an important conclusion emerges: private investors in India continue to favour India's better-off states over the poorer states. In common sense terms this is not all that surprising. What it does underline, however, is that the pattern of economic reforms in India is not following the free market logic of capital moving to capital scarce areas. The logic evident instead is more akin to a Mathew effect, namely, to him who hath shall be given.

If "initial conditions" of Indian states are clearly important for attracting investment and for growing, two important qualifications ought to be added. First, varying initial conditions are themselves a product of past patterns of development, especially the role of varying state governments and of state politics. Thus, such important factors as quality of roads, availability of electricity, levels of education, labour discipline, and law and order conditions – all factors that private investors take into account when deciding in which state to invest – are traceable back to the past developmental activities of state governments. And second, variation in initial conditions does not explain everything; the quality of state governments also matters. For example, why has Gujarat experienced more rapid industrial growth in the post-reform period than other similar better-off states? And why do economic prospects of some such poorer states as Bihar seem a lot worse than of some other poorer states, say, Madhya Pradesh? I will return to some such issues momentarily. For now, why have such middle income states as West Bengal and Kerala experienced rapid growth in the post-reform period? This is especially puzzling in light of the fact that these are India's "radical" states that are presumably not too attractive to private investors. More detailed state-level research is clearly needed.[6] One tantalising clue to the economic performance of these radical states is provided in Figure 1C. Labour militancy declined in both these states during the 1990s: for example, labour disputes in West Bengal declined from some 9.6 million in 1981 to 3.8 million in 1995, and in Kerala from 2.2 million in 1981 to 1.7 million in 1995. Is it possible that, desiring growth, communist parties in power have demobilised their organised supporters? If so, significant improvement in industrial production might reflect improved productivity via enhanced capacity utilisation, as well as by attracting some new investment.

Leaving aside the issue of cross-state variations, let us now briefly contrast the specific states of Bihar and Gujarat to get a sense of how differences in initial conditions are combining with governmental initiatives to create the Mathew effect. Bihar is well known for its poor infrastructure, poor quality workforce, and poor governance [see Kohli 1991; World Bank 2005]. In spite of these obstacles, Bihar's economy during the 1980s grew at a respectable rate of some five per cent per annum. Following the reforms, however, the average growth rate fell by a whole point (Table 4). A pronounced deceleration in agricultural growth rate was part of this decline. However, the deceleration of growth in the secondary sector as a whole was also quite significant [Bhattacharya and Sakthivel 2004, Table 6], and that in registered manufacturing during the 1990s was quite dramatic [Nagaraj

Figure 1C: Economic Growth and Labour Unrest in the States

		Post-reform Growth Rate (1990-2004)	
		Accelerated	Decelerated
Labour Unrest	Decreased	West Bengal, Kerala	UP, Orissa, Rajasthan
	Unchanged or Increased	Gujarat	Bihar, Punjab

Note: The figures on labour unrest are "mandays lost" and were taken from various issues of the *Statistical Abstracts of India*. The decrease or increase in labour unrest is estimated by the changing picture in the 1990s when compared to the 1980s.

Figure 1D: Economic Growth in the 1980s and in the Post-reform Period

		Post-reform Growth Rate (1990-2004)	
		Accelerated	Decelerated
Growth Rate in the 1980s	High	Gujarat	Orissa, Rajasthan, UP
	Low	West Bengal, Kerala	Punjab, Bihar

Note: Growth rates in the 1980s are categorised as high or low simply as above or below the national average.

Figure 1E: Economic Growth in States with Varying Infrastructure

		Post-reform Growth Rate (1990-2004)	
		Accelerated	Decelerated
Quality of Infrastructure	Good	Gujarat, Kerala	Punjab
	Poor	West Bengal	Rajasthan, Bihar, UP, Orissa

Note: The data for the quality of infrastructure is from *India Today*, August 16, 2004, p 20. The factors they included were standardised measures of availability of electricity, paved roads, bank branches, post offices and telephones. The top 10 "big states" have been categorised as having "good" infrastructure and the bottom 10 as having "poor" infrastructure.

2002, Table 3]. While the reasons behind the deceleration are many [see World Bank 2005], the decline in both public and private investments is noticeable. A variety of fiscal pressures, including the need to "service" a populist polity, led to significant decline in public investment, from an annual average of some 15-20 per cent of total public spending in the 1980s to some 5-10 per cent in the post-reform period [World Bank 2003, Ch 3].

While data on private investment in Bihar is not available, the data on new state level private projects collected by the CMIE indicates that Bihar in recent years was attracting the fewest projects among all of India's major states. A variety of Bihar's initial conditions, including the investment climate, are clearly part of this "story." However, it is also the case that repeated governments in Bihar have simply not been developmental. Consumed by the need to broaden and maintain their electoral power, the priorities of Bihar's political leadership are anything but growth promotion. In the words of the World Bank, yes, the World Bank:

> Bihar has not been proactive in courting private investment or articulating a development strategy and "vision." Thus, the government does not have an investment council, conveying a lack of concern about fostering and protecting private investment [World Bank 2005: p 32].

This absence of state activism for development is costing Bihar dearly.

By contrast, "liberalisation" has proved to be a boon to a state like Gujarat. The average annual rate of economic growth in the post-reform period in Gujarat accelerated by more than two per cent over the 1980s (Table 4), with the growth in the secondary sector jumping by nearly three percentage points, up into the double digits. The underlying dynamics are again not hard to understand. The initial advantages were significant: good infrastructure; productive labour force; and a prolonged record of pro-business government. If Bihar was at the lowest end of attracting new private investment, Gujarat was at the other extreme. As part of an explanation, Aseema Sinha (2004) has very nicely documented, how in the 1990s Gujarat became even more of an activist, pro-business state:

> The government (of Gujarat) continued to invest in projects and sectors where it expected private investment to need further encouragement. To accelerate development of the electronics industry for instance, the state government announced a special incentive package, which included investment subsidy and sales, tax benefit, and five additional electronics industrial estates were planned. In 1995-2000 many new state agencies were created, such as the Gujarat Infrastructure Development Board and the Gujarat Power Corporation. These signified an enhancement of the state rather than its withdrawal (p 88).

This activist industrial policy is a lot more east Asia than neoliberalism at work.

To sum up, the reforms of 1991 have opened up new opportunities for some Indian states and left others at a disadvantage. While initial economic advantages and disadvantages were important, so has been the contrasting behaviour of state level governments. Here too, of course, institutional inheritance matters. Nevertheless, the interstate dynamics of differential growth rates seem to be propelled by similar forces as were evident at the national level: regional states that have effectively created a pro-business alliance for growth seem to be experiencing the most rapid economic growth.

Conclusion

In this essay I have argued that the recent acceleration of economic growth in India was more a function of the pro-business tilt of the Indian state and less a result of the post-1991 economic liberalisation. In order to support this argument, I have offered three types of evidence: first, growth acceleration around 1980 coincided with the striking but the less noticed shift in the state's economic role initiated by Indira Gandhi; second, the aggregate economic performance since liberalisation, especially industrial growth, has not improved over the 1980s; and finally, the interstate variation in economic growth in the 1990s also seems to follow the same pattern, with pro-business state governments succeeding handsomely in attracting private investment and thus growing rapidly.

With the argument now in place, what remains is mainly to tease out some concluding implications. Readers may wonder what the stakes are in distinguishing pro-business and pro-market policies? The answer is in part scholarly, that is, getting causal connections right, and in part normative, that is, are the ongoing changes fair and just? We are now living in a world in which democracy and capitalism have emerged as the most desirable modes for organising national political economies. The real debate about national choices is thus increasingly about "varieties of capitalism". With advanced industrial economies providing mainly three alternatives – the neo-liberal model of Anglo-America, the social democratic model of Scandinavia, and the statist model of Japan and South Korea – the debate for developing countries increasingly is, which model is best to emulate. My personal preferences are social democratic, but for now that is not too relevant. The neo-liberal model has in the recent years been hegemonic, or near hegemonic. With numerous countries adopting – or apparently adopting – neo-liberal policies, a pressing scholarly issue is: how successful have these policies been?

The discussion about India is part and parcel of this broader global debate. Champions of neo-liberalism generally want to embrace all successful cases – such as recent India – as examples of the virtues of their prescriptions, while distancing themselves from failures, often arguing that their prescriptions were not really implemented, or urging us to imagine how much worse things might be had their prescriptions not been implemented. Against these arguments – which are often put forward and supported by enormously powerful institutions around the world – some lone scholars chip away at this hegemony, arguing instead that growth successes in the developing world resemble more the statist model of Japan or South Korea, where activist states have allied closely with business groups to push national economies on an upward trajectory. Since a narrow alliance of political and economic elite is not easy to institutionalise, east Asian models have also often had unsavoury politics. Against the neo-liberal model that holds that all good things can go together, the east Asian model puts into sharp relief the tradeoffs that modern development efforts might involve.

If India's recent economic growth was really a result of pro-market policies, then, in principle, there ought to be very few costs, only widespread benefits: after all, decentralised markets support democracy; competition creates a level-playing field; efficient use of factors of production ought to create labour-intensive industrialisation and thus rapid employment growth; terms of trade ought to shift towards the countryside, benefiting the rural poor; and since capital moves to capital-scarce areas in search of high returns, regional inequalities ought to diminish over time, mitigating inequalities. Unfortunately, many of the trends noted above do not fit these expectations. India's growth acceleration is instead being accompanied by growing inequalities, growing capital intensity of the economy, growing concentration of ownership of private industry, and nearly stagnant growth in employment in manufacturing industries. This evidence is more consistent with the view that the development model pursued in India since about 1980 is a pro-business model that rests on a fairly narrow ruling alliance of the political and the economic elite.

Rapid economic growth is essential for poor India. It is also the case that India's development strategy from the Nehru period was much in need of change. However, none of this implies, or ought not to imply, that any new growth strategy that produces these outcomes is beyond critical scrutiny. India's success at growth acceleration is to be admired. However, the current growth experiment has to be kept in proper perspective. India's economic growth has not accelerated dramatically. What aggregate change is noticeable predates the liberalising reforms by a whole decade and industrial growth in the post-reform period did not pick up. Moreover, the problems posed by India's current pro-business model of development include disquieting implications for the quality of India's democracy. I raise them at the end only as questions. Why should the common people in a democracy accept a narrow ruling alliance at the helm? Is ethnic and nationalistic mobilisation a substitute for pro-poor politics? And, is India increasingly stuck with a two-track democracy, in which common people are only needed at the time of elections, and then it is best that they all go home, forget politics, and let the "rational" elite quietly run a pro-business show? EPW

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Notes

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1 There is an interesting parallel here with the situation in Latin America. An important study of Latin American reforms by ECLA thus concluded: "The reform results were neither as positive as supporters predicted nor as negative as opponents feared. Indeed, the reforms per se seem to have had a surprisingly small impact at the aggregate level (including on growth, investment and inequality)" [Stallings and Peres 2000, p 384].
2 Sengupta provided this information to me in a personal communication, for which I am much obliged. Also see Sengupta (2004).
3 Advocates and critics alike do not always clarify why they think what they think. Ahluwalia, for example, seems to suggest that further lowering of tariff barriers, further opening of the economy to direct foreign investment, and enhancing labour "flexibility," are the next steps necessary to improve India's economic performance. Why he believes that these policies will do the trick is never made explicit; it is as if all "sensible" people must of course agree. An occasional reference is made to east Asia, with a suggestion that this is how east Asia did it. While my analysis too is influenced by east Asian successes, East Asia is a diverse place, and the fastest growing states within that region, such as South Korea or Taiwan, were hardly during their peak performing periods models of open economies with "flexible" labour regimes [see Amsden 1989; Wade 1990; Kohli 2004]. Critics of reform, by contrast, seem to hark back to some imagined golden period of Nehru and Mahalanobis. Not only is the desirability of the return to that old import substitution model of development highly debatable, it is also not likely that such a return is a realistic option in the contemporary "globalised" world.
4 These are my own calculations. Company data was taken from *Businessworld*, August 22-September 6, 1998 and December 27, 2004, the sales data for 2004 were collected from www.valuenotes.com. For one study that documents that further consolidation has been the main corporate response (along with growing use of foreign technology) to economic reforms, see Basant 2000.
5 See Bhattacharya and Sakthivel 2004, Table 6. One exception is Punjab, where the decline in overall growth rate seems to be driven more by decline in the agriculture growth rate rather than by a decline in the rate of growth in the secondary sector, which seems to have remained in the 6 per cent range during both the 1980s and the 1990s. The secondary sector data for the 1990s also indicates considerable growth pick-up in Tamil Nadu and Madhya Pradesh and a considerable decline in Haryana.
6 For one such study, see Sinha (2005).

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