# 1 Introduction: Growth-Oriented Policies and Poor Electorates

In 2006, the Tata group, one of India's largest conglomerates and arguably its most respected one, announced that it would produce the world's cheapest car – the Nano. Priced at US$2,500, the Nano was expected to bring car ownership within the reach of a class of consumers who would have otherwise never had access to it. Widely celebrated in the media, the car was hailed as an "icon of Indian ingenuity and entrepreneurialism" and touted as a prime example of *jugaad*, the type of frugal innovation at which India seems to excel ("A New Home for the Nano" 2008: 85; "Asian Innovation" 2012: 68). For some, the Nano was much more than a car. India had arrived on the world stage after languishing for decades in economic obscurity, and the Nano symbolized this very ascent.

When it came to selecting the production location for this high-profile project, the Tata group chose the Communist-run state of West Bengal. The Left Front had continuously held power in West Bengal since 1977, and the state had witnessed steady deindustrialization in that time. Since the mid-1990s, the Communists had attempted to change gears and refashion the state as a business-friendly destination, along the lines of their Chinese counterparts. Landing India's most fêted private sector project at the time was nothing short of a major coup for West Bengal.

But the project soon ran into trouble. To attract the investment of the Tatas, West Bengal offered a generous package that included 997 acres of highly subsidized farmland as well as other substantial, but undisclosed, concessions. However, land acquisition by the government for the Nano plant proved extremely contentious. Two years of sustained, often violent, protests from local farmers, activists, and the main opposition party brought the project to a standstill. In 2008, the Tata group announced that it would move out of West Bengal.

Immediately, several other Indian states went into overdrive, offering competing packages of concessions and incentives, hoping to bring the Nano plant to their jurisdictions. In the end, the western state of Gujarat beat out rival offers. Celebrated in business circles for its investor-friendly orientation, the state was nevertheless extremely controversial for its majoritarian politics under the Hindu-nationalist Bharatiya Janata Party (BJP), which was at the helm of affairs since the early 1990s. Like West Bengal, Gujarat offered the Tatas a generous package of incentives. Key benefits were said to include 1,100 acres of subsidized government land; a soft loan of Rs. 95,700 million at an interest rate of 0.1 percent, payable after 20 years; free water, and exemptions from electricity duty, registration, and transfer of land charges ("Sop Opera on Nano Begins in Gujarat" 2008; "Nano Gets New Home, Gujarat Signs MoU with Tata" 2008).[1]

Concessions aside, it was Gujarat's proactive approach that ultimately won over the Tatas. Commenting on the decision to relocate to Gujarat, a senior management official of Tata Motors, who was directly involved in negotiations with state governments, offered the following explanation:

> When we announced the decision to move out [of West Bengal], we started having meetings with chief ministers of Maharashtra, Andhra Pradesh, and Karnataka. We had offers from these states. We then had a meeting with the Gujarat chief minister, Narendra Modi, and he was very keen ... *The three factors that influenced our decision in the end were location, commercial terms and political execution. It was in this third aspect that Gujarat stood out, way ahead of others in this respect ... Many would suggest this was an exception for Nano but, even if it is 75 percent of the treatment that we got, it is far superior to other states.*[2]

In many ways, the Nano vignette highlights a fundamental dialectic in the politics of growth in poor democracies, which lies at the heart of this book. In an era characterized by market-based models of development and competition for investment, governments need to attract private capital to spur growth. To do so, they have to undertake business-friendly measures. But governments in developing countries simultaneously have to balance the imperatives to attract capital with demands of a broader, largely poor electorate. And they have to achieve that balance in the midst of resource constraints. Often, as the contestation surrounding the Nano project in West Bengal showed, these pressures are at odds. How governments mediate between these two sets of demands and what policies they undertake depends on their political ability, capacity, and willingness. In the end, it was Gujarat's superior "political execution" that made a critical difference to the Tatas.

That political factors influence economic decisions and policies is not surprising at all. Indeed, it is patently obvious in a deeply political society

[1] The Gujarat government chose not to make full details of the package offered to the Tata group public, but press reports have offered some information on the nature of benefits received.

[2] Italics mine. Interview with a senior management official of Tata Motors, Mumbai, June 3, 2010.

such as India, where high levels of contestation inform every aspect of democracy. Yet, the specific political and social factors that affect economic policy making in poor democracies and the mechanisms through which they work are still poorly understood in the scholarly literature. At a basic level, this book endeavors to identify and trace these mechanisms in the context of India's economic transformation since 1991.

The analysis is motivated by a large yet highly consequential question: What are the political conditions favorable to growth-oriented policies in poor democracies? Conventional wisdom in the political science literature, outlined in the next chapter, suggests that poor democracies are unlikely to focus on growth-oriented policies.[3] Yet, as a largely poor and highly competitive democracy that has seen an extensive growth transformation over the past two and a half decades, India challenges this hypothesis. Nevertheless, *within* India, there is considerable variation in the formulation and implementation of growth-oriented policies across states. These differences offer a well-defined empirical puzzle that allows me to gain traction on the broader issue of political conditions conducive to growth-oriented policies in the midst of poor electorates. Specifically, I examine policy variation in the competition for private industrial investment across states.[4] Investment is one of the primary factors that drive growth at a proximate level, as the next section describes in greater detail, and I therefore treat policies related to investment as a proxy for growth-oriented measures.

As the Tata Nano story highlights, states in India are engaged in open competition for private industrial investment, a phenomenon that came to the fore after the country adopted extensive market reforms in 1991. Even though they experienced a common shock in the form of the 1991 reforms, Indian states have reacted very differently to the competition for investment.[5] Some states have been far more proactive and business-friendly than others in the competition for investment; both the speed and scope of policies designed to attract investment have varied across

[3] As explained in detail in the next chapter, micro- and macro-level hypotheses from the literature on redistribution, democratization, and public goods suggest that poor democracies are unlikely to prioritize growth-oriented policies, particularly those targeted at business (e.g., Acemoglu and Robinson 2005; Alesina and Angeletos 2005; Alesina and La Ferrara 2005a; Boix 2003; Iversen and Soskice 2001; Meltzer and Richard 1981; Romer 1975).

[4] The term "investment" throughout this book refers to private industrial investment – domestic and foreign direct investment by the corporate sector. It does not include portfolio investment or agricultural investment, except for investment in agro-based or agro-processing industries.

[5] States form the tier of Indian federalism directly below the central government. The terms "state," "subnational," and "regional" are used interchangeably in this book to refer to this level of government.

states. Despite being accountable to largely poor electorates and despite being subject to similar legal, electoral, and fiscal rules, why have states varied in their policies? This is the specific question I address in this book.[6]

Through the analysis of subnational policies in the competition for investment in India, this book offers a novel explanation that links social identity, class, and economic-policy outcomes through the avenue of electoral competition. Two main claims are advanced. First, at a proximate level, I argue that the social base of voters backing governments, which I refer to as electoral coalitions, critically affects policy responses.[7] Who votes for particular governments matters strongly for policy outcomes. I find that certain configurations of electoral coalitions with a narrow class base are more favorable than others to growth-oriented policies. Specifically, *narrow-capitalist coalitions*, characterized by the joint presence of core groups with similar, relatively wealthy profiles and substantial representation of business interests, are most conducive to a growth-friendly policy agenda. These coalitions represent a congruence of political and economic power, and I find that this overlap is most conducive to the formulation and implementation of a growth-oriented policy framework.

Such narrow, growth-friendly class coalitions, however, cannot readily win electoral power in largely poor polities. How then do they emerge in the first place? The second claim of this book is that narrow coalitions can arise in the presence of poor electorates when the primary logic of electoral politics is non-economic and rests instead on symbolic factors. In several poor democracies, symbolic concerns such as identity, ethnicity, or nationalism form the principal basis of electoral contestation; both party strategies of mobilization and voter attachments are driven primarily by social identity rather than economic interests. Members of specific social groups act in a similar fashion in the electoral arena, irrespective of class interests. Consequently, where social identity cuts across economic interests, the vote of the poor tends to be fragmented; this prevents large lower-class formations from emerging in the electoral arena. In such cases, narrow class coalitions can emerge even though the broader electorate is largely poor. These coalitions, in turn, shape policy outcomes.

[6] The links between growth, investment, and business-friendly policies are elaborated in the next section.

[7] Throughout this book, the nature of electoral coalitions refers to the social base of voters who support a particular government and not to a coalition of parties in government. However, governments composed of a coalition of parties have often come to power in India. In such cases, the socioeconomic vote base of all parties that comprise the government is taken into account.

The specific social attachments at play and the mechanisms through which they work depend on the local context. In the case of Indian states, I focus on the role of identity politics, mainly along the dimension of caste and, to a lesser extent, religion and regional nationalism. Identity politics has been the main idiom of electoral competition in India since independence. I argue that social identity has shaped the formation of electoral coalitions in India primarily through its effects on party strategies and voter attachments.[8] In addition, I highlight the association between social identity and entrepreneurship, which conditions the nature of business representation in electoral coalitions in India. Through these avenues, this book links social identity to the class composition of electoral coalitions and, subsequently, to economic policies.

In a nutshell, this book highlights the social origins of economic policies. It does so through an examination of India's political economy during a seminal and extensive phase of economic and political transformation – a period in which the country, to borrow a term from Corbridge and Harriss (2000), was "reinvented." It is a book that is first and foremost about the political economy of India during a momentous period, and in that sense, it does not attempt to make any bold claims of generalizability across all poor democracies. To be certain, India has followed a different trajectory than other prominent cases of late development in that competitive democratic politics preceded high growth by almost four and a half decades. Economic change also occurred in the midst of a largely poor and highly ethnically diverse electorate. These trends are atypical in light of previous patterns of growth and industrialization as well as in light of multiple scholarly perspectives, as the next chapter outlines.[9]

[8] In this book, I utilize the empirical regularity that party and voter behavior in India has been primarily driven by identity, and I subsequently link this empirical trend to economic policy outcomes in my explanation. I do not attempt to explain why micro-level linkages between voters and political parties in India are based on identity in the first place. Several explanations exist for why social identity has been the primary basis of electoral politics in India, notably those that focus on patronage and clientelism, service provision, and a more sociological explanation that points to the entrenched role of caste in Indian society. A discussion of these studies is included in more detail in Chapter 2.

[9] India's growth transformation is a puzzle in terms of several strands of the literature. Most notably, the literature on redistribution and democratization suggests that poor democracies are unlikely to prioritize growth-oriented policies (e.g., Acemoglu and Robinson 2005; Alesina and Angeletos 2005; Alesina and La Ferrara 2005; Boix 2003; Iversen and Soskice 2001; Meltzer and Richard 1981; Romer 1975). As an ethnically diverse country that has seen high growth, India also acts as an exception to theories that link ethnic fragmentation to weak economic policies and outcomes (Alesina et al. 1999; Alesina and La Ferrara 2005; Easterly and Levine 1997; Miguel and Gugerty 2005). The economic reforms that catalyzed India's high growth also took place in the midst of growing political fragmentation. This is surprising from the point of view of one strand of scholarship that

At the same time, India offers a useful background within which to study broader trends related to economic policy making in poor democracies. In particular, some of the empirical dynamics analyzed here have clear parallels in other poor democracies. This book analyzes a context that is now widely shared by developing countries – one in which policy makers have to undertake business-friendly policies to stimulate growth while balancing demands from largely poor and often ethnically diverse electorates. As explained later in the chapter, economic policy making across Indian states acts as a microcosm for some of these broader trends. Implications from this study are, therefore, relevant to other cases. While I pay close attention to the local context in India and remain cautious about making broad generalizations, I briefly draw on examples from Africa and Southeast Asia in the concluding chapter to identify parallels between cases in these regions and the analysis offered here.

This book also engages with and makes contributions to several scholarly debates that have global appeal. By tracing the origins of growth-oriented policies, this analysis tackles a deeply consequential question in the comparative political economy of development. By pointing to the links between social identity and economic policy outcomes, my argument emphasizes an association that has received limited attention in the political economy literature. Yet, the pervasive role of social identity in electoral politics is clearly evident in many poor democracies. In turn, through its effects on electoral competition, social identity affects economic policy choices. These dynamics suggest a marked difference in economic policy making between cases in which social identity plays an influential role in electoral politics and those in which programmatic or explicit class-based mobilization is more developed. In highlighting these distinctions, this book attempts to partially fill a gap in our current understanding of the factors influencing economic decision making in poor democracies.

In its emphasis on policies undertaken by governments, this book shares an affinity with the developmental state literature. Unlike the case of classic developmental states in East Asia, which were supported by authoritarian political regimes, examining the state's economic role in the Indian context provides insights into constraints and challenges engendered by democratic contestation. By exploring the association between social identity, the business class and policy making, this analysis is likely to be of interest to those studying ethnicity and its impact on

analyzed market reforms, mainly in Latin America in the 1980s and 1990s, which suggested that political autonomy and insulation were necessary for the successful implementation of policies (e.g., Nelson and Waterbury 1989; Nelson 1990; Williamson 1994).

economic outcomes. By focusing on the competition for investment, I engage directly with a debate in international political economy on the influence of mobile capital on policy making. This book also joins a growing body of political economy studies on India that focus on the subnational level and highlight the impact of diverse historical, social, and political trajectories on varied regional outcomes.

Finally, a key empirical finding of this analysis – the link between business-friendly policies and exclusionary political dynamics – sheds light on an issue that has important normative implications for Indian democracy. Governments that have been most proactive in the competition for investment in India have been backed by narrow class coalitions that are unrepresentative of the broader, largely poor electorate. Moreover, in some Indian states, pro-business policies have been accompanied by identity politics and illiberal trends. This coincidence is not accidental. Rather, it reflects an underlying political problem that has characterized India's high-growth phase and arises from the nature of its growth model. To attract investment and generate growth, governments have formulated and implemented policies that privilege business, particularly in the short term. Yet, ensuing growth in India has been capital intensive and service sector led, and it has resulted in weak employment generation in a country that remains largely rural and agricultural (e.g., Anant et al. 2006; Subramanian 2008). In addition, almost 93 percent of India's workforce continues to be employed in the informal sector (Agarwala 2013). It is important to note that India's high-growth phase has institutionalized certain existing inequalities of economic and political power while creating new ones. For Varshney and Sinha (2011), India in recent years has come to resemble the United States in the Gilded Age. Commenting on India's high growth phase, Drèze and Sen suggest "over this period of rapid growth, while some people, particularly among the privileged classes, have done very well, many more continue to lead unnecessarily deprived and precarious lives" (2013: viii).

In short, India's high-growth era has been far from inclusive. Kohli (2006, 2012) surmises that these non-inclusive patterns of growth have led to a question of legitimacy for India's political elite. What political formula simultaneously allows elites to enjoy legitimacy with the poor in the electoral arena while pro-business interests are pursued in the policy realm? The finding that identity politics and illiberal trends have accompanied pro-business policies in some cases reflects one type of response to this broader dilemma of political legitimacy. In that sense, this book suggests that a model of growth that relies on attracting private capital in the midst of poor electorates and results in uneven benefits has an affinity with exclusionary political trends. As such, it offers a sobering perspective on the prospects for a virtuous cycle of growth and democratic politics in India under the current economic framework.[10]

The remainder of this chapter places the central question of this book in a broader perspective and is organized as follows. The first section lays out the rationale for a study of investment policies in India, followed by a second section that outlines the links between pro-business policies, investment, and growth. A third section describes in more detail the background of economic reforms in India and the specific empirical puzzle of subnational policy variation in the competition for investment. A preview of the central argument, which is explained in greater detail in Chapter 2, follows in the fourth section. A fifth section describes the research methodology and case selection. And a final section provides a roadmap for the rest of the book.

## Why a Study of Investment Policies?

Understanding the factors leading to economic growth has been a long-standing concern in both academic and policy circles. Growth is one of the most vital facets of economic development; it is critical to reducing poverty and tends to be strongly correlated with a variety of outcomes that citizens care about such as health and education. In turn, investment is a key input for the growth process. The sheer magnitude of poverty in India and the indirect impact of investment through the growth process make a study of investment policies worthwhile. According to the World Bank, 288.5 million people (23.6 percent of the total population) lived on less than US$1.25 a day in India in 2012 and 723.4 million (59.2 percent) lived on less than US$2 a day.[11]

In turn, the significance of investment to economic growth has been highlighted by numerous theoretical, empirical, and policy-oriented studies. At a theoretical level, neoclassical growth models clearly emphasize the role of capital accumulation (e.g., Barro and Sala-i-Martin 2004). At an empirical level, several studies have found a positive relationship

[10] Theoretically, a social democratic model, particularly one that focuses on human capital investment as the means to promote growth, might alleviate tensions between growth and democratic politics. However, the argument made here is based on observed empirical patterns. On the ground, Indian states have overwhelmingly ignored alternative growth strategies based on human capital development and have focused primarily on attracting private capital through pro-business policies. As a result, I do not emphasize social democratic alternatives. In general, social democratic regimes are rare in the developing world. I discuss tensions between growth and democratic politics in the neoliberal era, the potential of social democratic frameworks, and the general paucity of such strategies in India in more detail in Chapter 2.

[11] Data from the World Bank's Poverty and Inequality Database (databank.worldbank.org); accessed December 7, 2014.

between investment and growth (e.g., Barro 1997; Levine and Renelt 1992; Mankiw et al. 1992). For scholars of the East Asian developmental state, close business–state ties and the ability of the state to mold levels and patterns of investment were at the heart of the region's growth miracle (e.g., Amsden 1989; Evans 1995; Kohli 2004; Wade 1990). The importance of investment and measures related to it has also been emphasized in policy circles. The World Bank, for example, claims that "as populations get larger, economic growth provides the only sustainable way of improving living standards. A good investment climate drives growth by encouraging investment and higher productivity. Investment underpins growth by bringing more inputs into the production process" (World Bank 2005b: 5).

One point of clarification is in order here. Although central to the growth process, I do not claim that investment is the sole determinant of growth. As a voluminous literature suggests, growth is multi-causal, and a plethora of factors have been found to affect growth.[12] Nevertheless, investment has been identified as one of the primary factors that drive growth at a proximate level of causation. Policies related to it, therefore, merit a close examination.

Aside from its importance in the growth process generally, aspects specific to the Indian context also justify a focus on investment policies. Even though India's overall economic performance over the past two decades has been impressive, growth has been extremely uneven. Healthy national averages mask extremely varied outcomes below the surface. For several scholars, the discernible existence of "two Indias" has been clearly evident in the post-liberalization period (e.g., Ahluwalia 2000; P. Chatterjee 2008; Corbridge and Harriss 2000; Frankel 2005; Kohli 2006, 2012; Subramanian 2008). While states in the south and the west have driven the country's economic resurgence, those in the north and east have fallen behind. Yet a disproportionate number of India's poor continue to be concentrated in the slow-growing and populous northern states.

At a proximate level of causation, many commentators have suggested that such regional growth differentials are themselves products of diverging investment patterns (e.g., Ahluwalia 2000; Besley et al. 2007; Kohli 2006, 2012; Subramanian 2008). Moreover, several scholars suggest that policy differences across states are partially responsible for varied investment patterns (Ahluwalia 2000; Besley et al. 2007; Subramanian 2008). For federal polities such as India, regional inequalities can be deeply

[12] Useful reviews on the determinants of growth can be found in Barro and Sala-i-Martin (2004), Bosworth and Collins (2004), and Durlauf and Quah (1999).

consequential, as they often act as sources of potential political tensions. Differing economic outcomes have clear repercussions for the nature and quality of Indian democracy (e.g., P. Chatterjee 2008; Frankel 2005; Kohli 2006, 2012). For Kohli (2006), the spatial disparity of economic gains in conjunction with the pro-business nature of India's current economic paradigm threatens to heighten the "two-track" nature of Indian democracy whereby policy making is in the hands of a pro-business elite while the poor are strictly confined to the electoral process.

## Linking Pro-Business Policies, Investment, and Growth

The more narrowly defined question addressed in this book asks why some subnational governments are more business friendly than their counterparts in the competition for investment. This implies an underlying connection between business-friendly policies, investment, and growth. How are pro-business policies, investment, and growth related?

The links between these three aspects stem in large part from a particular empirical context in which growth in the developing world must now occur. Prompted by international financial institutions, countries across the developing world began to shift from statist to market models after the 1980s. In this era, private investment became a key input for generating growth. Moreover, neoliberal economic policies also emphasized a removal of trade and financial barriers, leading to greater mobility of private capital. This ability of capital to move across political boundaries meant that governments had to compete to attract investment to their jurisdictions. To attract investment, governments had to adopt business-friendly policies, a point highlighted in both the scholarly literature and policy circles. For instance, in reviewing the existing literature on the politics of growth, Nooruddin emphasizes that "a pro-growth policy is one that encourages and enables private actors to invest in the economy, make profits, and plough returns back into the economy in a search for further profit" (2011: 37). Furthermore, "the politics of growth ... involves two things: (1) making pro-investor and pro-growth policies, and (2) convincing investors that such policy commitments are credible" (Nooruddin 2011: 40). Similarly, numerous policy reports of international financial institutions (IFIs) have often underscored the need for a favorable investment climate to attract capital and spur growth (e.g., World Bank 2002, 2005b, 2007b, 2009; World Bank and International Finance Corporation 2004a, 2009, 2012).[13]

[13] Pro-business strategies can devolve into crony capitalism under certain circumstances. Indeed, India has witnessed several instances of crony capitalism after market reforms,