The Political Economy of Growth under Clientelism: An Analysis of Gujarat, Tamil Nadu and Pakistan

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ABSTRACT

The thesis is an institutional analysis of governance and industrial development using case studies of different parts of the Indian subcontinent. It uses the framework of 'political settlements' that emerge when the interaction of institutions and organizations achieves a sustainable level of political and economic viability. The analysis focuses on how the distribution of organizational power at the relevant level of a polity described by a political settlement can be an important determinant of economic policies and institutions. Even more so, the political settlement affects the enforcement and implementation of particular policies and institutions in ways that have implications for growth and stability. Over time, this distribution of power also changes, making the analysis dynamic and path dependent. This approach contrasts with the dominant 'good governance' analysis where a standard set of institutions and governance capabilities are identified as necessary for all developing countries.

Gujarat, Tamil Nadu and Pakistan after 1980 are examples of different configurations of organizational power. Gujarat has sometimes been described as a sub-national developmental state. However, Gujarat's political settlement is significantly different from East Asian developmental states. It has achieved high rates of industrial growth but without using conditional rent strategies characteristic of East Asia and this has limited the scope of capability development in its industrial sector. Tamil Nadu has intense clientelist competition and has yet managed high rates of industrial growth. The analysis sheds light on its success and identifies some of its vulnerabilities as its two-party system threatens to fragment further. Pakistan is an extreme case where there has been sustained violence and poor economic development in this period despite attempts at good governance reforms and liberalization. The analysis suggests that institutional and policy evolution has been dominated by a crisis of legitimacy of its ruling coalitions and weak economic organizations inherited from the populist 1970s. Liberalization in this context produced adverse results. The analysis offers an alternative framework for understanding differences in industrial performance and for evaluating future policy responses.

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Abbreviations

ADB	Asia Development Bank
ASI	Annual Survey of Industries
AIADMK	All India Anna Dravida Munnethra Kazagham
BJP	Bharatiya Janata Party
CAG	Comptroller and Auditor General
CSO	Central Statistical Organization
DMK	Dravida Munnethra Kazagham
FATA	Federally Administered Tribal Areas
GGA	Good Governance Agenda
GoI	Government of India
GoGjt	Government of Gujarat
GoP	Government of Pakistan
GoTN	Government of Tamil Nadu
IMF	International Monetary Fund
JI	Jamaat-e-Islami
MoSPI	Ministry of Statistics Planning and Implementation
MBC	Most Backward Caste
MQM	Muttahida Quami Movement
NSSO	National Sample Survey Organization
NWWW	North Wallis Weingast Webb
OBC	Other Backward Classes
PML (N)	Pakistan Muslim League (Nawaz)
PPP	Pakistan People's Party

RSS	Rashtriya Swayamsevak Sangh
SC	Scheduled Caste
ST	Scheduled Tribe
UNIDO	United Nations Industrial Development Organization
VHP	Vishwa Hindu Parishad
WB	World Bank

Chapter 1 . Introduction

Economics began with the quest to understand the sources of the ‘wealth of nations’. However, for a long time the discipline focused on ‘lower-level’ problems about the determinants of value, the conditions of general equilibrium, the effects of aggregate demand and the variants of competitive markets. Interest seems now to have swung back to a greater interest in understanding the wealth of nations, this time in developing countries with questions of convergence and the obstacles that may prevent it. The earlier literature in this field focused on the role of technology and capital accumulation. Later literature started focusing increasingly on the underlying structures in a social order that affected the choices leading to specific growth outcomes. This literature included the study of institutions or rules that made social and economic interaction possible (North 1990; North 1995) as well as the study of the interaction of politics and economics that refers to a broad set of questions in political economy. As a first approximation this thesis is broadly located in the area of economics investigating the political economy of institutions. Specifically it studies institutional choices, their implementation and the effect of their implementation on the economy. The issue of implementation and modification of policies and institutions is important for understanding the trajectories of development in different contexts. As Khan puts it: “(a)t the heart of the problem is that the analysis of development has paid inadequate attention to the critical problem of how the relative power of organizations in that society affects the enforceability of different institutional rules” (M. H. Khan 2010b). Our approach is in contrast with much of institutional analysis that attempts an analysis of the growth implications of different institutions regardless of the likelihood of their implementation in different contexts. This includes the ‘good governance’ analysis that dominates policy discussions of required reforms in developing countries, where a standard set of institutions and governance capabilities are identified as necessary for all developing countries.

The thesis is an institutional analysis of governance and industrial development using case studies of different parts of the Indian subcontinent. It argues that the choice of institutions and policies and their implementation depends on the relevant political context. The importance of the political context for determining the choice and implementation of policies and institutions is in general not contested. The argument in this thesis uses a particular analytical framework, that of 'Political Settlements', for examining the implications of institutions and organizations in a common framework in different contexts (M. H. Khan 2010b). A political settlement is a combination of institutions and organizations that achieves a sustainable level of political and economic viability, and is therefore reproducible over time in its broad features (though political settlements are always evolving). The critical characteristic of a political settlement is that the distribution of power across organizations has driven institutional change and the modification of institutions so that the distribution of benefits across institutions is broadly compatible with this distribution of power. This simply means that the distribution of power across organizations is now relatively stable because the institutions and their implementation create a distribution of benefits across organizations compatible with their relative power. The analysis focuses on how the distribution of organizational power at the relevant level of a polity, described as a political settlement, can be an important determinant of economic policies, institutions and technology adoption. In particular, we are interested in how a political settlement affects the enforcement and implementation of particular policies and institutions in ways that have implications for growth and stability. Over time, this distribution of power also changes, making the analysis dynamic and path dependent. This approach contrasts with the most common approach in institutional analysis, which ignores the distribution of power across organizations and how that affects institutional choice and implementation. In the standard approach, it is common for a standard set of institutions and governance capabilities to be identified as efficiency or growth-enhancing for all developing countries.

Political settlements in developing countries are in general substantially different from those in developed countries. Developed countries are typically characterized by a formal institutional structure based on the enforcement of a rule of law and property rights. In contrast, developing countries that are still going through a capitalist (or structural) transformation are typically characterized by the existence of significant informal institutions like clientelist networks and informal economic and political organizations. Hence political settlements in transition economies have a significant role for both informal institutions and organizations. Significantly the distribution of power must reflect the effective power of many informal organizations like clientelist political parties in informal institutions such as informal rent allocations and modifications in the operation of formal institutions that provide informal rents to informal organizations and these aspects of the institutional structure may be at least as important or even more important in these contexts than formal institutions. These informal institutions and organizations are another way of describing informally organized power. Identifying the relevant informal features of the political settlement in developing countries can help us identify the problems of enforcing particular institutions at the micro level. For instance, the structure and relative power of informal organizations may imply that particular formal institutions that impact on the incomes of powerful organizations are modified to a greater extent (for better or worse from the perspective of economic performance) relative to other formal institutions. Thus the growth trajectories of developing economies can depend very significantly on the characteristics of their political settlements (M. H. Khan 2010b).

The research establishes that the success of any institution or intervention in a developing country in terms of promoting growth requires appropriate implementation capabilities. The institutions and policies required for sustaining growth in developing countries are complex because they have to ensure much more than efficient markets. Markets, even if they are moderately efficient, are insufficient for organizing the significant structural transformations that are required during the process of development. Institutions and policies therefore need to assist in the achievement of these structural changes. The capacities of the state and political organizations to implement these types of institutions in turn depends on the political settlement since the enforcement of particular interventions may require overcoming the possible resistance of powerful organizations representing specific constituencies.

Political organizations play a particularly important role in the political settlement. The ‘ruling coalition’ in a country is composed of some political organizations while others are temporarily or permanently excluded, depending on the formal and informal institutions regulating political competition in that polity. We look at the social and historical processes that led to the creation of the current ‘ruling coalition’ and how the distribution of power across political organizations can help to explain the enforcement capabilities of the state with respect to particular institutions and policies that are relevant for our analysis of development. In a developing country we need to look at both formal and informal political organizations and the formal and informal institutional arrangements through which they acquire their incomes and benefits, and which therefore underpins their relative power. This configuration is important for understanding the enforcement capabilities of the ‘state’, (by ‘state’ here we mean the range of organizations that claim policy making and enforcement powers in a society, based on a claim ultimately to a monopoly of violence, but all these claims may be only partially fulfilled in developing countries) with respect to particular policies and institutions since those policies or institutions that threaten the incomes of powerful political organizations will be obstructed or modified, while those that reinforce the interests of powerful organizations may be strongly enforced.

The configuration of power at this level of detail can explain why growth could be triggered and sustained in ‘second tier’ developing countries defined as countries that exhibited strong growth in the period after 1980 but which had neither strong formal industrial policy institutions of the East Asian type nor met the “good governance” requirements of market-enhancing capabilities. An important policy implication of this analysis is that some of these high-growth developing countries are often unable to ensure that their growth can be sustained simply because they do not have a good understanding of the institutional basis of their growth, and how to incrementally improve these conditions given the nature of their political settlement. Equally, countries that are not performing well often do not understand that if the ‘good’ policies that they have been trying to implement cannot be implemented, the only strategy may be to attempt the implementation of institutions and policies that may not be recommended by prevailing theory but which may have a better chance of implementation. This suggests that bureaucratic ineffectiveness and reforms enhancing bureaucratic capabilities are not sufficient for ensuring more effective policies. Clearly, both bureaucratic capabilities and policies matter, but the appropriate policy depends on the political settlement in a way that goes against the standard frameworks for thinking about the ‘right’ policies and governance capabilities. A developing country with a reasonably effective bureaucracy could have a policy implementation crisis if the ruling coalition was persuaded to adopt without further analysis, the policies that worked in an apparently similar country somewhere else. Our argument is essentially that the complexity of the argument suggested by the political settlements analysis for identifying feasible and implementable policies in different contexts raises challenges for bureaucratic and political leaderships in developing countries. This type of analysis is usually not conducted even in academic policy circles in developing countries, let alone by political and bureaucratic leaders. When effective policies emerge it is often because of serendipity and experimentation rather than a compelling ex ante analysis. This is not a problem for successful countries, but in developing countries that are performing less well, a better analytical frame is required, particularly because experimentation can itself be blocked by powerful interests. Triggering or sustaining growth requires strengthening institutional and political capabilities that are developmental in the context of specific political settlements and these may not necessarily be capabilities supported by standard policy prescriptions or even the example of successful developmental states. Without this understanding, the adoption of some types of governance reforms like the good governance reforms may inadvertently even undermine national capabilities to sustain growth. Why politicians and academics have been so quick to adopt explanations that a more careful investigation would find questionable requires an explanation that is beyond the scope of this thesis.

The analysis of institutions and implementation is located in a broader analytical frame that recognizes that developing countries suffer from significant market failures and also that growth in many developing countries is generally based on institutional capabilities that address specific *market failures* in ways that inevitably combine formal institutions with informal modifications or informal rules of implementation. Growth in these countries is therefore likely to be vulnerable to shocks and to changes in conditions (M. H. Khan 2010b). And effective institutions are likely to look different from country to country (Rodrik 2004, 2008; John and Putzel 2009; Sen 2013). Note that we do not define market failures using a benchmark of a general equilibrium as the ‘first best’ nor do we imply that markets can work perfectly if some institutional conditions are met that reduce transaction costs. The reference to market failure simply tells us that there are missed contracting opportunities, and if markets (private contracting) cannot address these, different types of interventions or policy responses are required. We will use three case studies of Pakistan and the Indian states of Gujarat and Tamil Nadu to look at the relationship between institutional and political configurations and growth. Two of our cases are states within the Indian Union, while Pakistan is a country. This is not necessarily a problem because our aim is not a straightforward comparison to identify the significance of particular explanatory variables. Rather, our claim is that our analytical methodology can be used to investigate and shed light on all three transformation stories. Our hypothesis is that by identifying the institutions and organizations relevant for aspects of the economic transformation in these polities, and the specific political settlements in which implementation was being attempted, we can shed light on the differences in the economic experiences of these polities.

The analysis of growth in India coming from the liberal economics tradition often miss critical differences between Indian states and attribute growth to economic liberalization and to governance structures that often have a much weaker presence in reality than in the models. Growth across states in India, from 1980 to 2010, the period that this research roughly spans, has been very varied and driven by different sets of factors in each case, which is not surprising given the very different political and institutional arrangements across states. In the case of Pakistan growth has been inconsistent since the 1980s and the liberalization reforms it attempted do not seem to have achieved the intended results. We argue that this is not because the Pakistani state did not go far enough in attempting to implement the reforms but because the state did not actually have the implementation capacity or the *legitimacy* to implement these reforms to an extent that may have made any difference. If we interpret liberalization and associated good governance reforms as a package that aims to reduce transaction costs and make markets more efficient, it is unlikely that these reforms could make sufficient progress in *any* developing country to an extent that development would be significantly accelerated by these means alone. However, in Pakistan the reforms were particularly inimical to the interests of powerful informal organizations who resisted their implementation.

If anything market-based growth strategies based on enforcing a rule of law and ensuring property rights require much higher enforcement capacity on the part of a state since here enforcement refers to *all* property rights and formal rules. The typical developing country attempting to create a viable productive sector is unlikely to possess these capabilities. Not surprisingly, growth-enhancing strategies in developing countries that have succeeded in catching up have prioritised sectors and selected interventions and incentives according to available implementation capabilities. Historically none of the countries that have made the transition to or towards developed economies, like Japan, Taiwan, South Korea and Malaysia achieved this change using the 'market-enhancing' good governance reform package. Developing states do indeed need to allocate their scarce resources properly in order to achieve growth and development. However, this allocation is unlikely to be achieved through markets as transaction costs in these economies are particularly high because of the weak enforcement of formal institutions and policies. Hence the state needs to have some capabilities of enforcing specific and targeted interventions and institutions that solve specific allocative and contracting problems. These capabilities are precisely the ones that the good governance agenda ignores in developing countries (M. H. Khan 2008a, 2008b, 2010b). One argument that the neo liberal view puts forward against solving 'market failures' is that intervention can result in government failures, and the loss of welfare due to the activity of the state can be greater than the initial market failure. If this was always likely to be true, government inactivity is a better policy that intervention (Krueger 1974). However, the design of institutions and policies so that they are compatible with the political settlement is precisely the strategy that reduces the chances of government failures due to failures of implementation.

In order to solve these 'contracting problems' a state must have legitimacy, which means that its general strategy of development must have some broad support in society, and the specific policies or institutions have to be compatible with the political settlement in the sense that powerful organizations will not block these strategies. There is an important if subtle difference between this position and the liberal argument that a state is legitimate if it can protect property rights. A developing country state simply does not have the capacity to protect all property rights but some of these states are much more legitimate than others (M. H. Khan 2009a). Legitimacy has complex determinants in developing countries and depends on the distribution of benefits in a society being acceptable to those who have the capacity to challenge the political settlement. Legitimacy in the short-term therefore depends on powerful organizations (usually led by organizers from the middle and lower middle classes) accepting that they have a fair share of the rents in society. As the mobilization of demands is always increasing, sustaining legitimacy also requires economic growth and so the distribution of rents in the political settlement has to achieve a combination of political stability and economic growth. Legitimacy in turn affects the enforcement capabilities of the state, and this can easily result in vicious or virtuous cycles of development with legitimate states driving development that reinforces their legitimacy and vice versa.

In liberal economics and political economy, stable property rights are achieved through a state's capacity to impose social order, and this is based on the state being accountable to the polity, restricting itself to only deliver the limited public goods on which there is broad consensus and to 'signal' its commitment to not expropriate property rights in the future by reducing the size of the state *ex-ante* and agreeing to checks and balances that make appropriation in the future less likely (Bates 2001; Acemoglu and Robinson 2012a). Stable property rights in turn lead to lower transaction costs. Low transaction costs are a key determinant of efficiency in new institutional economics (NIE) as will be discussed in Chapter Two. Economic efficiency and growth in turn further strengthen the legitimacy of the state, and virtuous cycles of economic and political development are then set up. The problem is that developing country states cannot first achieve the enforcement of broad-based property rights and security because these public goods are expensive to deliver, and none of the dramatic success stories of development in the last century would fit the sequence of enforcement, legitimacy, transaction cost reduction and growth that is asserted in the liberal story. After the events of 9/11 in the USA, the significance of delivering security as a condition of state legitimacy and therefore as a precondition for development has emerged even more strongly in the development discourse (WB 2011). However in developing countries where legitimacy is more likely to be based on a complex negotiation of inclusion of powerful organizations into the rent allocation mechanisms of the state, an excessive focus on security can create incentives for the ruling coalition to use force in limiting access, with very damaging consequences for legitimacy and development. As the legitimacy of such a state declines it only becomes even more dependent on foreign aid and particularly on security aid, creating a vicious circle detrimental for growth. We see this clearly outlined in the case of Pakistan. The country is today a $1200 per capita economy that prioritises security, receives significant foreign assistance to achieve security, and yet the current ruling coalition is steadily losing legitimacy and developmental capacity. In Afghanistan the loss of legitimacy of the state and its ruling coalition is much more advanced as its president is incapable of constructing a ruling coalition that is even likely to survive without the military assistance of his Western allies. This is despite billions of dollars of aid being given to the government in order for it to deliver services and security. Clearly, there are limitations in the mainstream understanding of how legitimacy is to be understood and constructed.

Gujarat, Tamil Nadu and Pakistan after 1980 are examples of different configurations of organizational power, and therefore of different political settlements. Gujarat has sometimes been described as a sub-national developmental state (Sinha 2005; Kohli

2012). However, Gujarat's political settlement is significantly different from East Asian developmental states. It has achieved high rates of industrial growth but without using conditional rent strategies characteristic of East Asia and this has limited the scope of capability development in its industrial sector. The ruling coalition in the state also used a strategy of violence and exclusion to signal authority and its cohesiveness as a ruling coalition. However, the excluded groups here were generally weak to start with and the imposition of conditional inclusion on them (Muslims could gain inclusion if they accepted they were part of a 'Hindu nation') signalled both the strength of the ruling coalition and its commitment to the development of the majority community that for a time at least helped rather than reduced its legitimacy. We discuss the types of economic policies and institutions that became implementable in this political settlement as a result, and the types of developmental interventions that still remained outside the enforcement capabilities of the Gujarati polity. Tamil Nadu is a state characterized by intense clientelist competition between competing political organizations that cycle in and out of power, and yet it has managed high rates of industrial growth. The analysis sheds light on the institutional determinants of its success and identifies some of its vulnerabilities as its two-party system threatens to fragment further. Pakistan presents the reverse trajectory as its growth in the 1990s was lower than in the 1980s, and the country made a transition from the growth leader in the Indian subcontinent to become the growth laggard. In addition it suffered from growing violence and instability in a context where it continued to make attempts at implementing good governance reforms and liberalization. The analysis suggests that its institutional and policy evolution has been dominated by a crisis of legitimacy of its ruling coalitions and weak economic organizations inherited from the populist 1970s. Liberalization in this context produced adverse results and this needs to be understood in the context of a deeper analysis of the political crisis facing Pakistan. While we focus on the construction of the ruling coalition in all three case studies, the dissertation has a larger section dealing with Pakistan. We draw on revisionist histories of partition and the creation of Pakistan in 1947 and its further split in 1971 when Bangladesh broke away from Pakistan. These partitions were essentially the result of a failure to construct viable political settlements that included all the relevant political organizations. In particular, the 1947 partition was driven by the failure to accommodate the organizations of the substantial Muslim minority in undivided India. Both Pakistan and India have used their own vastly different interpretations of history to justify why they were the 'good guys' in this disaster, and these inadequate histories continue to justify the confrontation between the countries. Pakistan's security-centric development strategy and its consequences are related to this history. In this context the formation of the ruling coalition in Pakistan has also been affected by the geo-political environment Pakistan finds itself in. Its alliance with the USA and its involvement in Afghanistan after 9/11 has created rents that have enabled the ruling coalition to exclude powerful organizations. Aid rents related to security have had a retrogressive impact on the construction of stable ruling coalitions in Pakistan and this has significant implications for the enforcement and management of institutions and policies that can be supportive of growth.

The thesis offers an alternative framework for analysing the interaction of institutions and organizations that affect industrial performance and that should inform the development and evaluation of future policy responses. We also establish that an understanding of these processes has to be rooted in history, and sometimes an investigation of fairly long-period historical processes may be useful and necessary. We also demonstrate that the mechanisms supporting growth in these polities have not been mainly formal institutions and policies. Rather combinations of formal and informal institutions have had good or bad effects in the context of political settlements that have to be understood as balances of formal and informal institutions and organizations. We identify some of these mechanisms and trace their evolution over time. This allows us to analyse how particular market failures were overcome and we identify vulnerabilities in these arrangements as the often fine balances that result in good outcomes can be easily upset. We are also able to identify some of the reasons why the characteristics of the growth-generating sectors have differed across states. For instance Gujarat and Tamil Nadu have different manufacturing profiles based on differing mixes of sectors and technologies. The differences in the political settlements of these states provide an important set of additional explanations for these differences to complement the more usual explanation based on factor endowments. Gujarat's current political settlement that we characterize as 'authoritarian clientelism' with features of a dominant party and long-term time horizon for the exclusionary ruling coalition has made Gujarat a leader in infrastructure investments in India. In this sector solving credit and land market failures are imperative and Gujarat's government has been able to provide this with little opposition from opposing interests like famers because of the specific nature of its ruling coalition as we outline in Chapter Five. In Tamil Nadu on the other hand despite intense competitive clientelism and the regular cycling in and out of its two main political parties the fact that neither reneges on large investment decisions made by the previous government has signalled enough credible commitment to high-end manufacturing companies to invest in the state. Of course like Gujarat Tamil Nadu was already industrially advanced by the time the Indian economy opened up in 1992. In Pakistan's case the inability to develop new globally competitive manufacturing sectors in the 1980s and 1990s is related to the rent capture strategies of a security-focused ruling coalition receiving significant security-based rents that are easy to control and allocate from above. Ironically, the social contestation that this strategy actually resulted in explains the weak implementation capacities of the ruling coalition. As the Pakistani state lacked the incentives and capacities to support targeted policies to promote growth, it relied more seriously on liberalization and good governance reforms than the Indian polities that did well. These strategies too could not be properly implemented, and the result was declining growth rates and even more social contestation as the state suffered from a vicious cycle of gradually declining legitimacy and performance. Effective policy responses in Pakistan are likely to have to address the problem of declining legitimacy and its roots in the failing security agenda that is associated with the US strategy in Afghanistan. However, our framework is not a prescriptive one but rather a framework for discussing policies for growth in alternative political scenarios whose political realism has to be assessed by political entrepreneurs on the ground.

Chapter 2 . Property Rights, Transaction Costs and Power in Institutional Change

2.1 Introduction

The primary concern of this thesis is to examine some of the ways in which institutions, policies and the configuration of organizations can help to explain the development trajectories of developing economies. Our discussion of theory and the case study evidence suggests that a pure institutional analysis is insufficient for understanding the ways in which institutions and policies actually operate because there is a significant gap between the formal specification of an institution and its operation in practice. This gap in the operation of formal institutions and policies is particularly important in developing countries. The 'variable' that we focus on as an important determinant of institutional operation is the distribution of power across organizations in a polity. The relative power of organizations is an endogenous variable at a macro level and an exogenous variable when we are analysing the effects and outcomes associated with particular formal institutions at the micro level. The relative power of organizations is described at the macro level by the interaction of organizations and institutions that determines the distribution of benefits and incomes across organizations as an outcome of this ongoing and interactive process. The macro-distribution of organizational power and the balance between institutions and organizations that underpins it are described as the 'political settlement'. At the micro-level, the political settlement is effectively an exogenous variable that helps to explain why particular formal institutions and policies have outcomes that are specific to contexts. The insight is that the distribution of power across organizations affects the enforceability of particular institutions because any particular institution implies specific income flows and benefits that will be either supported or obstructed by powerful organizations. If a particular institution does not support the interests of powerful organizations, their activity can have a number of implications. The formal institution may be reversed (or in many cases not adopted in the first place), it can be modified formally or informally so that the distribution is more acceptable to powerful organizations and this may affect the outcomes associated with the institution, or there may be a conflict with other organizations including state organizations that results in enforcement eventually but at a more or less high enforcement cost. In each case, the political settlement affects the outcomes associated with the institution and this can help to explain why different formal institutions and policies emerge in different contexts and why similar institutions have different effects across these contexts. This analysis draws on and extends the analytical framework in Khan (2010b).

The framework of 'political settlements' used in this thesis suggests that the primary problems of instability and volatile growth in economies going through developmental transformations is due to the presence of informal institutions that support a distribution of power that is not in line with the incomes supported by formal institutions in that economy. The existence of powerful organizations in a country whose demands cannot be supported by formal institutions means that the formal institutions cannot be enforced effectively without informal modifications that make these institutions workable in the presence of these organizations. These informal modifications create and distribute benefits, or rents (M. H. Khan 2010b) that are either directly captured by the organizations in question or distributed by ruling coalitions to organizations to maintain their capacity to rule. Hence how ruling coalitions are constructed and how power is distributed between the ruling coalition and excluded political organisations is an important analytical feature examined in this thesis. Different configurations of organizational power lead to different strategies to support or modify the formal institutions that deliver rents. These strategies in turn have implications for growth and development. In other words just as the distribution of informal and formal rents supports a distribution of power at the level of the macro-political economy, the distribution of power across organizations sets constraints for economic and institutional policy and the outcomes associated with them. This constraint could take the form of the choice of policy itself, as was the case of West Bengal in India which adopted agricultural growth strategies rather than policies and institutions that supported industry (M. H.

Khan 2009a; P. Roy 2012) or it could take the form of an implementation constraint affecting particular policies, as was the case with industrial policies in Pakistan which will be discussed later in this thesis.

This distribution of power across organizations is thus important because it affects the enforceability of formal institutions and determines the types of modifications (formal or informal) that determine outcomes. The relevant outcomes include both economic growth and political stability. Indeed, the macro-political settlement can be understood as a reproducible combination of institutions and organizations where the institutions support a distribution of benefits that is acceptable to and reproduces the relative power of the relevant organizations *and* achieves the minimal economic and political conditions that ensure the reproducibility of the system (M. H. Khan 2012f). Two features of the macro-political settlement and its micro implications are given particular importance in our analysis. First, we look at how the ruling coalition and other powerful organizations in a society are configured and how this has historically evolved. This 'data' gives us an idea of the political settlements in our case studies and the directions in which they have been evolving. Secondly, at the micro-level, we look for evidence of the gap between formal institutions and their expected outcomes on the one hand and the actual implementation and outcomes on the other, to examine the extent to which this gap reflects the distribution of power across affected organizations. The purpose of this analysis is to explain the differential performance of economic regions in the Indian subcontinent and to draw out policy conclusions about feasible reform strategies in the future.

The organization of the ruling coalition and the configuration of power across political organizations can be classified in a variety of ways. A typical feature of political competition in South Asia is the presence of a relatively large number of political entrepreneurs and organizers who organize their political supporters to seek rents through political competition. When the number of potential political organizations is large, the ruling coalition is typically composed of a subset of powerful political organizations. Excluded political organizations compete from outside to replace the existing ruling coalition, typically through elections. This political context can have many variations but is broadly described as competitive clientelism in Khan (2012f). When the ruling coalition is able to include enough political organizations within it (and if necessary, effectively repress the rest), the coalition has a longer time horizon. This configuration of power can result in the same party ruling for a long time and the power structure can be described as 'patrimonial'. There are several variants of the patrimonial ruling coalition. If the ruling coalition can exclude others at little cost or with limited coercion, and if the leadership of the coalition have the upper hand in bargaining with lower levels, we have 'strong patrimonialism' of the type characterizing East Asia in the 1960s. If the ruling coalition finds it difficult to exclude others and has to take recourse to frequent suppression to stay in power, it is 'vulnerable patrimonialism'. If it is sufficiently inclusive to make suppression unnecessary, the leadership may sometimes find they are unable to impose discipline on their followers and these contexts can be described as 'constrained patrimonialism'. One party rule may be sustained with little violence but the capacity to implement may be low because of many powerful factions within the ruling party. In order to analyse the implications of these differences properly we need to define a few fundamental concepts like 'rents' as well as 'power' as these concepts have been variously used in social science. This will enable us to address the issues concerning constraints on growth in the different political settlements that we examine in our case studies. In this thesis we examine case studies of Pakistan, Gujarat and Tamil Nadu through the lens of political settlements to map how specific distributions of power affected growth, stability and the pace and type of technology adoption.

2.2 The Institutional Analysis of Growth

Institutional economics is increasingly concerned with broad historical questions of differences in performance across countries. Countries with similar natural endowments and similar rules and regulations, have exhibited widely different economic performances. Put another way, while factor endowments and economic policies can explain some of the differences between countries, there is still a residual in performance differences that has to be explained with deeper institutional, political and other differences between countries. What then are these other variables that affect economic growth? One possible candidate is culture and cultural norms which can affect the acceptability and implementation of formal institutions and the ways in which they operate in practice (North 1993; Fukuyama 1996; O. E. Williamson 1998). Some heterodox political economists have placed politics and political organizations at the heart of differences in institutional performance (Bardhan 1997; M. H. Khan 2010b). The core idea is an old one. Marx's political economy with its focus on class conflict and the 'Veblen dichotomy' between negative business interests and positive industrial interests identified in the old institutional economics focused on the link between contestations over distribution and the enforcement of particular institutions as a key process driving economic growth.

In contrast, much of modern institutional economics is concerned with what can be described as a 'static' institutional analysis where the background political conditions and contests are abstracted from. More specifically the question concerning modern institutional economists for much of the time has been the identification of the theoretically appropriate property rights structure that ensures economic efficiency and the minimization of transaction costs. A property right is an institution (a rule) that specifies the right to enjoy or use a good and this can be specified in greater detail as the rules governing who can make what decisions about the use and allocation of a particular asset (Allen 2000). Property rights are institutions and institutions in Douglass North's famous definition are 'the humanly devised constraints that structure political, economic, and social interactions. They consist of both informal constraints–sanctions, taboos, customs, traditions, and codes of conduct, and formal rules–constitutions, laws, property rights' (North 1990). Transaction costs are the costs of creating, maintaining, transacting and interacting with institutions in general and property rights in particular (Allen 2000) . They can also be broadly defined as the costs of running the economic system (Arrow 1962). This thesis adopts a broader heterodox view of transaction costs, where the costs of contestation over the choice of different specifications of rights and the costs of protecting and enforcing rights in the context of distributive contests are included in our definition of transaction costs. Thus the distribution of power among the organizations affected by a particular right can be an important determinant of the relevant transaction costs of enforcing a particular right. However before we move to this level of analysis we need to differentiate our approach from the analysis of property rights and transaction costs in both neo classical economics (NCE) and NIE. Both property rights and transaction costs play an important part in NIE analysis while property rights are a cornerstone of NCE analysis.

At the heart of the neo classical economic (NCE) analysis are some specific assumptions about the property rights over endowments that allow efficient exchanges and contracts to be conducted. Property rights are complete in the sense that all valuable assets and activities have rights and liabilities defined over them, these rights are exclusive in most models and finally they are transferable and negotiable, which is what allows markets to work. Property rights with these characteristics are necessary and sufficient for markets to result in efficient outcomes. Much of NCE has been concerned with demonstrating the efficiency outcomes that follow from market exchanges. Market failures are recognized, and solutions to market failures are identified as corrective interventions of different types. However, NCE did not in general go much further in identifying the deeper causes of incomplete specifications of property rights and other sources of market failures.

NCE models are largely models of transactions where transaction costs are either absent or only present as costs at the point of exchange and never within the firm or at the level of collective enforcement. Where they exist, transactions costs are modelled like taxes or transportation costs. Demand for a good with high transaction costs adjusts as consumers respond to higher prices and hence in strict NCE there are no transaction costs that affect the very possibility of exchange (Allen 2000) . Efficiency implications for NCE arise only when market failures are due to missing property rights or contracting failures. Missing property rights can lead to externalities and in these cases policy is required to achieve what would otherwise have been negotiated in a market. Public goods are another source of market failure, this time due to a free rider problem where individuals try not to pay for the provision of a jointly consumed (non-rival and non-excludable) good. If many individuals fail to make a contribution to the provision of such a good, it will be under-provided in a market. This is a market failure and the government can improve welfare by providing the good and financing its provision with taxation. Monopolies result in market failures if a single supplier produces or supplies a product. The ability to set prices enables the monopolist to maximize profits by restricting output and this too results in welfare losses compared to the alternative where competition brings in additional production (assuming divisible technology). The principal agent problem is another source of a market failure where moral hazard issues arise as the principal is unable to prevent the agent from cheating or modifying a contract in a context of asymmetric information. Thus, market failures in NCE are due to the absence of the appropriate welfare maximizing rules existing or being enforced.

The point of departure of the New Institutional Economics or NIE was the analysis that market failures exist because the transaction costs of introducing or enforcing the appropriate rules would be too high. For instance, in the case of the negative externality the costs of defining property rights over each unit of pollution, or determining the marginal social costs of pollution and then firming the appropriate taxes on every polluter may be prohibitive. Thus, in the NIE analysis, the appropriate rules or institutions are not only able to reduce transaction costs (and therefore increase efficiency) but the creation and enforcement of these rules themselves have transaction costs. NIE was thus able to begin to explain not only the sources of market failures, but also why these failures may persist.

The analysis of the social gains from institutions like property rights was extended, as was the analysis of the costs of creating and transacting with these rights. Some of this was simply formalization of old insights. Adam Smith had recognized that the risk of expropriation would harm investment. Property rights are therefore needed to extend the time horizons of asset users. Without property rights, valuable assets can be overused (as in the tragedy of the commons) or investments in improvement may not be forthcoming. Property rights allow efficient market exchanges only if they are well defined over all relevant assets so that assets can be transferred to the highest valued uses and the effects of all activities can be fully taken into account (Coase 1960). And finally more detailed specifications of property rights within the organization of production are required to create incentives and compulsions to increase efficiency. Thus, Alchian and Demsetz argued that the structure of rights within the capitalist firm that created the 'residual claimant' was efficient because it created incentives for monitoring team production. This was a narrower version of the point made by Marx a long time ago about how capitalist property rights created the incentives and compulsions for both static and dynamic productivity growth (E. M. Wood 2002; M. H. Khan 2009a).

The analysis of transaction costs was significantly deepened in the context of the analysis of the firm (Coase 1937; O. E. Williamson 1985). Williamson argued that NCE saw the firm as a production function and hence a construct described by technology. In contrast for the NIE or more specifically for the transaction cost economics approach within NIE, the firm is a governance structure. This introduced for the first time the issue of aligning governance structures with the transactions problems that needed to be addressed, a territory completely uncharted by NCE (O. E. Williamson 1998). The NIE school has since undergone many iterations and refinements and is now a far broader field of economics than one that is just concerned with transaction costs at the firm level. Even Williamson has extended the approach to look at the role of institutions in society (O. E. Williamson 1998). The next step was to extend the language of institutions, transaction costs and governance to the classical concerns of political economy analysis involving power structures, institutions and organizations. Authors in this area ranged from Pranab Bardhan and Mushtaq Khan at one end to game theoretic approaches in the work of Avner Greif at the other. In the latter approach institutions are modelled as the equilibrium behaviour of individuals in non-cooperative games like Prisoner's Dilemma or Chicken Games. Property rights thus occupy centre stage in both NCE and NIE. However NCE begins with property rights and assumes either that they can be enforced costlessly or that deviations from that benchmark can be corrected with costless government interventions. In contrast, NIE maintains that both property rights and other institutions have to be created and their enforcement is not costless. The effects of property rights and institutions on efficiency and growth depend on the 'transaction costs' of their creation and enforcement relative to the savings in transaction costs that would follow if the creation and enforcement succeeded.

2.3 Property Rights, Transaction Costs and Conflict

Transactions costs are an important part of institutional analysis as they determine (by definition) the efficiency of transactions in a society. Since transactions can be in markets but also through other institutions, the transaction cost framework is a general way of looking at all social interactions. Limiting the discussion for now to the transaction costs associated with property rights, it is helpful to distinguish between ex-ante and ex-post transaction costs as they refer to different problems related to transacting with property rights. Ex-ante costs include discovering and negotiating prices, finding the right partners and devising the contract. Ex-post costs include monitoring the implementation of the contract, enforcing the contract, and engaging with any distributive conflicts that may emerge from differing interpretations of the contract (M. H. Khan 2009a). In game theoretic terms transaction costs therefore include coordination costs, the costs of distributive conflicts and the costs of containing free riding (Greif and Laitin 2004). There are cases however where property rights cannot be created because the transaction costs of creating the right (through negotiation or other processes) is itself too high, or the reduction in transaction costs that can be achieved is too low to make the cost of creating and enforcing these rights unjustifiable. It was with reference to such a situation that Ronald Coase explicitly recognized the possibility that where transaction costs were too high the allocation of rights or liabilities by law should aim to achieve the most efficient solution (Coase 1960) .

The insight that Coase is known for is that in a situation where transaction costs are low, the allocation of rights or liabilities does not matter (except in a distributive sense) because bargaining will result in an allocation of the asset or activity to maximize net social benefit. This is the core of the now famous Coase Theorem. But Coase also recognized that if transaction costs were significant, the initial allocation of the property right mattered precisely because there would be a limited range of transactions. While no institutional system is ever going to achieve zero transaction costs the policy question in a context of substantial transaction costs is to decide what types of rights to create and how to allocate them given that these decisions matter in the context of positive transaction costs.

The evolution of rights and institutions is a largely endogenous process within societies. Institutional change in an economy takes place through the interaction of its institutions and organizations, with organizations being the agencies driving processes of institutional change (North 1993). Organizations are collections of individuals that may themselves operate under institutional rules but their goal is to engage in collective action to pursue their own goals (M. H. Khan 2012f). While collective action by organizations has the potential to improve social outcomes, changes brought about by powerful organizations in their own interest can also damage societies. Institutional evolution is therefore subject to 'path dependence', that is change is incrementally driven by pre-existing organizations working under pre-existing institutions and the direction of travel may not always be progressive from the perspective of society or particular distributive goals. In general, the cost of changing institutions in another direction may be costlier than the direction it is already headed in even if the former change is socially more beneficial (North 1981). This is one of the reasons why developing countries so often fail to move towards efficient institutions.

Consider the important concern amongst mainstream economists with the failure of developing countries to create and maintain stable and well protected property rights (Krueger 1974; Besley 1995; Mauro 1996; Kauffman, et al. 1999; Olson 2000; Bates 2001; Acemoglu, et al. 2004). The main idea here is that weakly protected or ill defined property rights raise the transaction costs of negotiating institutional change and this impedes the enhancement of net social benefit. The policy recommendation coming from much of this literature is to implement policy reforms that strengthen property rights. This sums up the 'good governance agenda' that has been the dominant policy prescription for developing countries for some time now. However while a strengthening of property rights may in theory make further institutional changes easier and make markets more efficient, this approach ignores the distributive conflicts and transaction costs that may impede the achievement of well-defined property rights in the first place. As Khan has argued, the problem is that traditional pre-capitalist societies also had property rights appropriate to the social and economic problems they were addressing. The transition from a pre capitalist to a more productively organized capitalist society requires the creation of new property rights and the destruction or transformation of old ones. This process is never uncontested and is seldom peaceful. This is why distributive conflicts are so prevalent in developing countries (M. H. Khan 2002a, 2004b, 2009a, 2012f).

The conventional literature thus ignores many of the severe costs of contestation and conflict that mark the creation of the property rights that a productive capitalism requires. If the 'transaction costs' for creating these property rights are large (Khan calls the costs of conflicts during periods of institutional change transition costs) then the property rights required for the modern economy may emerge very slowly and indeed, trying to force the transition may not even be justifiable in terms of a calculus of maximizing net social benefits. Using the logic of NIE comparisons of net social benefits under different alternatives, there could be two reasons for externalities to persist as a result of missing property rights. One is that the potential net social benefit is more than the potential transaction cost of creating the right, but there is lack of knowledge about this on the part of the organizations involved or the state. Alternatively it could be that the net social benefit that is to be achieved is lower than the potential transaction cost so that solving the externality would not in fact be a Pareto improvement (Dahlman 1979). However NIE ignores a third factor which is the political (or transition) cost of creating or altering the rights in question. Different groups may block the change because they want an alternative specification or allocation of rights and the costs of these clients can be high depending on the relative power of these groups.

Before moving on to an analysis of what determines a state's enforcement capacity, we will look at some of the seminal NIE literature on transaction costs as the argument in this dissertation can be better understood with reference to this literature. Two branches of the NIE literature are relevant for us. The first focuses on the types of assets that are used in production (distinguishing between different levels of asset-specificity for instance) and the types of production processes (team production versus separable production) and asks what types of property rights are appropriate in each context. The second concerns itself with distributional conflicts and power structures in determining structures of property rights. One of the major concepts in the former body of NIE literature is the concept of the 'residual claimant' (Alchian and Demsetz 1972). This idea is based on the observation that the specification of property rights within a firm affects the incentives of putting in effort of different types, which in turn affects output. In a firm engaged in team production, the contribution of every factor provider is not additively separable and so their contribution cannot be judged simply by looking at the composition of the output. This creates a moral hazard problem as individuals have an incentive to shirk.

To address this problem a residual claimant emerges, though in Alchian and Demsetz's story, this process is unrealistically described as a voluntary one. Team members choose a monitor from amongst themselves and voluntarily grant that person rights over the residual to create incentives to monitor the others and thereby enhance efficiency. This addresses the free rider problem in team production through a voluntary contract. The residual claimant has the incentive to be an effective monitor because they have an incentive to monitor effort *ex-ante* and thereby ensure that output is maximized. But this functionalist approach to property rights ignores the distributive conflicts that could emerge in the identification of the residual claimant who would become the monitor. For instance it would seem implausible that workers who had equal rights to the output in the first place would give up their claims to the residual and agree voluntarily to be monitored. Even if the savings in efficiency were so large that all workers would actually be better off, there may still be a distributive conflict because each worker may want to be the chosen one who becomes the residual claimant because the latter is the biggest gainer. Unless one of them has characteristics that make it easy to choose that person over all others, a more or less long period of conflict and contestation may precede the emergence of the appropriate property rights solution in this case.

Williamson’s analysis of property rights introduces the concepts of opportunism and asset specificity. He also borrows from Herbert Simon’s theory of bounded rationality which posits that human beings are rational but can only be so in a bounded manner because it is not possible to have all the relevant information or to process it fully to make a fully rational decision (O. E. Williamson 1998). This is a serious challenge to the ‘Olympian’ rationality assumption of NCE where individuals are supposed to possess access to all relevant information and to have the computational ability to process it. Asset specificity refers to the fact that many assets are significantly less useful in their next best use, so their owners effectively earn quasi rents in the first best use. This is different from owners of property in NCE theory where asset-owners earn no rents. Williamson was particularly interested in physical assets and looked at the ownership structures that would develop in the face of asset specificity, essentially the emergence of integrated ownership. This insight can be extended beyond physical assets, to include investments in human capital, production chains or brand reputations. They are essentially investments in assets that are specific to a relationship or production process that may have little value elsewhere.

When assets are specific, their owners can become hostage to opportunistic decisions of buyers and suppliers who may want to dictate terms to the owners. For instance if a vendor is producing a very specific component this may induce opportunistic behaviour on the part of the buyer who may feel that prices can be negotiated downward as the vendor cannot sell the part anywhere else or use the capital assets to produce something else of equivalent value. The vendor’s bargaining power depends on how specific the buyer’s assets are, for instance how easy it is for the buyer to shift orders to other possible vendors. If the vendor’s supply is not easily substitutable it may be the vendor who can hold the buyer hostage because the latter has more specific assets. In either case, the owner of the more specific assets is the one who stands to lose more quasi-rents as a result of opportunistic behaviour and the outcome is that there is likely to be a merger of ownership through a restructuring of property rights. More complex ownership structures and contractual agreements therefore emerge because of such opportunism making market transactions costly.

It is in this context that Williamson also makes the Keynesian distinction between uncertainty (not knowing the probability of what will go wrong) and risk (knowledge of the probability of what will go wrong). In a world where uncertainty is important, *ex-ante* contracts and governance structures for enforcing contracts are insufficient and acceptable arrangements for *ex-post* modifications are needed. Again, this implies that appropriate property rights structures have to emerge. To go back to the example of the component vendor and the auto assembler, governance based on the enforcement of contracts in a market will be insufficient. Williamson suggests that in these contexts there could be a takeover of the vendor by the car-maker but in reality this may not happen because the result would be a loss in flexibility or in a dilution of management. Alternatively, the two producers would need to invest in relationships and the development of trust, including investments by the buyer in upgrading the technology or capabilities of the vendor. These complex arrangements can be examined as possible solutions to the opportunism problem that could prevent sufficient investments in technology by the owner of the more specific assets. The more specific the asset (or specialization) the higher the costs of relying on market contracts while the costs of internal governance (or alternative forms of governance) go down with integration or other forms of joint investments or cost sharing arrangements.

Williamson's model raises interesting questions but does not tell us who becomes the residual claimant in the integrated production process, or how other types of relationships can be structured. In his *Economic Analysis of Property Rights* Yoram Barzel tries to take this model further role by suggesting that the owner of the factor that can cause the biggest variation in income should logically become the residual claimant (Barzel 1989). This extends Williamson's analysis of identifying specific assets as a problem for market contracting by using the potential variations in joint output that each party can make to decide on which party should be the residual claimant on grounds of efficiency. In Barzel's model the problem of monitoring is reduced the most if the factor owner who can produce the greatest variation in output is the residual claimant and therefore does not need to be externally monitored. There is a common thread running through Coase's analysis of property rights and externalities, Alchian and Demsetz's analysis of residual claimant rights enabling efficient monitoring, Williamson's analysis of integrated production as a way of reducing the negative effects of opportunism and Barzel's analysis of determining property rights based on their capacities to vary joint output. In all these cases, the emergence of the appropriate property rights depends on calculations of rational individuals to maximize the joint net product and to negotiate compensations that leave all of them better off.

The alternative approach is to recognize the relevance of the underlying economic logic in some of these models but to examine conflicts that can explain why the emergence of solutions may be blocked. For instance in the Barzel model, the party that can cause the greatest variation in output may not be the most capable residual claimant or indeed may have less bargaining power than other contenders for the right. Similarly, in the case of Alchian and Demsetz, there is an assumption that the choice of the residual claimant is the outcome of a participatory decision but in reality the more likely outcome may be that the residual claimant emerges through contestation or primitive accumulation as in the classical Marxist political economy analysis (E. M. Wood 2002). The common limitation in all these influential models of NIE is that little attention is paid to the resolution of conflicting roles and interests that property rights represent, and the role of power, bargaining and conflicts in determining institutional outcomes. The framework of political settlements that we use in this thesis is an attempt to bring in this level of analysis to the political economy of institutions.

2.4 Power and Institutional Change

The second branch of the NIE literature that is relevant for us focuses on politics, power and conflicts as variables affecting institutional outcomes. Admitting power as a variable in institutional analysis allows us to examine the effects of contestation affecting the implementation of institutional changes regardless of whether they are potentially socially beneficial or not. While not explicitly looking at conflicts and power, North was nonetheless one of the first NIE economists to use the transaction costs framework to assess how countries evolved in their economic structures. In *Structure and Change in Economic History* North (1981) postulates that property rights evolve not just to reduce transaction costs but also in response to the motivation of the state to achieve its distributive objectives (primarily to benefit itself). This tension between distributive goals and efficiency goals was an important insight that is lost in some of North's subsequent work.

In his second book North (1990) contends that the differing economic performance of countries is not due to their choice of policies and interventions but largely a consequence of their institutional foundations that change slowly and in particular directions. This trajectory is defined by North as 'path dependency' because initial institutional conditions limit the types of changes that are feasible. This implies that inefficient institutions can persist and the path of change can be slow or even proceeding in the wrong direction. North gave examples of the English and Spanish feudal systems and said that differing feudal systems in each ultimately led to England's ascendance as a world power and Spain's subsequent decline. In addition, the absence of an effective democracy in Spain meant that the cost of changing its path was prohibitive. Hence path dependency was one reason why institutional change was a difficult process. Any significant path change implicitly faces significant transaction costs. In North's analysis this is because complex and large compensations have to be negotiated for all the losers and the larger the scale of the change and the more it goes against the existing institutional structure, the more costly it is to agree about and enforce the compensations required.

North explored 'mental models' and culture as explanations for the more rapid evolution of efficient institutions in some economies (North 1995). However, North's analysis of culture and norms is different from the game theoretic argument. In the latter, ideology or culture can help if it makes players believe that there is a high enough probability that others will play a cooperative strategy. North's argument instead makes use of cognitive capabilities to explain differences in institutional reform strategies. Individuals and organizations respond to economic performance by comparing actual economic outcomes with the expectations of their mental models. A discrepancy should result in changes in analysis as the model is updated in light of the evidence. If repeated failures do not result in models being updated and different models being attempted, North suggests that this may be a failure in cognitive processes in some population groups. Clearly, this line of argument can result in problematic conclusions about the prospects of reform in some population groups. Fortunately, the historical evidence suggests that mental models and cognitive faculties cannot be an important determinant of institutional change because there have been many sudden changes in the paths of change in countries which cannot be explained with reference to these variables. For instance, it is difficult to explain the Chinese economic takeoff in the 1980s in terms of a sudden change in these explanatory variables. Nor is there much evidence that South Korea underwent significant changes in norms and values prior to the takeoff in the early 1960s. However in both cases the economic takeoffs were preceded by political changes that may be much more significant. In his most recent work North no longer pursues this argument and this is discussed further later in this chapter.

Modelled as a chicken game, conflict in response to institutional change that changes the distribution of benefits is likely to continue, even though it appears to be irrational, till one of the parties establishes that it will not concede on its strategy. While beliefs are being adjusted in this way, conflict is in fact the rational outcome and can be long drawn. This brings us to the concept of 'holding power' which refers to the ability of a party to hold out in a contest. However, holding power is not necessarily equivalent to economic power though the latter can contribute to the abilities of individuals and organizations to hold out in conflicts. Conflicts are expensive in terms of lost opportunities and the cost of 'weapons' broadly understood and so the organization that can mobilize more resources has an advantage in holding out. But holding power also depends on other abilities, such as organizational capabilities and the ability to absorb pain (M. H. Khan 2010b). The ability to absorb pain can sometimes more than compensate for the inability to inflict pain. These organizational and ideological differences between groups explain why richer groups do not always win in conflicts. The poorer side can often win distributional conflicts especially if they successfully deploy a cohesive ideology.

The holding power of the Viet Cong or indeed the Afghan Taliban can be explained in these terms. Both these organizations used very specific ideologies and enforcement capabilities within their organizations to solve their internal collective action problems. But in addition, ideologies also helped them to establish a reputation to fight. When leaders and groups are belligerent and appear to be behaving irrationally they are not necessarily being irrational. They may be (unconsciously) signalling their willingness to continue the conflict indefinitely to establish their holding power. Hence the resolution of both prisoner's dilemma problems and the establishment of credible holding power can be embedded in building and maintaining power relationships. However, Bardhan cautions against the danger of defining power by its outcome (successful collective action or victory in distributive conflicts) as the analysis can then become tautologous. He suggests that power has to be defined in a way that is independent of its outcome to establish its usefulness as a variable in social science analysis. Given the multiple sources of holding power discussed earlier, it would be difficult to quantify power but it may be possible to rank organizations in terms of their holding power based on an analysis that is independent of outcomes. Groups can be assessed and analysed in terms of their economic, organizational and ideological capabilities that can contribute to their holding power and judgements can be made about the relative holding power of groups. The relative holding power of groups can therefore be an important variable that could explain the pace and direction of institutional change. It could also explain the levels of contestation associated with particular strategies of institutional change that can be described as 'transition costs' (M. H. Khan 1995).

The analysis of politics in terms of the distribution of holding power can be distinguished from a focus on political institutions. North approached politics as the 'political market' defined by political institutions where negotiations take place to change economic institutions that in turn affect the 'incentive structure' of the economy. According to North the most efficient institutional structure for the political market is the legislature in a representative democracy as these institutions can lower the transaction costs of negotiating institutional changes by allowing the negotiation of compensations and reducing uncertainty. However as John and Putzel argue democracy doesn't just provide incentives. It also allocates privileges and hence has distributional consequences (John and Putzel 2009). However North does not follow up this line of analysis. He argues only that institutional analysis needs to look at both political and economic transaction costs but limits his own analysis to political institutions as the determinant of political transaction costs. Democratic political institutions reduce political transaction costs through a number of mechanisms. The ease of negotiating compensations in a democratic legislature has already been mentioned. In addition, NIE analysts often assume that politicians will cooperate with each other based on *ex-ante* agreements based on their electoral mandates while authoritarian regimes can use more 'discretion' in allocating property rights and this can have negative effects on investors (Fukuyama 2005). These arguments do not always hold because some authoritarian regimes in East Asia have done very well with industrial policy and late development. Their performance can be explained because some type of conditional rent allocations can be helped by *ex-post* flexibility in revoking allocations of rights in the light of future performance (Okuno-Fujiwara 1997; M. H. Khan 2000a).

Engerman and Sokoloff argued that colonial histories in some developing countries left them with elites enjoying very unequal asset distributions and created an oligopolistic power structure that enabled these powerful elites to block growth-enhancing institutional changes if these threatened to change the asset distributions that underpinned their privileged positions in society (Engerman and Sokoloff 2002). Indeed, the only escape from situations like the one described by Engerman and Sokoloff would be to counter the established power structure with new mobilizations based on overcoming the collective action problems facing more dispersed groups who are disadvantaged by the institutional structure (Olson 1965, 1982). In Olson's analysis, the creation of a more dispersed distribution of power through the development of new organizations that have solved their collective action problems is not necessarily good in the long-term for the economic growth of society. The proliferation of groups can result in sectional rent seeking activities by groups that can result in hysteresis. Olson's analysis of the economic underperformance of the USA and the UK in the 1960s and 1970s relative to

Germany and Japan was in terms of the political stability in the first two countries that had slowly resulted in the proliferation of too many political organizations compared to the latter where war and defeat in the Second World War had disrupted these processes for a time. (Olson 1982).

The relationship between endowments, property rights and political power is an interactive one and the directions of causality run in both ways. However, by simplifying the story and focusing on one direction of causality can result in misleading conclusions. In the earlier analysis of Acemoglu, Johnson and Robinson (Acemoglu, et al. 2001) secure property rights are an important determinant of institutional change leading to growth. In a famous paper the three set out to prove that colonies which had settler populations (primarily America, Australia, Canada) did better than colonies where the Europeans' prime motive was extraction of the colony's resources (most of colonized Africa and Asia). This was because where the conquerors ruled from afar stable property rights could not develop as a result of their extractive strategies and predation. In the settler colonies, colonizers imported the robust property rights and institutions of the home country (England in many cases) as the settlers wanted to replicate the broad-based productive economies of the home country. The relationship between *outcomes* was never in question: stable property rights are observed in countries that are richer. Acemoglu et al. however were making a more fundamental point that economic growth happened in countries that *first* achieved the establishment of stable property rights.

However their analysis glosses over the question of power and sequence in the critical early days of the transition. Settlers did not actually first set up property rights to acquire the land from indigenous people in the settler colonies. Rather, in the colonies where settlers settled the power balance between the newcomers and the indigenous population allowed significant property right transformations often using violently unfair methods that wiped out a large part of the indigenous populations like American Indians and the Aborigines (M. H. Khan 2009a). Thus the property rights that helped construct the rapid capitalist transformation of these colonies were themselves the product of political processes that were not characterized by stable property rights and a rule of law. In this sense, the historical examples used by AJR do not actually prove the point they want to make, that economic transformations only require the establishment of property rights and the rule of law. In the later work of Acemoglu and Robinson *Why Nations Fail* (Acemoglu and Robinson 2012a) the authors add that the dispersed and stable property rights that they associate with growth (and which they now describe as inclusive economic institutions) require a dispersed distribution of political power (inclusive political institutions). But once again, while these characteristics can be associated with economies that have made substantial progress in economic development, the policy and analytical question is the sequence of events in the critical early years of transitions where conflicts with pre-existing property rights and distributions of power are likely to take place.

Another significant contribution in the NIE tradition on the determinants of economic and political development came from Robert Bates in his *Prosperity and Violence* (Bates 2001) . Bates' work is in line with some of North's as he was similarly concerned with the political foundations of economic development. He also saw the creation of organizations as a driver of institutional change and of economic growth. According to Bates institutions had to address the problem of risk to help support economic growth. The formation of capital entails returns after a considerable passage of time and the decision to invest therefore opens the investor to a considerable risk of expropriation. Institutions have to evolve to mitigate this risk if growth is to be supported. This influential work was based on two seemingly simple premises. One that development from an agrarian to an industrial society involves the taming or 'domestication' of violence by centralizing the capacity for violence in the state and second that it requires the delegation of authority from the state (where violence capacity is concentrated) to those who run economic organizations who can use that power productively. Again, this balance does approximate what we observe in advanced countries and does not appear to exist in developing countries, but we do not have a good analysis of the details of the process of transformation that leads from one situation to the other.

In developed countries, the state does have significant coercive capabilities but the threat of coercion is used not to capture wealth but to safeguard prosperity. Indeed the centralized capacity for violence is arguably an important requirement for protecting economic growth. Secondly, the holders of political power in the state delegate considerable powers to organizations in the private sphere that have the power to reward or penalize others. In this manner private interests are empowered to act in a way that is good for collective welfare in a context of competitive markets that discipline the private use of authority. Bates uses examples from developing countries, especially African ones like Ghana, Kenya, Somalia and Sudan to make the point that the transformation to an industrial society only happens when there is a balance between economic and political interests of this type. However, there is once again a distinction between patterns seen in advanced and developing countries and the processes through which the latter transform into the former. For instance, the delegation of authority to firms only works once there are many competitive and productive firms whose competition can impose some amount of discipline. But even in advanced countries the balance between regulation, firm autonomy and the meeting of other distributive demands in society is a matter of ongoing negotiation. In developing countries where the productive sector is weak and oligopolistic, a rapid delegation of authority to economic organizations may be counterproductive. The state has played a significant role in pushing economic transformation in late developers. The political balance that Bates describes is emerging in some East Asian countries as the *outcome* of a process of successful development that had different characteristics in terms of the balance between economic and political power while it was happening.

In terms of the processes going on in developing countries, Bates' analysis has a number of shortcomings. First, violence capacity is difficult to monopolize in developing countries, and it is not clear what the policy implication of identifying this as a necessary condition for development may mean. There are many groups competing for political power in a developing country making it difficult for any one of them to monopolize violence over a sustained period. The taming of violence requires a strong state and a legitimate ruling coalition that does not face significant challenges from excluded groups outside the legal mechanisms of political competition. These features are absent in most developing countries. Second the balance between economic and political interests identified by Bates describes features of developed countries but cannot be a policy objective for developing economies characterized by relatively small productive sectors, a relatively small number of competitive economic organizations and many competing political organizations that are engaged in political accumulation. A further reason that we discuss later in the context of political settlements makes the balance that Bates is defining difficult to achieve in developing countries. The capitalist sector is not yet large enough to generate enough tax for formal redistribution to create the incentives for political organizations to fully protect capitalists and delegate authority to them out of self interest. However Bates' analysis of the balance between political authorities and capitalists is an apt description of many western countries.

In Khan's analysis, the balance between economic and political organizations and economic and political power in developing countries is particularly interesting for understanding different trajectories of transition. In general, the balance between economics and politics in developing countries is different from that in advanced countries. There are large swathes of voters who are not asset owners but are members of large political organizations that can mobilize well enough to challenge the ruling coalition and the formal institutions of the state. These mobilizations can have long historical roots and new mobilizations are constantly emerging in developing countries. For instance in 2013 a highly successful mobilization of the Islamist Hefazat-e-Islam emerged in Bangladesh and took all analysts by surprise. It mobilized supporters from Bangladesh's poorer peasant class with no access to either economic resources or the political backing of the country's two main political parties. These types of mobilizations are continuously upsetting established political arrangements in developing countries and changing the character of the ruling coalition. In India the transition from stable one party rule by the Congress till the mid-1970s to an increasingly fragmented system of political coalitions is an example of major changes in politics being driven by the emergence of new political mobilizations with potentially significant implications for economics. Our analysis examines how the changing distribution of power among political organizations can help or hinder growth-enhancing institutional changes in this critical phase of social transformation. These processes of transformation are important to understand because they do not follow a simple trajectory that can be described in terms of the causal links suggested by comparing the patterns of politics and economics observed in advanced and developing countries. For instance, we see in our case studies and others that more inclusive political institutions in developing countries do not necessarily lead to more inclusive economic institutions and most such generalizations do not work (M. H. Khan 2004b, 2004c, 2005, 2006a, 2010b).

2.5 Informality

The modern sectors in developing countries can be described as 'capitalist sectors' based on organizations with capitalist property rights (of the type described by Alchian and Demsetz, Williamson and earlier by Marx), operating on the profit motive and based on modern technologies and organizational principles. These sectors can be distinguished from the traditional trade, agricultural and informal artisanal sectors. The latter are also typically located in the informal sectors of the economy that are not even in principle incorporated or regulated according to rules enforced by the state. The modern capitalist sectors are relatively small in developing countries (and this is why the average productivity of these countries is still low). Apart from the informal sector proper, many apparently formal economic organizations also have significant informally organized activities and network as not all economic activities can be carried out in purely rule-following ways in a polity that is largely informally organized. The networks of formal economic organizations with political organizations and the rent seeking they engage in often has large elements of informality in the sense that their rent seeking is not formally regulated as in advanced countries. Most political organizations are also characterized by large elements of informality. Political organizations can include informally organized networks and mobilizations (like the Hefazat-e-Islam referred to in the last section), or they can be informal networks and even mafia and criminal extensions operating in and through apparently formally organized political parties and organizations. Taken together informally organized organizations have considerable economic and political significance in developing countries, and this makes the latter structurally distinct from advanced countries.

The importance of informal (economic and political) organizations in developing countries has implications for the types of institutions we expect to see in these countries. In advanced countries, where formal organizations dominate, institutional change is driven by the rent seeking activities of formal organizations. The likely effects are incremental changes in formal institutions. Developing countries too have formal institutions that regulate formal organizations but in general informal organizations are not able to define their benefits and income flows by changes in formal institutions. The rent seeking by informal organizations is therefore likely to result in informal resource allocations (for instance through patron-client networks) or through informal modifications of formal institutions (for instance through modifying the rules of allocation of public goods to benefit powerful informal organizations). The informality that we see in developing countries is therefore not entirely accidental and some or much of the informality may reflect the fact that powerful organizations that happen to be informal organizations have achieved rent flows, rights and incomes through informal mechanisms that can be described as informal institutions (M. H. Khan 2010b).

This 'materialist' analysis of informality provides a different explanation of informality compared to the neo-Weberian analysis of informal resource allocation mechanisms like patron-client networks in developing countries. Weber explained patron-client networks in developing societies in terms of the operation of traditional political hierarchies in the context of a patrimonial society where rule is based on the exercise of personal charisma. This type of personalised interaction was antithetical to the logic of capitalism. The latter required a rational rule-following formal bureaucracy and this type of rule is associated in Weber's analysis with capitalism (Weber 1968). Later neo-Weberians developed these observations to argue that contemporary developing societies are still based on impersonal rather than formal rules though no longer based on traditional hierarchy. Neo-Weberians attribute informality in contemporary developing countries to the weakness of formal structures of democracy, resulting for instance in the deleterious 'crony capitalism' observed in South East Asia (Kang 2002; N. J. White 2004). This analysis assumes that informality is a mechanism through which elites capture rents *and* that democratic accountability could stop this process. However, the evidence suggests that while informality is indeed connected with rent capture, democratic processes do not stop it and indeed informal political organizations operate in developing country democracies to drive these processes. What is missing in the neo-Weberian analysis is a systemic analysis of how political order is maintained in a context where formal tax revenues are insufficient to maintain political stability.

In advanced countries tax revenues are used to provide significant redistribution to than social stability. The fact that formal economic organizations pay formal taxes on a sufficient scale to achieve stability creates incentives for political organizations to ensure that the formal rules that ensure the profitability of these economic organizations are protected and enforced (M. H. Khan 2010b). This dialectical relationship between economic and political organizations is consistent with the observations of the balance between political and economic organizations in the work of Bates and Acemoglu and Robinson, but without asserting a causal relationship between them or claiming that this is achievable in a developing country. For instance, the UK's National Health Service (NHS) is based on redistributive transfers that are part of the country's social contract that maintains a welfare state, and capitalist firms pay these taxes because ultimately the contract ensures that the economic system is protected (Bardhan 2012). Paying taxes not only protects the dominant capitalist sector but also gives the capitalist sector added credibility and leverage to demand incentives from the state to increase their productivity. Of course this social contract is currently under pressure as the capitalist sector in many advanced countries is now dominated by the financial sector, and rent seeking by the financial sector has resulted in various banking crises followed by the socialization of losses and the privatization of profits (OECD 2013; World Bank 2013).

The economies of developing countries, even of a behemoth like China, are simply not rich enough in per capita terms to achieve social stability purely through formal redistribution. The 'problem' with formal redistribution is that this has to happen on the basis of taxing and transferring to *generalized* categories of citizens and firms. Since the most powerful organizations in any society are not those of the very poor, and since generalized distribution cannot exclude the very poor, a society is only likely to achieve stability through formal redistribution when the resources available for redistribution are sufficient to ensure that rules-based redistribution can provide enough to everybody who matters. The 'advantage' of informal redistribution is that scarce resources can be targeted to the most powerful organizations to ensure that they do not engage in disruptive activities against the ruling coalition or even the state in general. A by-product is that consequently the capitalist sector has to operate in a context where significant informal organizations and informal rent allocations are happening. In addition, much of the capitalist sector itself has low productivity and is not yet competitive enough to survive in global competition. Thus, the capitalist sector not only finds it has to engage in some informal rent seeking of its own, it has incentives to do that too, apart from the fact that these processes can also be an avenue of enrichment beyond any economic necessity (M. H. Khan 2004b, 2004a, 2007, 2010b).

The period of transformation during which the capitalist sector is growing is also one of 'primitive accumulation' where the emerging modern sector is accumulating wealth not just through market transactions but also using non-market or 'political' means that can be legal like politically allocated land, land reform, policy-induced resource transfers like access to subsidized credit, and illegal activities like land grabs, tax evasion or extortion. This is another reason why the emerging capitalist sector has low legitimacy and cannot engage in legalized rent seeking, simply because it is politically difficult to legalize even the parts of their rent seeking that could be legalized. In developed capitalist societies economic and political power converges and capitalist firms dominate in terms of their collective rent seeking power. The rest of society is dependent on the capitalist sector for employment directly or by being part of a supply chain whether in services or manufacturing, or because their employment in the public sector depends on taxes from the capitalist sector. Hence capitalist property rights are seldom challenged and distributive conflicts operate within narrow limits that do not normally extend to fundamentally challenging the survival of the capitalist sector (M. H. Khan 2002b, 2005, 2010b).

The political economy of advanced economies is therefore close to the 'good governance' model of stable property rights, a credible rule of law, a government that is accountable and low corruption. But as we have discussed this presupposes a high enough per capita income that allows adequate formal redistribution and generates the resources for the enforcement of formal institutions. In economies still going through the transition period, the property rights of the capitalist sector and property rights in general cannot be formalized for the reasons laid out above. This does not mean there are no formal institutions in developing countries, there are and the scope of formalization is gradually growing, but formal institutions are always subject to challenge and organizations can quickly mobilize against them leading at least to systemic modifications, but sometimes to paralysis and economic logjams or occasionally political violence. This is the case in contemporary India and will be discussed further in the next chapter.

The norm in developing countries is that capitalists need informal protection of their property rights and informal resource allocations to support their accumulation. Emerging capitalists are therefore likely to be members of patron-client networks and linked to political parties. This makes for complex links between corruption and growth. When the business-government relationships result in informal allocations of resources that have damaging effects that corruption becomes predatorial. We discuss this in more detail in section 2.6. One reason why informal rent seeking by business can become predatory is if powerful capitalists acquire enough holding power to inflict political costs on their political patrons if the latter try to withdraw their support. In these situations politicians can be held hostage and lose the ability to have a say on the types of rents that are created. Since they continue to need access to rents for their own political survival, the result can be a proliferation of 'scams'. What we observe in India is a steady increase in the bargaining power of business organizations relative to political organizations following the gradual liberalization after 1992. We argue in Chapter Four that this has led to a growth in value-reducing rent capture in India. Here a shift in the distribution of power to economic organizations has had adverse consequences on India's growth. We discuss business-government relationships in the context of patron-client networks in Chapter Four. On the other hand informal business-government relationships operating through patron-client networks can also help overcome market failures in contexts where legal and formal institutional solutions are not always available (M. H. Khan 2002a, 2005, 2006b, 2010b).

We have many instances of these potentially growth-enhancing business-government relationships in India. For instance many large business houses use their political contacts to organise land transfers to acquire contiguously located plots of land for large projects. Of course this does not always support productive projects and speculative land capture also happens. Similarly, not all incentives or rents created through influence rent seeking are damaging. Many developing countries have used rents whose creation and management involved informal processes to promote industrial growth. These countries include South Korea, Taiwan, Japan, Pakistan and India in the 1950s and 1960s, Singapore, China and more recently Ethiopia, with varying levels of success (Papanek 1965; Amsden 1989; Wade 1990; M. H. Khan 2008b). The rent-creating instruments have included subsidies, duty exemptions, concessions on land prices, subsidized credit, and the granting of licenses for industrial investments, imports and other scarce commodities. Finally, informal resource allocations through political networks have been vital instruments for maintaining political stability.

Thus, there are structural reasons in developing countries that ensure that the relationships between political and economic organizations are different from the formal arm's length ones observed in developed countries. Even in developed countries the relationships between economic and political organizations are not always arm's length ones but the degree of formality is higher than in developing countries. As with formal rent seeking relationships, the outcomes of informal rent seeking depend on the details of the bargaining process and the incentives and compulsions of both sides. A capitalist in a developing country might need informal access to the ruling coalition to secure a tax or import duty subsidy that would make an industrial venture profitable. These processes may be formally illegal but the outcome could still be positive if the subsidy is used in ways that increase net social benefit. State capability or an appropriate balance of factors is needed not just to provide the subsidy but also to ensure that the conditions are right for its disciplined use by the capitalists receiving it. In India and Pakistan in the 1960s, states provided subsidies to capitalists to accelerate the catching-up process but the state was not strong enough to withdraw them and the outcomes were generally far less impressive compared to East Asia. The ruling coalition could not credibly threaten to discipline well-connected economic organizations because in South Asia the latter could make alliances with sub-groups within the ruling coalition who would protect them for a price or threaten to shift their allegiance to other political organizations leaving the ruling coalition in trouble (Gordon 1954; I. Ali and Malik 2009; M. H. Khan 2009a; Walter 2010; M. H. Khan 2011b). In the case of India in the 1960s and 1970s, business organizations could not credibly threaten to move away from the Congress, but they could protect their subsidies by making alliances with sub-organizations or powerful politicians within Congress. As a political organization, Congress was internally a work coalition and the leadership could not discipline individual politicians or sub-organizations. Thus, the imperative of maintaining political stability by allowing sub-organizations access to rents meant that the disciplining of potentially growth-enhancing rents was compromised. This system was less dynamic than the East Asian one but did achieve some capability development based on centrally allocated rents. We will see that by the 2000s, the bargaining power of big business was to make business-government relationships more problematic in many instances.

2.6 Alternative theories of Rents and Rent Seeking

In the NCE analysis rents are defined as incomes higher than the minimum a person would have accepted over her next best opportunity. Rents are usually taken in this analysis as a signal of inefficiency because they signal a deviation from the competitive market equilibrium necessary to achieve Pareto efficiency or the maximization of social welfare. In the simplest analysis, a competitive equilibrium achieves an efficient allocation of resources and at this point there are no rents.

Interventions or restrictions on entry or exit create inefficiencies but they also create rents for some. In NCE although rents are essentially transfers, they are also associated with deadweight losses. Hence rents typically signal inefficiency and this is one reason why the policy agenda of free markets looks at the presence of rents as prima facie evidence of uncompetitive markets. Indeed some interventions that create monopolies by preventing market entry or that transfer incomes from one group to another, can be welfare-reducing as a result of creating dead weight losses.

Rent seeking is the process (legal or illegal, formal or informal) through which groups or individuals spend resources to create rents for themselves or protect existing rents, or change the conditions of their allocation. As Olson pointed out, this is the objective of special interest groups when they try to solve their internal collective action problems. The rent seeking process has social costs as resources are used up in these activities. NCE economists like Krueger, Posner and Bhagwati maintain that there are very high costs associated with rent seeking as individuals and groups spend resources in order to create rents or protect their rent by influencing the state (Krueger 1974; J. N. Bhagwati 1982). This prevents these resources being used productively elsewhere leading to a global inefficiency as a result of this loss. Rent seeking is therefore a variant of government failure because it describes the political process through which resources are wasted and inefficiency is created through interventions that create rents. As the government's willingness to intervene triggers rent seeking, NCE economists argue that the cost of government failure can be more than the market failure the government was claiming to target in the first place. According to the specific model that Krueger develops, rent seeking uses up resources equal in magnitude to the total rent. Hence all rents have a damaging consequence because they generate social costs through rent seeking.

There are two weaknesses with the basic neoclassical argument. First, while some rents are indeed socially damaging, many other rents are associated with interventions that are very beneficial, and particularly in the context of late development. Second, rent seeking costs can vary quite a lot depending on the nature of the political market. In Khan (2000b) an analysis of rents and rent seeking is presented that shows that if some rents are associated with very beneficial interventions and the rent seeking cost is not too high, the overall effect the rent seeking process can be socially beneficial. This is true regardless of the legality or formality of the rent seeking process. Rents can be associated with interventions that correct market failures like credit market failures or learning failures. In addition, it may also be necessary to allow transfers (rents) to factions and classes who would otherwise be disruptive. The challenge of development is for the system to maintain sufficient political stability (through transfers) while creating and managing growth-enhancing rents in ways that ensure they are not misused.

All countries have significant rents in their economic and political systems, and in developing countries many of these rents and rent seeking processes are informal and sometimes illegal. The simple NCE analysis of rents and rent seeking cannot explain both the persistence of underdevelopment and violence in many developing countries with high levels of rents and high rates of growth in some others with similar levels of rents. Khan's framework allows an analysis of specific political structures that can help explain why some configurations of rent creation and the associated institutional structures can be growth promoting. Of course, some economists within the mainstream NCE position or who are working closely with these frameworks admit to some rents being necessary for efficiency, growth or stability (Stiglitz 1989; Bardhan 1997; North, et al. 2009). More generally, a focus on rents can provide a useful lens through which to look at the interactions between state and society.

A contemporary attempt at analyzing the role of rents in developing countries comes from Douglass North, John Wallis and Barry Weingast and subsequently Steve Webb (North, et al. 2007) or NWWW. These authors introduced into the mainstream institutional economics debate the explicit recognition that widespread rents in developing economies are not the result of any pathology. The framework of 'Limited Access Orders' or LAO is an attempt to understand the structural differences between advanced and developing countries without characterizing the latter as inferior in any normative sense. They attempt to understand developing economies as social orders whose macro-political economies need to be studied in their own terms. The LAO is defined as an order where violence between elites is controlled by creating rents for them. The rents are created by limiting access to organizational capabilities hence the term ‘limited access orders’. In their analysis, the most important capability or tool for creating rents is the capability to create organizations. If everybody had the tools to set up organizations and any feasible organization could be set up, they argue rents would be competed away and we would be in an Open Access Order of the type that exists in advanced countries.

This part of their analysis is weak, as it does not describe the rent seeking process in advanced countries. However, they do identify the fact that in developing countries rents have to be created often through informal means to create incentives for the organizationally powerful to desist from violence. This is also one of the first instances where mainstream institutional analysis ascribes a positive role to informally created rents in maintaining political stability. There are some overlaps here with Bates’ ideas that the productive potential of a society is promoted through a stability that is born out of ‘domesticating violence’. However Bates’ had no analysis of rents as an instrument for achieving stability and this is the LAO framework’s contribution. The definition of the ‘Open Access Order’ (OAO) by NWWW in contrast borrows heavily from the model of open and competitive markets in NCE analysis. The idea that there are no rents in OAOs because organizational capabilities result in rents being competed away is the weak part of their analysis that is a throwback to a simple NCE view. This interpretation of the rent seeking process in a modern developed economy is similar to Acemoglu and Robinson’s claim that inclusive political and economic institutions ensure competitive markets, without rents (Acemoglu and Robinson 2012a). In reality, institutions in advanced countries allow and allocate significant rents but NWWW make a significant breakthrough in the mainstream institutional economics analysis of developing countries.

A common element in the LAO framework and the analysis of political settlements is that both models recognize that rents are important for maintaining political stability and that rents are organized differently in developed and developing countries. However, apart from this common agreement, the LAO framework is organized quite differently. The LAO identifies a ‘Dominant Coalition’ (DC) whose members support each other to create organizations that sustain their rents while limiting the access of others to organizational capabilities. The assumption is that collusion and cooperation between the individuals who are potentially violent ensures their organizations have the capacity to solve their internal collective action problems (and thereby generate rents for the elites) but keeps others out. This makes the LAO distinctly non-Weberian because the same rules do not apply to everybody, whereas OAOs are characterized by impersonal rules enabling any organization.

North et al also provide us with a typology of LAO's based around the ease setting up of organizations and adherence to the rule of law. A Fragile LAO is one where the DC is unable to sustain almost any organization due to high levels of violence and where it is not possible to separate political and economic organizations. The Basic LAO is one where the government is the DC and still heavily restricts access to organization building. The third is the Mature LAO where the DC allows private organizations to form outside the government but still restricts access to rents. The problem here is that the framework classifies the entire range of developing countries from The DRC to China with every possible variation in between using just one variable–the ease of setting up organizations. This is not enough to capture all the dimensions of these economies. For instance both China and India have characteristics of mature LAOs in the North et al analysis yet the two are vastly different from each other in the relationships of power. India despite its perceived greater openness vis-à-vis China in the political sphere may not actually be closer to make the transition to a developed country status compared to China. If anything, the high levels of political violence and damaging political rent seeking associated with India's political openness may make it more vulnerable or even fragile compared to China (M. H. Khan 2008b; P. Roy 2012). The relationship between the ease of forming organizations and the effects on the types of rents that are created is a complex one. It is this analysis that is required to assess the development prospects of countries. NWWW argue that there is no teleological hierarchy of the three types of LAOs, with countries necessarily moving from fragile to basic to mature. They also argue that is not necessary that mature LAOs are more developmental than basic LAOs. But then it is not clear what the classification adds to our understanding of the transition developing countries are going through.

The NWWW framework also develops the idea of a ‘double balance’ between economics and politics, a two-way relationship between the economic and political characteristics of a society. This is similar to Bates’ examination of the interaction between economic and political interests. In the NWWW framework, the specific assumption is that openness in the economic sphere creates pressures for openness in the political sphere and vice versa. In OAOs there is a balance between high levels of openness in both spheres and the reverse is true in LAOs. Using the framework of the political settlement, we will also examine a relationship between the *politics* of organizations seeking institutional changes to support their rents and the implications of these institutions and institutional changes for *economic* outcomes. But the rent seeking mechanism through which this interaction operates is different from both the Bates and the NWWW models.

The transition from LAO to OAO status is based on the achievement of three ‘doorstep conditions’. The first is a rule of law for elites. Once this is achieved, elites are constrained by rules and there is a steady institutionalization of such rules through the constant interaction between members of the DC. This paves the way eventually for the emergence of impersonal interactions more broadly, and the origin of the property rights and legal systems that are the cornerstone of advanced economies. The second is the emergence of perpetually lived organizations that live beyond their founding members, such as private corporations or even public corporations like municipal bodies. The most important perpetually lived organization is the government. A government that can only make credible commitments for the duration of its own life cannot credibly commit to support private organizations in perpetuity. This idea of perpetuity is one way in which the LAO model tries to address the problem of the short time horizons that many developing economies seem to struggle with. The third condition is central control over organizations that have the potential to exercise violence. As in much of the NIE literature, these conditions are identified as patterns based on observations of advanced OAO-type countries. The authors do not satisfactorily explain the process through which these doorstep conditions should lead to the emergence of an OAO or how these conditions are actually attained in developing countries.

In our analysis or rents and rent seeking in the framework of political settlements there is no assumption that elites in developing countries can generally cooperate and collude to exclude other organizations as in the LAO analysis. Rather, we argue that organizations are relatively easy to set up in developing countries and they are likely to compete with each rather than colluding. The relative power of different organizations and their strategies of conflict or compromise determine how the Ruling Coalition (RC) is set up. Unlike the DC, this does not necessarily include all of the elite and the elite do not cooperate to assist each other's organizations. The ruling coalition is a loose ensemble of the organizations that are for a time in control over the available instruments of the state. Perhaps the most significant difference between the framework of political settlements and the LAO framework is the role of rents. According to NWWW rents are competed away in an OAO because of the open access. The impersonal rule of law is important to ensure this because it means that any competent group of people can set up an organization. The law provides the tools and third party enforcement to make this easy.

However rents do exist in developed economies only that the rent seeking process is different and more formal. In an advanced capitalist economy the formal rule of law allows everyone equal access to formal rent seeking processes. However this does not imply an absence of rents. The reality is that access to land, finance, and knowledge is structurally limited to a few. As Marxist critiques point out, an asymmetric asset-ownership and power structure is the significant feature of advanced country capitalism. Rents are widespread in the formal financial sector and Schumpeterian rents are critical for technical progress in the advanced economy. Redistributive rents have a no less significant role than in developing countries but they are largely organized through formal transfers through the budget. In LAOs redistributive rents tend to be informal to a greater extent and are distributed through both formal and informal political organizations. Both the informal redistributions in the LAO and budgetary provisions in developed social democracies are needed to maintain political stability.

Apart from the issue of formality, a further critical difference between advanced and developing countries is that the rents required for economic dynamism in the latter are somewhat different. The social transformation of a society from one that is largely pre-capitalist to one that is largely capitalist involves significant structural changes in the allocation and definition of rights and in the acquisition of new technological and organizational capabilities. These processes require changes in property rights, the creation of new property rights, and policies that facilitate technical and organizational learning. All of these policies are likely to be associated with significant changes in the incomes of some, in other words, rents. The analysis of these rents is missing in much of the NIE inspired analyses, including Bates, Acemoglu and Robinson and NWWW. Whether as a result of conscious policy or as the outcome of complex processes, social transformations involve these changes and rents play a crucial role in these transitions. As mentioned earlier, rents can become damaging or predatory if the balance of power between organizations and between them and the state means that asset transfers and rents do not result in greater social productivity. Yet transformations where social productivity is rapidly increasing are also inevitably associated with significant rents. The LAO framework is important for identifying the importance of informal rent transfers in developing countries but it does not analyse productivity growth and hence it cannot be a frame of analysis for understanding development.

Our analysis based on Khan (2000b) identifies a number of types of rents that are critical in processes of development. What this alternative analysis suggests is that the effect of a rent depends critically on institutional conditions such as the enforcement capability of the state. For instance, import protection or export subsidies can have very different effects depending on the institutional and organizational conditions that can enforce obvious conditions to ensure that the support is not a free gift but an opportunity to raise productivity. For instance, in a top-down industrial policy as in South Korea, required conditions include state capacity to create rents for capability development but also the capability to discipline those who are receiving the rents and withdraw them if results are not delivered. This implies states should possess the organizational capability to identify priorities, and even more so, the ability to correct mistakes by re-allocating rents when necessary. These capabilities lead us back to the question of the distribution of power between organizations. If the distribution of power is such that state organizations are weaker than the business organizations they want to discipline, the outcome of the rent allocation is likely to have low or negative net social benefit. The recipients will resist disciplining and attempts to discipline them will have political costs for the ruling coalition and declining political stability or they 'capture' the rent with damaging implications for productivity. A top-down industrial policy is not the only way in which capability can be enhanced to raise productivity in developing countries but each rent allocation strategy requires an appropriate configuration of power for developmental outcomes to be achieved (M. H. Khan 2009b).

Khan outlines a number of rents like transfers, natural resource rents, monopoly rents, Schumpeterian rents and learning rents (M. H. Khan 2000b). NCE regards most rents to be signals of inefficiency but with some exceptions. For instance, rents associated with the creation of property rights over free access resources can signal an increase in net social benefit as a result of controlling over-use. Property rights extend time horizons of users and can create incentives for maximizing net social benefits over time. However, even in the simple case of creating property rights to address a free access problem, the allocation of the rights has to be compatible with the distribution of power across potential claimants if the costs of conflict are to be minimized. If this does not happen, an improvement in efficiency may not be achieved as a result of the high costs of contestation. NCE has also begun to recognize the importance of Schumpeterian rents for creating the incentives for technological innovation. Much like natural resource rents, Schumpeterian rents create incentives, in this case for innovators to take risks in creating new technologies. The protection of intellectual property rights creates the higher profits (Schumpeterian rents) that create the appropriate incentive. In this case the state has to have the capability to ensure that innovators do not use their rent seeking capabilities to achieve excessive periods of protection or to capture tax incentives or subsidies for innovation without the compulsions to deliver results. Formal rent seeking processes in advanced countries have arguably created intellectual property rights protection regimes that are excessively protectionist and that damage the pace of innovation (Stiglitz 1998).

Transfers like subsidies are rents because they create incomes that would otherwise not have been available to recipients. In NCE transfers are damaging because they are associated with dead weight losses. However this type of analysis typically ignores the potential welfare gains of transfers (though in some cases transfers could imply welfare losses if they are from poorer to richer people), and they ignore the benefits of political stabilization. Even in developed countries transfers to certain sectors (like the Common Agricultural Policy in the EU) may be necessary for maintaining political stability. This type of redistribution may not be directly productivity enhancing the political stability may indirectly contribute to social productivity. In developing countries these transfers happen through a combination of formal and informal mechanisms. In developing countries, political parties compete to form ruling coalitions by distributing rents to powerful political organizers and their constituencies to achieve the support they need to capture state power with the most economical distribution of rents to lower-level supporters. These strategies typically involve considerable elements of direct off-budget resource allocation to organizers and supporters as well as creating opportunities for supporters to capture rents outside the budget through government contracts and employment creation. In contrast to the political rent distribution in advanced countries, developing countries therefore have a much higher level of 'patron-client politics' and political corruption.

One rent that will play an important part in our analysis is the learning rent. These are rents associated with interventions or policies that can potentially help entrepreneurs and firms achieve the technical and organizational capabilities that they need to achieve competitiveness through the adoption of existing technologies. This is a critical part of the 'catching up' problem in developing economies. Given the lower labour costs in developing countries, the pace of technology adoption is often much slower than it could be and this is at the heart of the problem of underdevelopment. The proximate constraint is that the productivity of labour is so low that even with very low labour costs investments in many sectors are not profitable. The deeper problem is a contracting failure: the transaction costs of hiring and training managers and workers is too high because of the difficulty of making and enforcing the appropriate contracts that investors do not want to take the risk. The training that is relevant is not mainly the acquisition of formal skills. The most serious gap in developing countries is the lack of 'tacit knowledge' about how to organize and manage manufacturing processes. While technology can be relatively easily bought in the form of machines, the only way to gain skills in manufacturing and achieve high productivity is through 'learning by doing' carried out with high levels of effort. During this process someone has to finance the losses due to low levels of productivity till the tacit knowledge has been acquired. The problem is that the learning-by-doing process can fail unless all participants put in high levels of effort in the learning. This is difficult to observe, costly to monitor, and difficult to address because there are many contingencies that are difficult to contract for *ex-ante*.

If private investors face high transaction costs in organizing these investments, the only way learning can happen is through some form of public cost-sharing or subsidization, but with appropriate institutional conditions to ensure that high effort learning takes place. This is where a state's enforcement capability relative to the types of learning strategies being attempted becomes critical. If subsidies can be captured without firms having to take put in the high levels of effort to achieve competitiveness, satisficing solutions on the part of subsidy recipients can result in poor outcomes. This is essentially what happened with much of the industrial policy initiatives in South Asia in the 1950s, 1960s and 1970s. However, learning rents can also sometimes emerge in response to initiatives and rent seeking activities of firms and the regulatory conditions and incentives can sometimes produce desirable outcomes even in the absence of strong state capabilities for monitoring and withdrawal of learning rents from above. For instance, in the 1980s the Indian government allowed Suzuki access to the protected Indian automobile market provided its joint venture with Maruti could produce a car in India that would be significantly better than the already existing Ambassador and with 60 per cent domestic content within five years (M. H. Khan 2009b). This strategy promised significant rents to Suzuki *ex-post* because the Indian automobile sector had around 85 per cent tariff protection in the early 1980s, but Suzuki would first have to invest significantly in transferring tacit knowledge to Indian components producers. This was a case of a successful use of learning rents in India because the policy allocated these rents in such a way that the recipients could not easily capture the rent without achieving the learning, given the politics and capabilities of the ruling coalition and the Indian bureaucracy of that time.

Khan's analysis therefore does not recommend a return to the 'statist' model of industrial policy that worked in East Asian countries or any form of a 'big push' strategy in countries where the ruling coalition is weak and many powerful organizations are competing for rents (Rosenstein-Rodan 1943). Countries like India, Pakistan, Bangladesh, Tanzania or Indonesia, performed poorly when they tried to address market failures with policies and financing instruments that were similar to the East Asian model but without the political settlements that were required to enforce and implement these types of strategies. Their failure was not due to the fact that intervention by the state always led to government failure, as many NCE economists have tried to show (Krueger 1974; J. N. Bhagwati 1982; Shleifer and Vishny 1993). A more likely explanation (given the success of East Asia) is that in second-tier countries like these, the institutions of intervention were not commensurate with the underlying political settlement. Ambitious policies in second tier countries during their industrial policy phase did result in their expansion into new sectors but in many cases competitiveness was not achieved as the state did not have the capacity to discipline entrepreneurs. In contrast, South Korea's political settlement allowed state organizations to effectively allocate learning rents and discipline the large business houses receiving them, with the result that its industrial policy outcomes were much better. The configuration of economic, political and bureaucratic organizations described by the political settlement therefore affects the viability of particular institutions like industrial policy instruments and conditions. The macro configuration of organizational power determines the incentives and capabilities of the organizations involved in rent seeking and therefore not only the types of rents created but also the outcomes associated with these rents as a result of differences in their implementation and management. We examine the analytical framework of political settlements in greater detail in the next chapter.

Chapter 3 . Political Settlements, Organizational Power and Growth

This chapter presents our analytical framework of the political settlement which is a description of the distribution of power across organizations at a macro level and how this distribution is maintained by the distribution of benefits generated by formal and informal institutions. The features of the political settlement allow us to analyse institutional choice and institutional performance at the micro level. The first section analyses how the configuration of power sets the context for institutional policy making and the enforcement of particular institutions. The second section outlines the two-way relationship between institutions and the distribution of power. Institutions determine the distribution of benefits across organizations and therefore sustain a distribution of power. The relative power of organizations in turn determines the extent of enforcement of particular institutions. Formal institutions that hurt the interests of powerful organizations are likely to be blocked, or their enforcement modified in informal ways. The third section outlines a typology of political settlements focusing on the configuration of political organizations but also referring to the configuration of bureaucratic and economic organizations. This section also describes the purpose of mapping the features of the political settlement at a macro level. The characteristics of the political settlement help to explain institutional evolution and the effects of particular institutions at the micro level. The final section outlines the methodology used in this research.

3.1 Political Settlements and the Growth-Stability Trade-off

The framework of political settlements allows us to explore the key issue concerning this research—the institutional and organizational configurations that drive or block growth in developing countries. Significantly, in this framework there are no good or bad institutions in themselves. There are only good or bad combinations of institutions and political settlements. This suggests there is nothing 'intrinsically efficient' about a particular institution and nor is it transferable (John and Putzel 2009). For instance, the attempt to operate a particular institution in a specific political settlement may result in such major modifications in the institution or such high levels of conflict that there is a net negative effect on growth. But in a different structure of power the same institution could create the right incentives and be sufficiently enforced to support positive results. This is why an effective institution embedded in the politics of a particular state provides no guarantee that the institution will work in the same way somewhere else (M. H. Khan 2010b). This embeddedness is different from that identified by Williamson. Drawing on North, Williamson argues that formal institutions are embedded in 'informal institutions' including customs, traditions, norms and religion, and these have a 'pervasive influence' on long-term growth (O. E. Williamson 2000). In the Williamson-North approach to informality, the claim is that some types of customs or cultures increase the costs of enforcement of the required formal institutions. In contrast, in our analysis, the most important informal institutions are not culture and norms, but the informal institutions of rent allocation that exist because powerful informal organizations exist and seek rents. However, culture and ideology do matter because they can be used by political organizations to mobilize supporters and constituencies that in turn underpin their ability to seek rents. This indirect significance of culture and ideology will be particularly explored in our analysis of the case of Gujarat.

Khan defines a political settlement as a reproducible combination of a distribution of power across organizations and a distribution of benefits across them achieved by institutions, both formal and informal. The reproducibility of the system means that the distribution of power and the distribution of benefits across organizations are sufficiently aligned for a serious breakdown not to happen, though incremental changes in the institutional structure are always happening. A political settlement also has to be viable in the sense that minimum conditions of economic reproduction and political stability are achieved, but the degree of economic performance or political stability that this implies is specific to the tolerance limits of particular societies. Once a viable political settlement emerges where institutions and power are compatible the two are supportive of each other and this makes the social order robust and difficult to change. The emergence of a political settlement only implies that these systemic features exist, it does not imply that growth or stability is satisfactory in a normative sense.

Once a political settlement is established, any incremental institutional changes driven by particular organizations or the state will result in incremental changes in the distribution of benefits that may or may not be accepted by powerful groups within that settlement (M. H. Khan 2010b). Thus, the political settlement as a description of the macro-level balance between institutions and organizations affects the viability of particular institutional innovations and the outcomes associated with these at the micro-level. Hence our analysis of political settlements needs to be conducted both at the macro and a micro level of analysis. The macro-level analysis identifies the institutional and organizational architecture of a polity. The micro-level analysis examines the path dependent and incremental processes of institutional change by looking at the particular changes that emerge and their economic and political consequences given the macro-level political settlement. At the macro-level, the analysis of political settlements is an identification of its characteristics, and therefore a description. It is not a causal theory where the political settlement is 'explained' by other independent variables. We do not have any credible theory that can capture the complexity of interactions that have resulted in different types of political settlements in different contexts. Nor do we have a credible theory of how one macro-level political settlement can be transformed into a different one. The best we can do is to look at the ways in which micro-level institutional and policy changes happen and their consequences. The very general hypothesis is that if a social system is progressing in the direction of greater social productivity it is more likely to gradually progress towards higher living standards, greater political stability and the evolution of more formal social democratic systems, though none of the latter are necessary outcomes of development.

The micro level analysis of particular institutions and strategies looks at the implications of particular institutions for growth and political stability. An institution that has a positive effect on growth if implemented and enforced in a particular way may have negative effects on political stability. The intensity of the decline in political stability depends on the particular implications for distribution and the relative power of the organizations affected by these changes. In the general case, we can look for any particular trade-offs between growth and stability in the context of specific institutional changes in particular political settlements (M. H. Khan 2010b). This analysis can help to explain why similar institutions often produce differing results in different contexts.

To structure our discussion we begin with a broad distinction between the political settlements of advanced and developing countries. The political settlements of developing countries are broadly 'clientelist' political settlements which refer to the significant sources of informal power and informal resource allocation in these contexts. We will look at many important differences *between* developing countries but at a broad level, developing countries have a much greater range of informal institutions and organizations compared to more advanced countries. The formal-informal differentiation is not binary; there is clearly a range of levels of informality, which roughly corresponds to the level of development of the economy. Patron-client relationships operating through political parties and political organizations are a significant mechanism through which informal rent seeking and rent allocation takes place. These informal patron-client structures operate in a variety of contexts, from contexts of authoritarian military rule to democracies though there are differences of detail across these contexts.

The political pyramid in a clientelist political settlement can be loosely described as a pyramidal organization where patrons at higher levels of the pyramid deliver resources or allow rent capture by lower levels to build up the support and organizational strength that in turn allows the patron to capture rents using this organizational power in rent seeking contests at higher levels (M. H. Khan 2005, 2010b). Developing countries whether they are democracies, single party systems or authoritarian regimes usually have a number of competing political organizations organized as patron-client groupings. How fragmented or coordinated these organizations are and the strategies they follow in building up their organizational power is specific to particular contexts, and we need to keep in mind the point made earlier about the macro-analysis being primarily a description of the relevant characteristics and historical trends that have led to the emergence of the features of each case.

In most cases, patrons in the higher levels in each network make rational calculations about the pay-offs they have to deliver to lower levels to garner the support they need to engage in their own rent seeking contests. This rational and materialist analysis might seem at odds with the growth of ideological organizations in South Asia, such as Islamist organizations in Pakistan. But in most of these cases, while the mobilization may indeed be based around religious ideologies, the organization and its supporters also expect pay-offs for the political organization to be effective. Effective organizations need to have access to resources and they need to be able to distribute it within their organizations. The sources of these resources, the relative bargaining power of patrons and clients at different levels within the organization, and what the organization does with its bargaining power in terms of the rents they collectively target or the policies they pursue do of course differ across organizations.

The developing country political settlement can be contrasted with the general characteristics of the political settlements in advanced capitalist countries, though here too there are significant differences across countries. Here, the productive sector is largely modern, high productivity and formal and the rules that are enforced support the activities of these high-productivity economic organizations. Social redistribution also happens within these formal institutional structures, through unemployment benefits, pensions and health care. The main differences are that the productive enterprises can pay for the enforcement of rules, and the very numbers and diversity of these enterprises means that generalized rules have to be devised for that economic system to operate. Finally, the formal taxes these enterprises pay also allows political stability to be maintained through rule-following politics. Rule violation by politics is neither necessary nor in the interests of the economic organizations that pay the taxes. These feedbacks ensure that the political settlement here is largely formal and the rules support the interests of productive enterprises. But this does not mean that there are no rents and rent seeking. Both economic and political enterprises are engaged in formal, rule-following rent seeking. The rents that productive enterprises target are rents like Schumpeterian rents or financial sector rents that can often be potentially productive, but can sometimes be very damaging. There are also political rents that are sought by interests and organizations that can sometimes be necessary for stability and sometimes go far beyond what is necessary and constitute a drag on development. Thus, very similar issues are involved in advanced economies but we will not pursue these questions further here.

3.2 The Dialectical Relationship between Institutions and Power

A social order is stable and reproducible when the distribution of benefits allowed by formal and informal institutions is more or less aligned with the distribution of organizational power (M. H. Khan 2010b). This 'macro-equilibrium' is continuously being disturbed because economic and political activity changes the power of organizations and organizations are continuously engaged in rent seeking activities to change formal and informal institutions. However, as long as the disturbances are not significant and incremental institutional changes are supported by incremental changes in the distribution of power, the evolution of society can be relatively orderly. However, many important policy and institutional changes are not driven in this organic and incremental way and these institutions do not necessarily work as expected. One way of describing the functioning of formal institutions that are introduced by policy is to look at the gap between the theoretical rules embodied in the formal institution and the actual operation of that institution. If the institution in question implies a distribution of benefits that is likely to be resisted by powerful organizations a gap is likely to open up between the formal institution and its actual implementation. The gap can be due to the fact that its implementation results in conflicts and contestation that results in partial implementation (and that too with significant social costs due to the contestation), or its implementation is modified to bring distributive outcomes closer to the distribution of power, or some combination of the two.

The actual operation of an institution in the context of a specific distribution of power is described as its 'operational equilibrium' and this is usually substantially different in developing countries compared to the formal specification of the rules that assumes that individuals and organizations actually follow the rules specified by the formal institution. A partial or modified implementation of formal institutions is often the case because the underlying distribution of organizational power usually does not allow the effective enforcement of many formal institutions (M. H. Khan 2012f). For instance, the formal institution in question may be a rule that imposes a tax on certain activities. The tax may not be fully implemented because in the context of an informal power structure, the organizations that are to be taxed are able to resist its implementation using informal networks or even the threat of violence in some cases. The rule may therefore be imposed on some organizations and not others. In addition, even if the rule is imposed, it may be modified as a result of informal rent-sharing between the economic, bureaucratic and political organizations so that the tax is not properly assessed or delayed in its collection. In advanced countries, the operational equilibrium does not deviate to this extent from the formal specification of the rule because the overall political settlement allows the enforcement of formal rules. The likelihood of a particular formal institution being partially implemented or modified depends on the organizational power structure in which the institution is being imposed. This is why an analysis that simply focuses on the appropriateness of the formal institutional structure in a developing country often fails to identify the source of the institutional problem. A formal institution may be theoretically 'appropriate' but may not be appropriate in the political settlement of the society in question (M. H. Khan 2010b).

Operational equilibria can be strong, moderate or weak depending on how closely the actual implementation of the particular institution corresponds to its formal specification. If the formal institution exists only in name and is very indifferently implemented, the formal institution has a very weak operational equilibrium. In the extreme case of course resistance can result in the formal institutions not even emerging but the situation in many developing countries is that all sorts of formal institutions have a legal existence but are observed to varying degrees. Acemoglu and Robinson have tried to capture aspects of this problem when they identified the importance of 'political losers' and how they can create a wedge between the 'de jure' political power of political institutions and the 'de facto' political power exercised by these economic actors (Acemoglu and Robinson 2000; Acemoglu, et al. 2004; Acemoglu and Robinson 2008). A&R posit that the reason for the divergence in the industrial development of Britain and Germany on the one side and Austria-Hungary and Russia on the other is that in the latter technological change was successfully opposed by those who feared a loss of political power as a result of these changes and not just a loss of their economic rents. In the 2004 paper A&R offer a framework that attempts an analysis similar to ours where they argue that a combination of political institutions endowed with de jure powers and the initial distribution of economic resources determine the direction of economic growth. In their analysis, political institutions determine the distribution of de jure political power (the formal institutions in our framework). At another level the distribution of resources determines the real distribution of power (de facto or informal political power in our framework). Both sources of political power matter and their interaction determines the choice of economic institutions as well as the evolution of political institutions. This interaction explains the persistence of distributive outcomes as those with political power and access to economic rents in the existing system can block changes that threaten their interests.

In our framework, the sources of organizational power cannot just be read off from initial economic endowments and economic capabilities because organizational capabilities have independent determinants as we discussed earlier. In developing countries these organizational capabilities matter greatly, and the most powerful organizations are not necessarily the ones that represent the interests of the rich. In addition, we do not share A&R's institutional analysis about the types of institutions and rents that ensure dynamism during social transformations. Nevertheless, there is an overlap in our broad analytical methodologies linking formal and informal power to evolutionary institutional outcomes. They also recognize that exogenous changes can shift the balance of power and nudge the system towards (or further against) growth. However, as Kunal Sen points out A&R's theory is better positioned to explain ‘growth sustenance’ or ‘long-term growth stagnation’ rather than processes of transition. As Sen concludes, the political determinants of ‘growth maintenance’ are different from the determinants of ‘growth acceleration’ (Sen 2013).

Acemoglu and Johnson’s framework misses the important role informal institutions in any transition and the ways in which formal institutions are modified in informal ways to reflect the distribution of power. Their focus is on how informal power affects the trajectory of *formal* institutional development. In fact, particularly in developing countries, the effect of informal power is to influence the trajectory of informal institutional evolution, particularly by affecting the operational equilibria of formal institutions. The framework of political settlements allows us to highlight this level of analysis by looking at how the distribution of power at various levels affects institutional development at both the formal and informal levels. Figure 3.1 outlines the two-way relationship between the distribution of power and institutions. A particularly important dimension of the distribution of power is revealed in the construction of the ruling coalition in a polity. The organizational power that is reflected in the construction of the ruling coalition helps us to understand the evolution of the formal institutional and policy structure *and* the implementation of these through informal modifications. The interaction of these factors determines whether the specific institutions operating in this political settlement are growth-enhancing or not. The framework is not so much a theory of growth as an analytical model for understanding the interaction of institutions and politics in processes of transition.

The political settlements framework can provide insights at a number of levels and not all of them are relevant for the questions raised in this thesis. The interaction between the evolution of institutions and policies and the distribution of power (both formal and informal) has implications for both stability and growth in a society. As we have seen, the political settlements analysis also has both a macro and a micro level of analysis. The macro-level is primarily historical, looking at the configuration of organizations and the evidence of their relative power, and how they have evolved over time in the context of institutional evolution. Without this ‘data’ the political settlement analysis suggests that a detailed analysis of institutional performance and a policy discussion of institutional solutions to developmental problems cannot be effectively conducted. However, the macro-level analysis that needs to be constructed depends on the specific micro-institutional questions that are being asked. The relevant organizations and their relative organizational capabilities will vary depending on the institutional and policy questions that we are interested in. In this thesis we are interested in a number of strategies that were used in Tamil Nadu, Gujarat and Pakistan for promoting industrialization and we construct an overview of the relevant organizational power that can shed light on the institutional and policy choices and the success of their implementation.

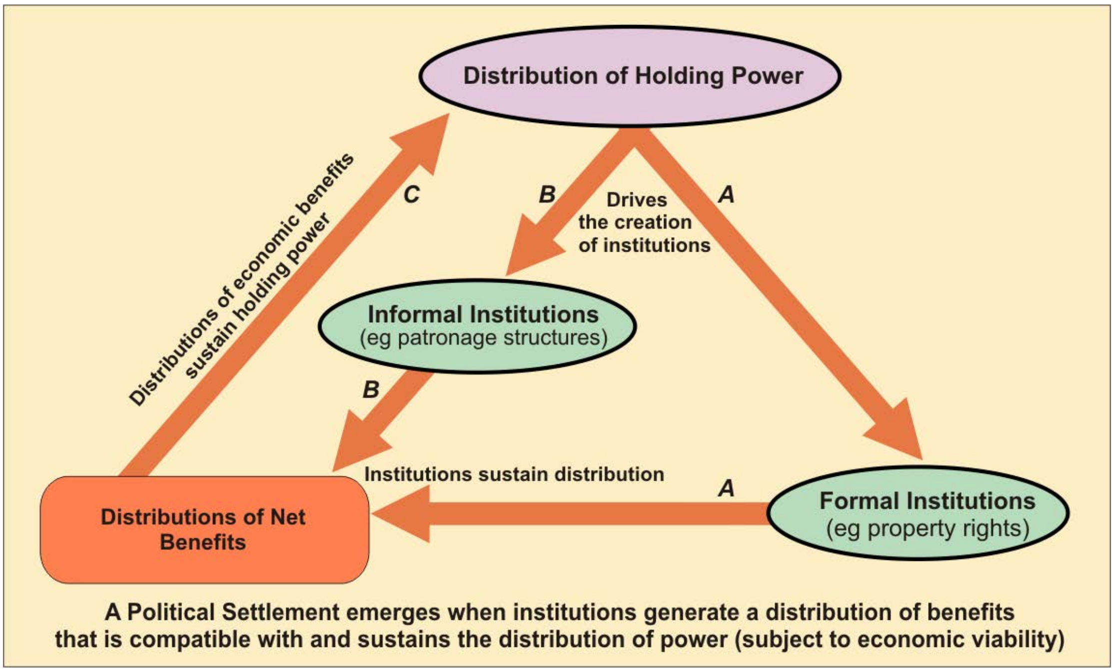

Figure 3.1 The two-way relationship between power and institutions

Source: (M. H. Khan 2010b: Figure 7)

The macro-level institutional and organizational structure of a society has many dimensions and for convenience these can be broken down into three interactive sub systems. These subsystems are political, bureaucratic and economic, each consisting of the relevant organizations and institutions (M. H. Khan 2010b). The overall political settlement includes all three but for specific purposes it may be useful to focus on one or two components at a time. The macro-micro distinction is useful because at the macro-level, the distribution of power is endogenous and is described by the balance of institutions and organizations, while at the micro-level, the distribution of power at the social level is exogenous and helps us to understand the pace and direction of institutional change and the operational equilibrium achieved by specific institutions. The distribution of power at the macro-level changes not only through incremental processes but can also change through various forms of social and political mobilizations that create new organizations or change their relative power. For a political settlement to be in a normal situation of reproduction and incremental change, the minimum conditions of political and economic viability have to be met. This does not necessarily mean high growth or low levels of conflict, but levels that are acceptable enough in that society so as not to provoke significant new mobilizations that result in non-incremental or disruptive changes. This means that in some cases a political settlement can be defined even with low levels of growth or high levels of political strife, and this is important for understanding political settlements in countries like Pakistan.

3.3 A Typology of Political Settlements

The political organizations that constitute the ruling coalition have the formal authority to define new policies and institutional rules. How the ruling coalition is constructed and what powers they actually have of implementing and enforcing the institutions they want is therefore likely to be relevant for understanding institutional evolution and performance. Political organizations operate under formal political institutions (such as democratic decision-making rules) but we expect the distribution of power across organizations to determine whether the formal political institutions are actually adhered to. The general features of the distribution of power across organizations in the typical developing country means that formal political institutions, like other formal institutions, operate in a way that is different from a strict adherence to the formal rules. The nature of the operational equilibrium will depend on the precise configuration of power and describing how the rules operate is indirectly a way of understanding this distribution of power.

In developing countries most political organizations are internally organized with significant informal rent distribution that can be described as patron-client relationships. The informality is more analytically interesting than the personal nature of these relationships. The operation of the political subsystem is an outcome of the formal political rules (institutions), the organization of political groups and parties and the formal and informal rents that are allocated to construct a viable ruling coalition. If the political subsystem has reproducible characteristics, the distribution of benefits to political players (both within political parties and across political parties) should be consistent with their relative power. So a description of the political organizations that are relevant and the distribution of rents within and between these organizations essentially indicates the relative power of different organizations and of the hierarchies within these organizations.

Keeping in mind that both formal and informal power matters, we need to look at two relevant dimensions of the distribution of power affecting the ruling coalition. The first is the horizontal distribution of power which defines the relative power of other political organizations that are currently excluded from the ruling coalition. The second is the vertical distribution of power that defines the relative power of those at the lower levels of the organization relative to those at higher levels. These two dimensions in the distribution of power define four types of political subsystems (Figure 3.2). These are ideal types and most real world cases would have mixed characteristics, but it is helpful to identify the four extreme variants. The first can be described as ‘strong patrimonialism’, where the ruling coalition is strong relative to excluded political organizations *and* its higher levels are strong relative to lower levels. Here the ruling coalition can take a long-term view because it is not credibly threatened and it also has high implementation capabilities. While strong patrimonialism may appear to be at risk of predatory behaviour, in fact the rational strategy of self-seeking leaders in this context is to be developmental as that gives them the highest returns in terms of net present value. Developmental states like South Korea under Chung Hee Park were characterized with this type of political settlement in the political subsystem. One important feature of this political context is that the institutions of developmental authoritarianism can be in a strong operational equilibrium here. There is likely to be little resistance and conflict facing their implementation and informal modifications would not distort the expected operation of these institutions. South Korean industrial policy was successful not only because the institutions made sense but also because they were implementable in this political settlement (Kohli 1994; M. H. Khan 1995; Woo-Cumings 1999).

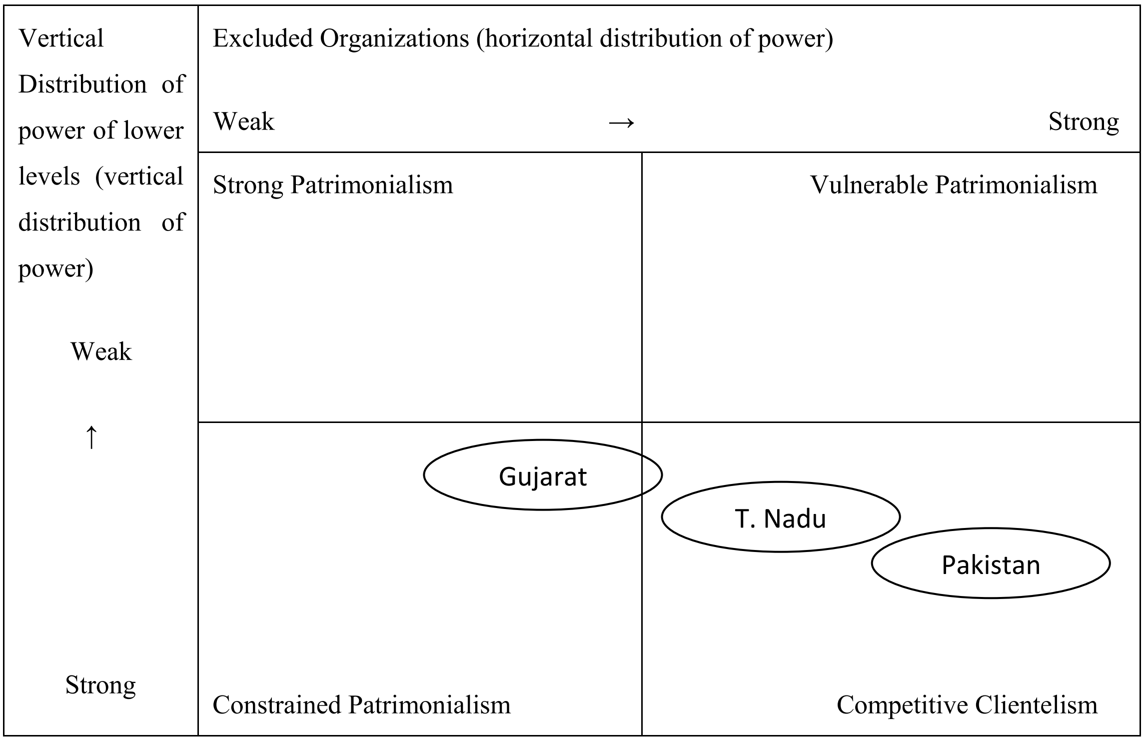

Figure 3.2 Distribution of power and the structure of ruling coalitions
Sources: (Based on M. H. Khan 2010b: Figure 17)

Note: the diagram refers to Gujarat from 2000-2013, Tamil Nadu from 1989 to 2013 and Pakistan from 2008-2013

Three issues are relevant here. The developmental authoritarianism here is about the ruling coalition having the ability to push through developmental agendas given the weak organizational ability of excluded organizations. The implementation is not necessarily formally democratic and indeed it is unlikely to be given that democratic rules would not be in a strong operational equilibrium here, but the ruling coalition is likely to have or rapidly achieve significant legitimacy precisely because it is capable of achieving developmental successes. Authoritarianism here is not about violent political repression that is paradoxically associated with authoritarianism when the ruling coalition is weaker. Secondly, the developmental state here is not necessarily a Weberian rule-following state and indeed this is unlikely given the absence of a broad-based productive class that we posit is necessary for the achievement of general rule-following behaviour as an operational equilibrium. The authoritarian developmental state can be expected to violate many rules and indeed at this level of development rules guiding behaviour or appropriate property rights may be missing in many areas. But formally or informally, the state is effectively able to enforce the rules that affect developmental outcomes. As the ruling coalition has an interest and an ability to enforce developmental outcomes, it is likely to do so, even if property rights and the rule of law are violated, as they were in South Korea in its early stages of development. Finally, we need to emphasize that our use of the term patrimonialism is to be distinguished from other usages. For instance it is not the same as the neo-patrimonialism referred to in sociology or in the analysis of political scientists like Kohli. Here the strong patrimonialism simply signals that this is a ruling coalition that behaves as if it has a right to rule and can actually impose its authority effectively given the distribution of power across organizations.

Our framework identifies two other 'patrimonial' structures where authority structures are much weaker, with significant implications for the operational equilibria of different institutions. In 'vulnerable patrimonialism' excluded political organizations are strong and to remain in power, the ruling coalition occasionally has to resort to suppression or even violence against them. A ruling coalition that has to use political repression is actually vulnerable. The more repression it uses the more vulnerable it is, and vulnerable patrimonialism has a tendency of becoming weaker over time. However this ruling coalition is characterized by relatively strong higher levels relative to lower levels within the organization, so that rent allocation to lower levels is subject to the enforcement of higher level decisions. Developmental interventions are likely to have a moderate operational equilibrium because of this enforcement capability, but institutions of authoritarian exclusion of other organizations is likely to be in weak and contested operational equilibrium. Sadly, as excluded organizations become stronger, they can promise lower-level organizers within the ruling coalition higher rents if they defect, and over time vulnerable patrimonialism begins to lose its enforcement capability over lower levels. This can lead to a sudden collapse of the political settlement. As we will see in a later chapter the Pakistani state under General Ayub Khan in the 1960s was an example of a vulnerable patrimonialism that achieved early developmental successes but then suffered a precipitous collapse.

A third variant is 'constrained patrimonialism' where the ruling coalition faces weak challenges from excluded organizations but this is because it includes all or most powerful organizations within it. However, this also means that there are many powerful internal organizations and the authority of higher levels over lower levels tends to be weak. This distribution of power is usually in operational equilibrium with institutions that support a Dominant Party, and indeed even democratic institutions will enable a single dominant party to win elections repeatedly. Here, the ruling coalition is likely to feel secure enough to take a long view of development, and both democratic and authoritarian political institutions could be in a moderate operational equilibrium. The ruling coalition is also likely to attempt developmental interventions given its long time horizon but these are likely to be in weak operational equilibrium and achieve poor results given the weaker enforcement capability over internal sub-organizations. Rents are likely to be captured by internal organizations and rent-re-allocation effectively resisted even if this is damaging for the collective interests of the ruling coalition.

India under the dominant Congress Party in the 1950s and 1960s is an example of constrained patrimonialism with democratic political institutions and a dirigiste growth strategy. China today is also an example of constrained patrimonialism with restricted (authoritarian) political institutions and a leading role played by the Communist Party under Deng Xiaoping and subsequent leaders in driving a capitalist transformation from Maoist statist structures. However, the internal discipline of the Communist Party, the product of a long history of war, revolution and social transformation meant that its internal hierarchical control structures quite strong. The Chinese political system in the 1980s was therefore not as constrained as India in the 1950s and 1960s in terms of higher levels being unable to impose conditions and rules on lower levels. China was therefore somewhere between constrained patrimonialism and strong patrimonialism, probably closer to the latter. Nevertheless, the internal ability to discipline subsidy-receiving capitalists was perhaps not as high in China as in South Korea and the same types of directed industrial policy institutions may not have been in an effective operational equilibrium. In China the ruling coalition initiated a broader accumulation strategy enabling more of its politically powerful intermediate levels to enter the ranks of the emerging capitalist class but with the ability to enforce competition and internal accountability in ways that ensured developmental outcomes. These strategies included the town and village enterprises (TVEs) and the promotion of special economic zones, while the rents in the SOEs were left intact as a form of political rent distribution. Put another way Heilmann posits that the post-Mao leadership 'experimented' with 'multiple models' rather than insisting on any single model and risk unrest (Heilmann 2011).

In contrast, the internal authority structures of the Congress Party in India were much weaker than China and sub-organizations and individual leaders could not be subjected to internal accountability and discipline to the same extent. Its formal development strategy provided potential learning rents to a group of medium to large capitalists and technology adoption was also promoted through public sector enterprises. Political redistribution took place through formal and informal rent distribution. The problem was that the institutions granting rents for economic development could not be properly disciplined because with a weak centre, lower level politicians and organizations protected businesses supported by industrial policy for a share of their rents and the compulsions for improving competitiveness were much weaker. By the mid-1960s, India was hit by a combination of declining economic growth and new mobilizations of emerging intermediate class groups, organizing under regional, caste and other ideological labels, demanding inclusion into the ruling coalition and a share of redistributive rents. By the late 1970s the dominant party system fell apart. In both India and China the political settlements were important for understanding institutional evolution, the operational equilibrium or effectiveness of these institutions and therefore the developmental outcomes. Deng benefited from the centralized statist structure established by Mao and the fragmented society that was the result of the Cultural Revolution. This meant that Deng and his successors had less to worry about in terms of redistributive demands coming from mobilized constituencies and could also impose greater discipline on lower levels of their own party. In contrast Nehru and even more so, Indira Gandhi, had to respond to a highly mobilized society where the construction of oppositional organizations was legitimate after a long history of colonial social reengineering and anti-colonial struggle. This mobilization is now even stronger and a critical feature of Indian politics.

To understand the operation of political parties in India and China, or within the same party across different states in India, it is not enough to look at the institutional structure of parties (their constitutions) but also the real distribution of power across the organizations that constitute it, and the constituencies they in turn can mobilize. Political parties can be analysed both as institutions (rules for internal representation and accountability) and as organizations (collections of sub-organizations and factions that come together for specific collective goals). The internal procedures of a party reflect the interaction of its institutions with its sub-organizations, just as the actual operation of a society reflects the interaction of its institutions and organizations, both formal and informal. The fact that a party has a formal hierarchical or inclusive representative structure does not mean it will actually operate in that way if its formal and informal sub-organizations block these procedures and have the power to do this or to modify procedures in important ways. The political settlements analysis would explain in these terms why higher levels in the Chinese Communist Party can effectively discipline and command lower levels to a much greater extent than the Indian Congress, or why the BJP in Gujarat is similarly different from the BJP in Karnataka. Another way of putting this is that party organization as a description of how groups within it behave depends to a large extent on the distribution of holding power across sub-organizations within it and not simply an independent variable that can be easily changed as a ‘policy’. Nevertheless, incremental changes in institutional rules can over time have an effect on party organizations but this is a relatively slow and uncertain process whose outcomes depend on the continuous interaction between its internal institutions and organizations.

Economic outcomes in particular contexts depends not just on the presence or absence of constrained patrimonialism or any other singular feature of the distribution of power across organizations but rather on the implementation and modification of particular policies and institutions in the context of the holding power of all affected organizations. The very different growth outcomes in India and China under constrained patrimonialism can be explained using the political settlements framework when we look at the differences in relevant policies and the holding power and capabilities of affected organizations. Any policy or institution has implications for the distribution of benefits and affected organizations can be expected to try and influence the implementation and modification of these policies and institutions. The political arena that is described by the distribution of power across political organizations is therefore only part of the story, the holding power and capabilities of economic organizations also matter in defining the relative power of relevant organizations and the implementation of different policies has to be examined in this context. This is why versions of constrained patrimonialism in India and China at different times were associated with very different outcomes. This is only partly because at a higher level of detail the organization of the dominant parties in different 'constrained patrimonial' polities is quite different in detail when we look at the underlying distribution of power across political sub-organizations. More importantly, their institutions and policies were also different, as were the power and capabilities of their economic organizations. The political settlements framework says that when we look at the broader distribution of power across all organizations, we are better able to explain why Chinese policies and institutions had a greater developmental impact in China relative to Indian policies and institutions in India. In India in the 1950s and 1960s the capitalists had some capability and had relatively stronger holding power relative to the state and hence were difficult to discipline. In the case of China in the 1980s economic organizations had moderate productive capabilities but had limited holding power relative to the state allowing important and effective changes in strategies of accumulation.

The fourth and last variant is 'competitive clientelism' characterized by a ruling coalition that is not very strong relative to currently excluded organizations and whose higher levels are similarly not very strong relative to lower levels. Here the ruling coalition is likely to have a short time horizon because it expects to be replaced by other coalitions soon, and it also has low enforcement capabilities. This configuration of organizational power is most common in developing countries. Once organizational power has fragmented to this extent, authoritarian political institutions cannot be in an operational equilibrium (without excessive violence) and the only political institutions that are viable are democratic ones. However, democracy in developing countries operating in the context of competitive clientelism works very differently from rule-following democracies in advanced countries (M. H. Khan 2002b). This is because given the high level of informal rent allocation necessary in developing countries per capita GDP is low, political organizations cannot be constructed and political power sought purely on the basis of credible fiscal promises of taxing and spending. Even in India where formal fiscal redistribution is significant, it is not possible to construct political organizations without offering significant informal incentives to organizers. What this means is that what is available in the formal fiscal programme would not attract those with the capacity to organize politics to invest their own time and money in organizational activity (M. H. Khan 2012f) .

This means that in these contexts formal democracy is the only institution that can be in an operational equilibrium without violence, but the operational equilibrium of democracy is likely to involve significant informal rent allocations that take the form of corruption. The political corruption in these contexts is often a manifestation of this informality in the allocation of rents. Informality also means that rule-following political competition is difficult and contested elections are common, whether in Kenya or Bangladesh. Stability here requires that the ruling coalition is able to provide credible assurances to the opposition that it will get a fair shot at gaining power based on its own informal strategies. The difficulty of ensuring a 'fair' level of informality on all sides means that democracy in many developing countries faces challenges. The opposition frequently resorts to violent protests to redress the balance. The repeated instability facing Bangladesh is to a large extent due to the intransigence of the incumbent party towards the opposition which repeatedly takes to the streets to prove its holding power. The combination of political instability and short time horizons of the ruling coalition means that a developmental agenda is difficult to implement.

In reality, the political subsystem can display hybrid characteristics in many contexts. A particularly interesting case is that of the 'authoritarian clientelism' of Gujarat which is a subset of constrained patrimonialism close to 'strong patrimonialism' but with features of competitive clientelism. We will see in Chapter Five on Gujarat that here the ruling coalition (the BJP) faces weak competition from opposition organizations but not so weak that it could ignore them completely. Being close to the conditions of strong patrimonialism, the dominant party also has stronger enforcement capabilities over its lower levels than the typical dominant party in constrained patrimonialism, but not as strong as in strong patrimonialism. Thus this configuration has characteristics of both constrained patrimonialism (weak vertical enforcement) and vulnerable patrimonialism (some opposition from excluded organizations). Unlike vulnerable patrimonialism where the excluded groups are stronger and the ruling coalition may repeatedly have to use repression against them, in the authoritarian clientelism of Gujarat excluded groups were much weaker and an episode of violence early on was sufficient to signal to them that they would be better off remaining quiescent. These characteristics of dominant party rule by the BJP in Gujarat help to explain important features of institutional performance in Gujarat. The very different regime of the BNP under Zia in Bangladesh also had some of these characteristics (M. H. Khan 2012a).

Competitive clientelism is the most relevant configuration of political power for our research because the majority of developing country democracies exhibit competitive clientelism or are moving towards it. Both Tamil Nadu and Pakistan had variants of competitive clientelism but with different characteristics and with very different outcomes. Competitive clientelism emerges when the growing demands for political rents as new social groups mobilize results in an increasing number of organizations and organizers and all powerful groups can no longer be accommodated in a single organization. As excluded organizations become stronger, the lower levels within the ruling coalition also become stronger: their bargaining power increases as the threat of leaving the coalition becomes more credible. Similarly as lower levels within the ruling coalition become stronger, excluded organizations can entice them away to increase their strength. Thus, both constrained patrimonialism and vulnerable patrimonialism tend to evolve in the direction of competitive clientelism. Ideologies and identities are regularly used both by dissatisfied political entrepreneurs who want to break away from existing organizations and also by centralizing political entrepreneurs who want to resist them. But in both cases ideology typically plays an instrumental rather than substantive role in politics. This means that while ideologies like a commitment to a linguistic group or a religion can mobilize intense conflicts, politics is rarely about the promotion of a language or religion per se.

Competitive clientelism can set constraints on growth in a number of ways. The formal and informal redistribution that keeps the ruling coalition together can be a source of stability but it can also go out of control and restrict the resources available for developmental investments. South Asia in the 1950s and 1960s saw the beginning of mobilizations based on language and regionalism that were portents of the much larger movements we see in the sub-continent today. The reorganization of Indian states according to language and the demand for more resources for East Pakistan were the main movements of that time. By the 1970s these movements were becoming larger, with the movement in East Pakistan becoming a secessionist one and India seeing the formation of a powerful political party comprising of rich north Indian farmers taking on Mrs Gandhi's Congress. In East Pakistan high levels of mobilization led to increased public investment in the region hitherto neglected by Ayub Khan's industrial policies but were not enough to stave off a war and another partition (Maniruzzaman 1980; M. H. Khan 1999). In the Indian case the so-called farmers' lobby eventually formed the first non-Congress government in New Delhi and this lobby has continued to hold sway over agricultural policies like fertilizer and electricity subsidies in India. In both cases these movements were the beginning of the end for the weak versions of patrimonialism that existed in these countries: vulnerable patrimonialism in Pakistan and constrained patrimonialism in India.

Later movements in the region like those based on affirmative action for India's backward castes in the 1980s, the anti-Ershad pro-democracy movement in Bangladesh in 1991 or the political mobilization by parties like Imran Khan's Tehreek-e-Insaaf in Pakistan are all mobilizations of new organizations mobilizing new social constituencies for new rent allocations and challenging the justice of existing allocations. Redistributive politics of this type is a rational accumulation strategy for political entrepreneurs from the intermediate or middle classes given the absence of credible productive alternatives (M. H. Khan 1998). The new mobilizations were based on different combinations of three factors: demographic changes as the size of the intermediate classes grew, growing aspirations and the activities of ambitious political entrepreneurs. Most of these entrepreneurs and the higher organizational levels of new organizations drew on ambitious individuals from the intermediate classes. In many cases, the intermediate classes were also the broader constituency, though parties also had to mobilize much poorer people to maximize their bargaining power. There are many definitions of the intermediate classes in the literature on South Asia (Misra 1961; Alavi 1973; Kalecki 1976; A. V. Desai 1981; Bardhan 1988). We use Khan's definition of the intermediate class as a residual category of individuals who are neither the tiny group of capitalists and surplus landlords at the top nor the roughly bottom fifty per cent of poor and landless peasants and workers whose only source of income is labour (M. H. Khan 1998). The middle thirty to forty per cent constitute a critical set of classes who have enough economic, educational and organizational resources to drive domestic political activities and organizations.

The construction of this political settlement means that attempts to completely dismantle redistributive rents or even just the informal redistributive rents may be impossible to achieve and therefore counterproductive. Most developing countries do not have the fiscal resources to achieve political stability purely through formal budgetary redistribution and growing budget deficits to increase the share of formal redistribution may also have damaging effects if they happen too rapidly. As long as political redistribution is stable and predictable the effects on accumulation and growth may be small. For instance, if political organizations can deliver stability in exchange for some rent sharing with emerging capitalist organizations, the latter may be able to purchase stability and the protection of their property rights for a relatively low price compared to the possibly untenable rates of taxation that may be necessary to achieve stability through generalized transfers. This was the case in Maharashtra in the 1970s and 1980s and Bangladesh in the 1980s when economic growth accelerated despite the persistence of forms of political corruption (M. H. Khan 2008b; P. Roy 2012).

Populist redistribution can however become unsustainable if economic growth does not keep pace with the growth of transfers. In some regions of South Asia, for instance in Gujarat, growth has been strong enough to allow for an increase in formal redistribution in a sustainable way. On the other hand India's Food Security Bill or the National Rural Employment Guarantee Act (both set up at the federal level) and providing subsidized food or guaranteed work and wages for the rural unemployed are examples of well-meaning but populist policies that are probably outstripping the fiscal capacity to fund them. The real issue is that these redistributive strategies do not provide significant rents to the intermediate classes who are the organizationally strongest parts of the population and it will be a long time before fiscal transfers deliver enough to this group. In the meantime, political organizations will have to remain dependent on providing informal benefits to organizers and the political settlement will be characterized by this informality.

The growth of an oligarchy in the Indian corporate sector seems to be pointing in this direction. A handful of companies that had achieved competitiveness in the 1980s and 1990s are still continuing productive investments and productive activity. But a growing number of regional and new corporate entities have resorted to what could be called destructive primitive accumulation in the form of capturing agricultural land, coal or the telecom spectrum with an increasingly short-termist ruling coalition sharing some of these rents. Chapter Four outlines this process in greater detail. Thus, differences in the configurations of political power have important implications for the enforcement of particular institutions and for the associated growth outcomes.

The economic sub-system is the equally important counterpart of the political one, and describes the economic organizations involved in productive activities. We are concerned with the formal and informal rent seeking activities of economic organizations and how these affect developmental outcomes. The economic organizations of relevance for our research are in the modern industrial sector. Two characteristics of economic organizations are relevant for describing the political settlement. First, the productive capabilities of the economic organizations matters. Productive capabilities are based on technical and organizational capabilities and describe the competitiveness of the economic organizations in question. Secondly, the political power of the economic organizations in bargaining with the policy-making leadership of the ruling coalition matters in determining the outcomes of rent seeking negotiations. Productive capabilities depend on the historical processes of accumulation, learning and capability development that have already taken place. Political power depends on the effective holding power of economic organizations relative to the leadership of the ruling coalition and this depends on the economic power of these organizations and their rent-sharing networks with political organizations within or outside the ruling coalition (M. H. Khan 2010b).

Once again, these two dimensions define four possible ideal-type combinations that can help to structure the discussion of real cases which are likely to have combined characteristics. This first scenario is one where economic organizations combine high productive capabilities with powerful political networks. In this case the high capability organizations are likely to have already achieved competitiveness but their rent seeking can have damaging outcomes. The difficulty of political disciplining in this case could lead to the emergence of monopolies or monopolistic overpricing in government contracts. A second scenario is a combination of low to moderate productive capabilities with powerful political networks. These organizations are less likely to have achieved competitiveness but supportive learning strategies are likely to fail because of difficulties in enforcing conditions on rents. This combination is more problematic from a developmental perspective compared to the first one.

A third scenario is a combination of high productive capabilities with low political networking power. This roughly describes the economic sector in East Asia and particularly South Korea in the 1960s and 1970s. Here if the political context is that of strong patrimonialism, East Asian industrial policy institutions can be very effective. But combining these economic features with a political context of weak patrimonialism or competitive clientelism can lead to poor support or even expropriation of politically weak economic organizations. This could happen if a ruling coalition with a limited enforcement capability or with a short time horizon decides to expropriate resources from profitable enterprises. The purportedly Communist Left Front parties in West Bengal in India did just this by transferring resources to their organization in the agrarian/rural sector at the expense of industry. This had very damaging consequences for the long-term industrial prospects of the state. Finally the combination of economic organizations with weak productive capabilities and weak political networks is potentially the most problematic one from a developmental perspective. Unless the ruling coalition is a strong patrimonial one and takes a long view in promoting productive capabilities in organizations that have limited immediate prospects, the likelihood is of damaging rent seeking processes between the economic and political sectors (M. H. Khan 2010b).

The relationship between the economic and political subsystems can be complex. A political subsystem may support developmental institutions with one configuration of economic organizations but may have different incentives with a different economic configuration. If economic organizations have high productive capabilities and are on or close to the competitiveness frontier, they are likely to have strong internal incentives to achieve higher productivity. These may be strong enough for them to push for supportive policies like the protection of Schumpeterian rents or learning rents for their expansion into new areas. The auto component sector in Tamil Nadu provides an example of developmental policies driven from below by economic organizations. But in such a context, policy-makers must have the minimal capabilities to enforce competition and the withdrawal of rents when they are no longer necessary or are failing to achieve developmental objectives. In the Indian sub-continent economic organizations, particularly when they are large, have rapidly developed informal relationships with political organizations. These relationships enable firms to avoid disciplining and to access unproductive rents by cornering markets or achieving preferential pricing in government contracts. This was certainly the case in India in the 1960s when the licensing system was captured by a few large industrial houses but these relationships have reappeared in new forms of 'crony capitalist' links between big business houses and politicians after the 1991 liberalization reforms (M. H. Khan 2009b).

Finally, the bureaucratic subsystem describing the capabilities and powers of bureaucratic organizations is also relevant for a full description of the political settlement as bureaucratic organizations can play an important role in determining the outcomes of institutional policies. Bureaucratic organizations can have their own interests in the regulation and enforcement of institutional rules. The strategies they are likely to use depend on their own capabilities and their bargaining power relative to other organizations. The bargaining power of bureaucratic organizations is based on their organizational capabilities (including military capabilities) and their networks with political and economic organizations. As with political organizations, the configuration of bureaucratic organizations can be classified into four ideal-typical combinations, this time based on the horizontal and vertical distribution of power across bureaucratic organizations. The first variant is that of concerted bureaucratic authority where the lead agency (for instance a leading department like a planning board or the president's office) has effective power to coordinate across agencies as well as sufficient command over its own lower agencies. The lead agency can then become the agency through which a strong ruling coalition could enforce its critical policies and institutions. This bureaucratic configuration is likely to reflect a strong patrimonial political system, and together the bureaucratic and political systems can ensure that hierarchical bureaucratic rules of business and formal powers of central enforcement are in a strong operational equilibrium.

A second configuration of bureaucratic organizations can be described as divided bureaucratic authority where the lead agency is unable to fully coordinate across agencies even though higher levels are able to impose discipline over lower levels. In some advanced countries like the US this could be the result of a deliberate institutional design and if the actual distribution of power across organizations also reflects this, the checks and balances will be in a strong operational equilibrium. Rule-following checks and balances can be preferred by economic interests in advanced countries because the required property rights already exist and checks and balances reduce the chances of *ex-post* policy changes or expropriation (Okuno-Fujiwara 1997). In developing countries such a bureaucratic configuration is likely to represent weak cooperation capabilities in a context where development needs to be cooperative and is therefore a less developmental configuration than the first one (M. H. Khan 2012e).

A third configuration is that of constrained bureaucratic authority where the lead agency has coordination capabilities across agencies but is unable to effectively discipline lower levels to make them implement and enforce institutions in the way in which higher levels want. The second and third configurations are likely to reflect a political structure which is weakly patrimonial, so that some institutions can be enforced but enforcement is weaker than in the first scenario. Finally the fourth scenario of fragmented bureaucratic authority is more problematic and is likely to emerge in contexts where political power is also fragmented as in competitive clientelism. In this configuration the leady agency can only weakly coordinate across agencies and has weak control over its lower levels. Here policy implementation and enforcement capacities of the bureaucracy are at their weakest with obvious implications for the enforcement of institutions.

The study of bureaucratic organizations in relation to the other two sub systems in a political settlement is a departure from conventional analyses of bureaucracies that have generally focussed on the presence or absence of the Weberian ideal defined as a meritocratic, rule following bureaucracy (Weber 1968). The idea was that bureaucratic postings based on merit rather than kinship or personal networks produced a professional organization where individual incentive structures would be aligned with enforcement of rules, and these in turn would support capitalist economic growth. However the literature from new political economy and public choice theory argued that bureaucrats could be self-seeking as well and in this context state involvement in the economy that created opportunities for bureaucratic enrichment could have negative effects (Niskanen 1973) (Krueger 1974; Buchanan, et al. 1980). On the other hand, the role of Japan's MITI had been highlighted as early as 1982 (Johnson 1982). Heterodox economists like Amsden and Wade produced seminal work on South Korea and Taiwan respectively showing how their states were able to discipline capitalists while providing learning rents for capability development (Amsden 1989; Wade 1990). In its East Asian Miracle report of 1993 the World Bank also recognized in a more diluted form the role of the state and of effective bureaucratic interventions in the success of countries like South Korea and Taiwan (World Bank 1993).

Paradoxically the World Bank's 1993 report was not the prelude to a deeper investigation of the bureaucratic capabilities that needed to be developed to support developmental interventions in different contexts. Rather, it strengthened the perception that most developing countries should not attempt these difficult interventions that require control over the rent seeking process (Knack and Keefer 1995; Mauro 1995; Easterly and Levine 1997). This strengthened the mainstream policy agenda of supporting the development of Weberian good governance in developing countries, defined as rule-following non-corrupt bureaucracies. Later work by Evans argued that developmental bureaucracies not only had to have 'Weberian' characteristics but also 'embedded autonomy' so that they could function independently enough to discipline capitalists who were misusing rents but were at the same time sufficiently networked with economic organizations to identify the needs of capitalists (Rauch and Evans 2000; M. H. Khan 2012b). From the perspective of our preceding analysis, the goal of attempting to create truly Weberian bureaucracies in developing countries is actually unachievable. What Evans meant by Weberian was effectiveness in enforcing some institutions. The East Asian states were effective in this sense but in a general sense they were not Weberian because not all rules and rights were equally enforced in an impersonal way. Amsden and Wade's work highlighted the importance of what we identify as the implementation capacity of political organizations in South Korea and Taiwan that ensured their bureaucracies had the incentive and capability to enforce particular institutions. From the perspective of the political settlements analysis, the institutions the East Asian countries enforced could not be replicated in other countries where major aspects of the political settlements were different. Rather, the question should have been to identify the institutions and governance capabilities that would be feasible to develop in different contexts to support developmental rent management.

3.3.1 Micro Institutional Analysis and the Growth-Stability Trade-off

The operational equilibrium of potentially developmental institutions may depend on characteristics of one or more of the subsystems discussed above. The macro-level configuration of organizational power in a society provides the background for assessing the likely operational equilibrium of particular institutions given these characteristics of the political settlement. The configuration of organizational power could allow or prevent the enforcement of the institution in ways that have desirable outcomes or otherwise. The discussion in the last section also suggests that the configuration of power across political, economic and bureaucratic organizations may be relevant for understanding the operational equilibrium of particular institutions. For instance two countries may have similar political organizations but differences in their economic organizations may result in different incentives and compulsions for political organizations and therefore different operational equilibria for similar institutions. Similar institutions and policies may therefore still result in different outcomes. Most conventional institutional analysis misses this complexity (M. H. Khan 2012f).

The results of a micro analysis of institutions identifying the likelihood of effective (developmental) implementation can be summarized in the form of a notional growth-stability trade-off facing the institution. Incremental improvements in the enforcement of a potentially developmental institution can result in greater opposition and resistance if the distribution of incomes associated with better enforcement goes against the interests of powerful organizations. The implementing agencies then have a choice in terms of how much conflict and instability costs they are willing to absorb. Improved enforcement is possible at a cost, but depending on the nature of the political settlement, the trade-off may be very steep, and sufficient enforcement may not be feasible in terms of political viability. The other alternative is that the formal institution is modified in such a way that even though the institution exists in theory, its implementation is substantially different in practice. In this case the developmental outcome is poor because the implementation of more effective enforcement is not pushed, and this too is likely if the institution faces a steep growth-stability trade-off. There can be many variations in the sequence of developments. The forced enforcement of an institution that is resisted can of course also result in the resistance collapsing as conflict reveals that the holding power of opposing organizations was actually not that high (M. H. Khan 2010b).

How successful a ruling coalition will be in effectively implementing growth-enhancing institutions thus depends on several critical factors. First, the incentives and compulsions of the policy-makers themselves are critical. The characteristics of political and bureaucratic organizations can help us understand their time horizons and limitations. In the most problematic cases, the ruling coalition may not even propose potentially developmental institutional changes because it lacks the appropriate incentives. In these cases, a consideration of the growth-stability trade-off is a notional exercise. Secondly, the levels of resistance a ruling coalition faces can depend on how well-organized and networked the potential losers are. Losers are not necessarily defined in terms of absolute losses. Individuals and organizations can resist institutional changes that change the relative distribution of benefits if these threaten to change the distribution of power in society. This is because organizations rightly understand that a change in the distribution of power can have multiplier effects on future institutional changes that could be to their disadvantage. In other words both the institutions that emerge and the growth-stability trade-off that particular institutions face will depend on the current political settlement. This trade-off will be different for different countries as their political settlements differ. This framework crucially helps to explain why institutions evolve differently and work differently in different contexts.

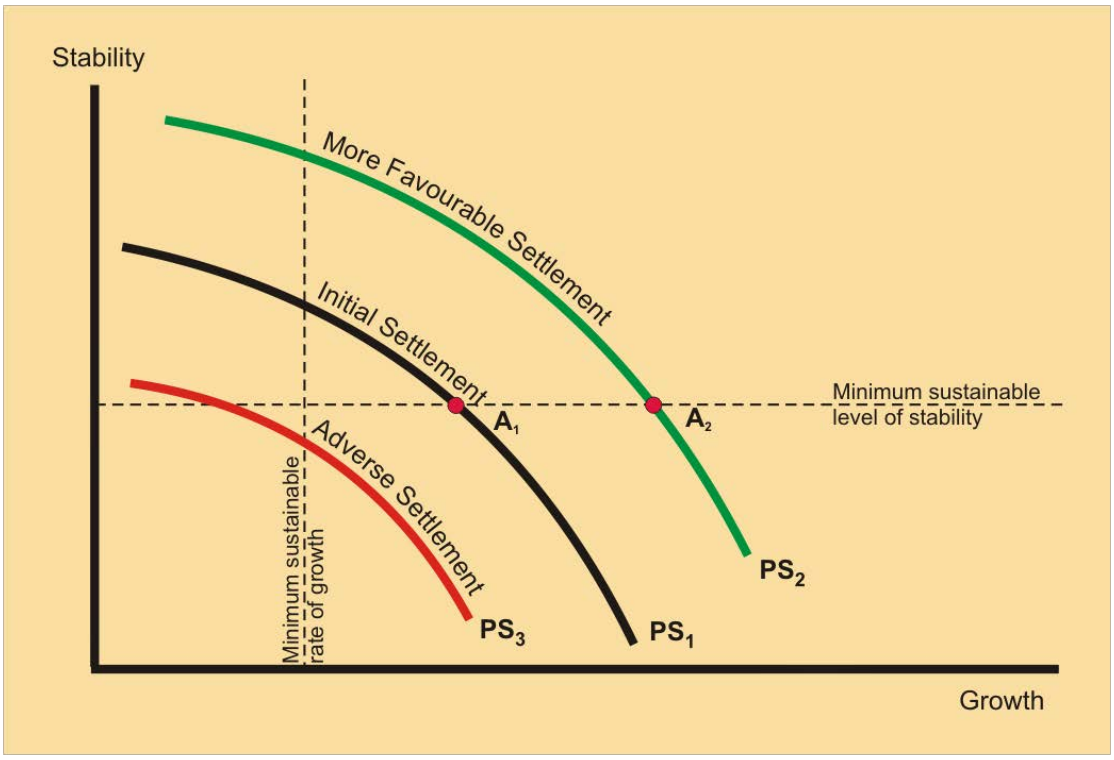

Figure 3.3 . Political settlements and trade-off curves

Source: (M. H. Khan 2010b: Figure 11)

The vertical axis in Figure 3.2 ordinally ranks the political costs associated with enforcing an institution in different ways and to different extents. The horizontal axis measures economic outcomes (growth is a shorthand for the economic outcome) associated with different levels of enforcement of the institution in question. The growth-stability trade-off curve captures the insight that a formal institution can be enforced and implemented in different ways as a result of informal modifications or partial enforcement. If the institution is potentially developmental, better enforcement of all the conditions required for developmental outcomes will improve 'growth' but may be associated with increasing resistance and therefore worse 'stability'. The shape and position of the trade-off will depend both on the specification of all dimensions of the macro-political settlement *and* the specific institution that is in question. The critical limit on the political cost that the ruling coalition can accept is defined by the minimum sustainable level of stability. It is unlikely that a ruling coalition will force enforcement beyond this point, but it may stop well short of this unless it has strong incentives and compulsions to push economic development. The minimum sustainable rate of economic development in the diagram is the level below which the normal reproduction of the system is likely to be affected. Political settlements face a crisis when political conditions prevent the achievement of the minimum economic requirements for reproduction (as in the curve PS_3 in the figure).

For any particular proposed institutional change, a change in the macro-political settlement (which is an exogenous variable at this level of analysis) can result in a shift in the level of the PS curve. For instance, if the groups politically resisting the institution get stronger, the curve rises, and vice versa. Secondly, given the political settlement, if the configuration of organizational power results in strong resistance to the better enforcement of a particular institution its trade-off curve is steep and vice versa. This conceptual relationship is a useful way of thinking about the operational equilibrium that particular institutions are likely to actually achieve in different contexts. For instance the better definition and enforcement of property rights in land markets in developing countries can face significant resistance from the land mafia if these institutional changes reduce their ability to gain informal rents by informally enforcing contested property rights. The mafia could operate through political parties, sharing some of the rents with powerful organizers within political parties who need access to these rents to reproduce their own political power. In these contexts, the potential resistance could be serious enough to imply a very steep and relatively high growth-stability trade-off curve forcing institutional changes in the land market. Thus, unexpected but powerful coalitions may be mobilized to block or informally modify the implementation of institutional changes that could in principle have developmental outcomes.

One of the objectives of this thesis is to identify the relevant characteristics of the political settlements in our three case studies of Gujarat, Tamil Nadu and Pakistan. In each case, the organizational structure relevant for understanding aspects of industrial and economic policies are identified and analysed. We argue that the political settlement in Gujarat has characteristics of authoritarian clientelism, based on a relatively homogeneous ruling coalition constructed in ideological terms and using a variety of strategies to keep opposition organizations weak. In Tamil Nadu the political settlement is more straightforwardly a competitive clientelist one, and yet it has characteristics that allow quite significant developmental outcomes. In Pakistan the political settlement has evolved in the direction of a very fragmented competitive clientelism but the organizational capacity of the army means that there are occasional revivals of vulnerable patrimonialism when the army takes over. Democracy as an institution is more contested. Yet further moves back to vulnerable patrimonialism under military rule may no longer be sustainable as excluded organizations both formal (political parties) and informal (like Islamist organizations) have growing holding power and their forcible exclusion implies unacceptable levels of repression and violence. A second objective is to demonstrate how this macro picture helps to provide a richer understanding of the evolution and enforcement of particular institutional strategies in these different contexts.

3.4 Methodology

The case studies in this dissertation were selected for their intrinsic interest in elaborating the application of the political settlement framework. The cases selected were the states of Gujarat and Tamil Nadu in India and the state of Pakistan. As the political settlement framework can operate at both the national and sub-national levels, provided the appropriate distribution of organizational power and institutions are identified, the selection of national and sub-national states as subjects of a single study is not necessarily a problem. Our aim is not to *explain* the relative performance of these entities but rather to *analyse aspects of relative performance* using the political settlements framework. An explanation of the relative performance of Gujarat and Tamil Nadu would require an examination of their economies as a whole and their interaction with the national economy. The relative performance of Pakistan as a whole is not strictly comparable as it is a country with its own national policies. The thesis should therefore not be read as an exercise in explaining relative performance as a whole. Rather our aim is to look at the relative performance of particular sectors and policies, using the analytical framework of political settlements to provide analytical insights and explanations.

Gujarat is interesting from an institutional perspective because it is a high growth state in India with institutional features different from other states. It has induced observers to claim either that it is closer to 'good governance' than other Indian states or even that is a 'developmental state' within India. The political settlements approach classifies Gujarat quite differently as a type of authoritarian clientelism and argues that this can explain many of its developmental features but also its limitations as a model. Tamil Nadu and Pakistan both have features of competitive clientelism: high levels of political fragmentation and contestation and high levels of political corruption. But while Tamil Nadu is a high growth and industrializing state in India, Pakistan suffers from poor capability development in industry and growing levels of violence. Again, the political settlement framework can explain some of these features through a more granular analysis of the configuration of organizational power in these two.

Our hypothesis is that standard institutional theory focusing on the enforcement of market institutions and liberalization is inadequate for explaining the variety of development outcomes seen in South Asia. Tamil Nadu and Gujarat are high growth states that in different ways fail to match the explanatory variables identified in these models. Pakistan attempted liberalization and good governance reforms with much more zeal than its Indian counterpart and achieved much poorer results. In Pakistan's case we chose to study the country as a whole rather than a particular province like Punjab or Sindh because no province performed significantly better. The adverse effects of liberalization in Pakistan affected the whole country, as does the growing problem of political violence.

In engaging in this analysis, clearly the relevant institutions and organizations are different depending on whether we are looking at national or sub-national systems. However, at a very general level, in each case we look at how the ruling coalition is put together in each polity and the relative strength of included and excluded organizations. This is a historical analysis to a large extent and so part of the analysis goes into economic, political and social history. In the case of Pakistan the background history is particularly important for understanding some of its contemporary challenges, and the historical section is appropriately longer. We then analyse the rent creation and rent management strategies that the ruling coalition(s) implemented to stay in power. Using this framework we show that we are able to explain the emergence of particular institutions and the degree of modification or enforcement of these institutions that help to explain important features of economic development and political stability. To limit the scope of the analysis to manageable proportions we focus on the industrial sector and look at issue of industrial competitiveness and capability development, but other related institutional issues are also covered when required. The aim is not to provide a comprehensive analysis of each economy along all sectoral dimensions but primarily to demonstrate that important aspects of institutional performance can be usefully analysed using the political settlements approach.

The identification of characteristics of the macro-political settlement was partly based on a reading of historical and contemporary sources on the evolution of organizational power and political strategies in these localities. However, this was also complemented with interviews and discussions with a broad range of individuals in business, politics, the bureaucracy, the media and in academia. As our hypotheses about particular configurations of power in a locality evolved they were repeatedly tested by asking different types of organizational representatives and through this process, the hypotheses were progressively refined. The selection of critical and knowledgeable respondents was therefore important and here the extensive experience of the author as a business journalist in South Asia was very useful. A broad range of valuable contacts were used to identify critical individuals to interview based on a range of organizational perspectives and interests.

The case study method is therefore the core methodology of research in this dissertation, providing a range of qualitative data that was used to evaluate the outcomes of formal institutional structures in our case studies. As Odell says, case studies are the relevant method where the researcher wants to 'refine received theory', document a process and allow for a stronger empirical grounding for a hypothesis for the cases considered (Odell 2001; M. H. Khan 2012f) .

The case study method allows us to provide a 'thick narrative' that is required for context-specific analysis. In Gujarat and Tamil Nadu the author conducted field work trips. In the case of Pakistan, political uncertainties during the fieldwork window of this research and the Indian passport of the author meant that information had to be indirectly collated from secondary literature and extensive telephone interviews. The most important of our interviewees are listed in an appendix. Some of our respondents either are or have been senior members of the bureaucracy at both state and national levels. Others were corporate leaders or owners of large business interests across both the states. Significantly we were also able to speak to members of political parties who were candid enough to provide insights into the informal workings of the formal institutions of the state. Finally we also accessed members of the local media who are often the best sources of information. They often possess useful information that is too sensitive for them to directly use but in many cases they were willing to share insights and information with the author.

Chapter 4 . The Growth Debates in India and Pakistan: Liberalization versus Capability Development

Introduction

The 'liberalization' reforms that both Pakistan and India implemented in the 1990s were extremely important for both the economies. The period we examine in the thesis is from 1980 to around 2010 and beyond when much of the economic policy in both countries was reset according to a liberalization agenda. Putting its state planning days behind and opting for free market reforms has often been the reason put forward by many economists as the reason for India's growth acceleration from the 1980s and especially since 1992. While the thesis does not directly address the process of liberalization this chapter briefly outlines the debates for and against liberalization and concludes with an analysis of how liberalization affected the capitalist transformation of the Indian and Pakistani economies. In India states gained greater powers of economic decision making, a departure from the days of central planning when economic development was guided by the centre. For economists studying India an analysis of the processes of accumulation within states became even more necessary in order to understand the processes of economic growth in India. Our case study states of Tamil Nadu and Gujarat demonstrate how ruling coalitions used the rent creation opportunities provided by liberalization to affect growth outcomes in their states in complex ways. Since liberalization usually implies significant institutional changes, our framework of political settlements is useful for analysing the implementation of liberalization in both Pakistan and India. According to the framework any significant institutional change requires a commensurate capability to enforce these changes. If the underlying distribution of organizational power does not support aspects of liberalization, these institutional changes are likely to be blocked or more likely, modified. This is the reason why the implications of liberalization reforms have been different in different parts of India, and between India and Pakistan. This is also one reason why we contend that the analysis and explanation of the Indian growth acceleration has to move beyond the identification of liberalization as a policy to a more detailed understanding of regionally specific strategies and policy implementation. A review of the debates around liberalization will allow us to locate these observations more effectively.

This chapter is divided into six sections. The first section sums up key literature that argues India's growth post the 1990s was driven by liberalization. Section 4.2 provides arguments that explain India's growth through the quality of its institutions. Section 4.3 considers political economy explanations. Section 4.4 considers if India's growth has been service sector led. Section 4.5 outlines that India's growth is essentially due to capability development in the years before liberalization. Section 4.6 considers debates about rent seeking in contemporary India. The final section 4.7 outlines a framework of 'reversible patron-client' relationships which reflect the changing configuration power between political and economic organizations in India.

4.1. The Market reforms of 1992

We define liberalization in the conventional way as an opening of markets with lower trade barriers and easier access to markets for new actors in the private sector. Economists in both India and Pakistan have advocated a liberalization of markets in this sense in order for economic growth to gather momentum or to be sustained (Amsden 2001; Srinivasan and Tendulkar 2003; Panagariya 2005; R. Rajan 2006; M. H. Khan 2011b; Lal 2011; World Bank 2012b; J. Bhagwati and Panagariya 2013). This stems from liberal economic theory that contends that free markets not only allow efficient allocation of resources but in developing countries allow global capital to flow to these economies. Developing countries potentially provide foreign investors with higher returns and foreign capital inflows provide developing economies with access to capital and technology. Apart from liberalization the policy corollary is that property rights in general, but particularly of foreign investors should be protected, and once this is assured convergence in growth rates is likely to take place. Liberalization reforms were often also backed by Structural Adjustment Programmes

(SAP) advocated by the IMF for developing countries on the verge of bankruptcy. Here liberalization was about cutting back budget deficits not just to avoid payments crisis, but also to prevent a crowding out of private investment as a result of high interest rates. SAPs were part of the neo liberal development prescription of the 'Washington Consensus' a term coined by John Williamson (J. Williamson 1990) that included measures like fiscal discipline, flexible exchange rates, ensuring security of property rights, trade liberalization and privatization as its major set of policy agendas. Financial aid was provided to the country under consideration as long as it adhered to the Washington Consensus prescriptions. In both countries, liberalization had pockets of local support, particularly from groups left out of the rent allocation systems of the existing institutional structure. But even a partial execution of liberalization took external shocks that enabled ruling elites to push through reforms (Jenkins 2000).

Pakistan's liberalization programme was more obviously driven by SAPs, the first of which were implemented in 1987-88, though a privatization programme to reverse some of Bhutto's nationalizations of the 1970s had begun much earlier. It was however the second series of reforms initiated in 1994 that had more stringent conditionalities on public spending. Many Pakistani economists have attributed a rise in inequality in the country and a fall in its social sector spending directly to the SAPs and the conditionalities of macroeconomic stability attached to them (Anwar 1996; Pasha, et al. 2002; Gera 2007; Husain 2010; Lieven 2011). More details on the consequence are analysed in the chapter on Pakistan. India's liberalization was forced when it faced a balance of payments crisis in 1991 with foreign exchange left for only two weeks' worth of payments. The country pledged its gold reserves in return for an IMF bailout and though it did not have conditionalities imposed on it the central government of the time, by then a different one from the one that pledged the gold, decided to open up the Indian economy for both domestic and foreign investors in 1992. However, long before then, the institutions and instruments of planning like the licensing system had ceased to be effective even though formal tariff barriers were still high (M. H. Khan 2008b, 2009b). This was even truer in the case of Pakistan where the formal instruments of planning had not been effective since the 1960s. However, in India liberalization was associated with a transition to its 'emerging market' story while in Pakistan it was associated with declining economic performance. But as Figure 4.1 shows while India's growth was robust till 2007, its growth thereafter has been slipping. The question is whether India's three decades of growth since around 1980 was based on capabilities that had been developed by specific capability development strategies that have gradual unwound. Sections 4.7 and 4.8 examine these questions in greater detail.

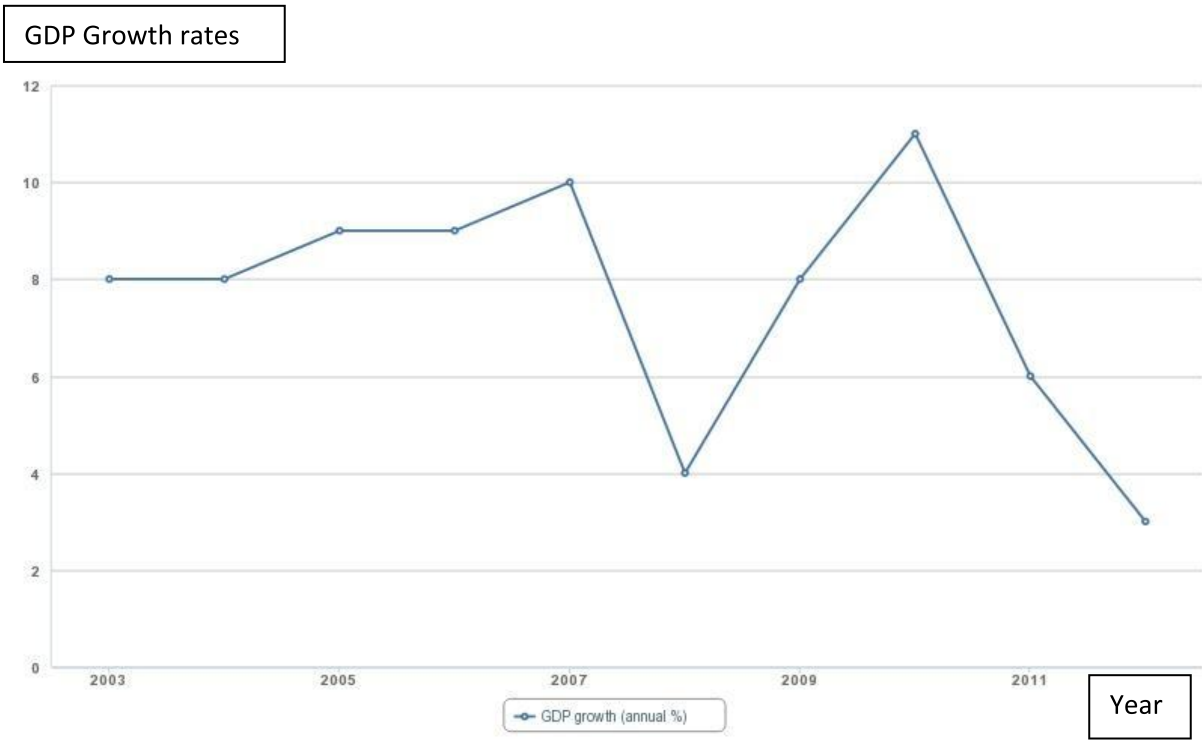

Figure 4.1 Annual GDP growth rates India

Source: World Development Indicators, World Bank 2013

The liberal economic analysis of India's growth take-off in the 1990s is unequivocal about the role of liberalization. At least till the late 1990s the World Bank was also one of the chief cheerleaders of India's reforms process (Corbridge and Harris 2000). However, the detailed mechanisms through which liberalization was supposed to have raised growth are often not clearly identified. A few more sophisticated liberal arguments have made the case for a 'creeping' liberalization before the 'big bang' reforms of 1991. These included arguments claiming that overinvestment in higher education in the previous planned economy period allowed the development of the information technology sector and of skill-intensive manufacturing once some of the controls on foreign capital and technology inflows were removed (Basu 2003; Veermani and Goldar 2005; Kochchar, et al. 2006). Most of these explanations ultimately identified greater capital inflows as an important gain of liberalization. However, the efficacy of these capital and technology inflows depended on some pre-existing technological capabilities, and this was indeed recognized in the more nuanced analyses.

Much of the mainstream literature was however concerned with establishing the further liberalization that still needs to happen. One of the major remaining constraints identified by this school of thought is India's rigid labour laws which it is argued prevents industry from hiring workers in large numbers as it is difficult to dismiss them if they are no longer required (Besley and Burgess 2004; Panagariya 2005; R. Rajan 2006). As a result, one problem of Indian industry was and is that it is excessively skill intensive. This is because (it was argued) it was easier to fire skilled workers compared to unskilled workers and hence labour intensive manufacturing suffered (Kochchar, et al. 2006; R. Rajan 2006). Besley and Burgess provided indirect support for the argument by econometrically linking state level performance in manufacturing to greater state support for pro-business labour market legislation (Besley and Burgess 2004). The policy implication for this was that more labour and capital market reforms were necessary to keep the growth process from flagging. However there is little evidence that it is easier to fire skilled workers than unskilled workers in India. Equally most units in India's organized manufacturing sector have been able to circumvent labour laws by hiring workers on a contractual basis and many of them flout formal labour laws as redress through the courts is expensive and time consuming. At best, further liberalization of the labour markets may add some dynamism to India's manufacturing growth but it is hard to argue that these laws are holding back India's investors to a very significant degree (Bhattacharjea 2006). Finally, the argument of Besley and Burgess is also weak because passing (or not passing) formal pro-business legislation does not necessarily translate into actual labour market flexibility.

4.2 India's 'Superior' Institutions and Growth

Another explanation for India's better growth outcomes following liberalization comes from the work of institutional economists like Rodrik and Subramanian (R&S), and Acemoglu Johnson and Robinson (AJR). AJR had argued in their articles on colonial roots (Acemoglu, et al. 2001, 2002) that countries like India, the regions of Meso America and South East Asia were richer than the developed countries of today in the pre colonial history. However the extractive institutions set up by colonisers in these countries (called non-settler colonies because the Europeans could not settle here due to disease, environments or population density) impeded their transition to higher productivity economies. In settler colonies like America or Australia on the other hand the colonisers settled the land and created secure and inclusive property rights. Hence in AJR's case the stress is on inclusive economic institutions supported by inclusive political institutions which create conditions for long run growth. Of course the key feature of their analysis missed by many is that the emergence of inclusive institutions in their framework did not itself happen through inclusive institutions but required the systematic extermination of indigenous population in both America and Australia (M. H. Khan 2009a, 2012c). Viewed this way the institutional history of the transition in settler colonies is certainly as disruptive of property rights *and* more violent than the disruptions of property rights that happened in the non-settler colonies. Despite the weakness of the argument in terms of identifying the institutions required to manage transitions, the claim that 'inclusive institutions' are important for growth strengthened the already existing 'good governance' ideas about the importance of stable property rights and accountable political institutions for ensuring sustainable growth.

Rodrik and Subramanian build on the assumption that there is an agreed set of institutional problems that need to be resolved to ensure growth. The core argument of R&S' influential paper in 2005 comes from Dani Rodrik's own work on institutional economics that suggests that economic growth does not necessarily require a formal protection of property rights but it does require 'effective' protection of the rights of private investors to create the right incentives for investment and economic activity (Rodrik, et al. 2004). This is further elaborated in Rodrik's other work on 'binding constraints', ' growth diagnostics', and 'second-best institutions' all of which point to the fact that developing countries should not emulate institutional policies of the developed world and instead evolve policies that solve the core institutional problems in ways that reflect their realities (Rodrik 2004; Rodrik, et al. 2004; Rodrik 2008). Aspects of Rodrik's argument are compatible with our own because he is effectively saying that many formal institutions may not be enforceable in developing countries and it is better to attempt alternative solutions where the combination of the formal with informal enforcement still yields developmental outcomes. Our difference with Rodrik is that the most relevant institutional problems in developing countries may not just be the protection of already existing investors. It may be to create new entrepreneurs and capabilities and the transformation of property rights to support new patterns of resource use. The transition therefore requires institutional solutions that are much more extensive and quite different from the protection of investors. These aspects of the developmental transformation are downplayed in Rodrik's analysis.

Using their analytical framework, R&S point out that India's growth rates actually started creeping up in the 1980s and since liberalization began in the 1990s the growth takeoff could not be attributed to liberalization. Instead they argue that the trigger for the takeoff was the pro-business 'attitudinal shift' on the part of the Indira and Rajiv Gandhi governments of the 1980s that created investor confidence that their rights would be much better protected in India. According to R&S India's institutional scores (formal institutions supporting property rights and government accountability) were already quite high for its level of per capita income. The shift in government attitude created the confidence that the institutions would work better and led to higher growth. Before the shift investors had less confidence in government intentions and therefore (in our language) in the likely operational equilibrium of the formal institutions. But with the signalling that came with repeated political statements in favour of the private sector, animal spirits were released and growth rates accelerated (Rodrik and Subramanian 2005). De Long has also attributed the growth acceleration to similar shifts in entrepreneurial attitude due to policy signals though he locates the shift in 1985, later than in the R&S analysis (De Long 2003).

There are several problems with this argument, even though these authors correctly identify that liberalization cannot be a full explanation of the growth takeoff simply because of the timing of the growth acceleration relative to the formal policy and institutional changes. Firstly a lot seems to hinge on the claim that pro-business statements are sufficient to change the behaviour of investors given existing formal institutions even though these are not properly enforced. The assumption is that the pro-business statements effectively result in better enforcement of the formal institutions but this does not necessarily have to be the case. Secondly the argument is subject to reverse causality where government attitude is not the independent variable but may itself be influenced by business groups lobbying for these changes. Media accounts of that period suggest that some business houses with high and underused capabilities were lobbying the government for greater openness while those who had 'invested' in closer relationships with the Congress in the hope of continuing rents from licences were opposed to deregulation (for instance the Rahul Bajaj owned Bajaj Group, the Thapars, and the Mafatlals in the latter case and the Tata Group and a slew of IT companies including Infosys in the former). Most importantly, what is missing in this account is a discussion of the different types of informal processes through which the existing formal institutional structure began to be used in the 1980s in the context of a changing political environment, long before the limited formal liberalization began in the 1990s.

4.3 Political Economy Explanations

Apart from the explanations related to institutional change we look at four significant political economy explanations for the growth takeoff in this period (Jenkins 2000; Chibber 2003; Sinha 2005; Kohli 2006a). Sinha's main thesis is that development in India has to be looked at from the point of view of both the centre and the regional players. Growth or stagnation were a result of the interface of the two and cannot be explained only with reference to the statist or free market policies of the central government. This was one of the first academic works that looked at the processes of accumulation discretely within Indian states in conjunction with an analysis of how political and business elites of these states negotiated policy with the centre. The ability to do this successfully after liberalization helped some states (Gujarat and Maharashtra for instance) to develop 'strategic capacities' (Sinha 2005). However Sinha emphasises an appropriate culture and ideology as the critical drivers of industrialisation strategies, or the lack of in the case of West Bengal. Her analysis of the concept of the developmental transformation of countries is also weak. She holds up Gujarat as a model of a developmental state but when compared to other case studies in the literature on such states Gujarat would not be considered as a developmental state along the lines of South Korea or Taiwan or even Malaysia. This is discussed in greater detail in the chapter on Gujarat.

Rob Jenkins provides a political analysis of how liberalization was implemented in a context of a political system characterized by patronage. According to his thesis India's more astute politicians pushed through these reforms because they realized the potential of liberalization as an alternative to the patronage regime that was part of the by then defunct central planning model. This led growth to be fast paced but it also meant that liberalization was not achieved by the sort of democracy promoted by the good governance agenda (Jenkins 2000). Jenkins' argument is insightful in reminding us that Indian democracy is far removed from the accountability or inclusion that is promoted in the good governance framework or in Acemoglu and Robinson's analysis of inclusive institutions. However, Jenkins still assumes that the institutional structure of liberalization when it was introduced operated as the formal institutional structure defined. In terms of his analysis of India's political economy we would expect even liberal institutions to operate in a different way, and this leads to the question of how these institutions operated in practice in different parts of India.

Two other political economy explanations are significant for our analysis. While Vivek Chibber's analysis focuses on why India' experiences with industrial planning failed and is not specifically about India's growth takeoff one of his key insights is that India lacked the 'state capacity' to implement planning. According to him South Korea under Chung Hee Park possessed this capacity. State capacity is itself decomposed in Chibber's analysis into a 'state's cohesiveness as a strategic actor' and its 'ability to extract performance from private firms'. Chibber's conclusion is that the Indian state was found wanting on both these counts (Chibber 2003). Chibber does not employ the lens of a distribution of power between organizations but his analysis of state capacity as enforcement capability is an area of overlap with our framework of political settlements. Chibber ascribes the ability of the Korean state to impose discipline on firms to its policy of export-led industrialization (ELI). According to Chibber the cohesive Korean state was able to discipline its capitalists because they *willingly* submitted to disciplining as a result of ELI. The necessity of achieving competitiveness in the export market provided a compulsion for South Korean manufacturers to upgrade their quality and technology and collectively they had no incentive to tolerate poor quality in other firms that may adversely affect their own competitiveness through poor quality inputs. This support from capitalists collectively allowed the state to impose discipline on individual firms which would allow them to manufacture in line with global standards. An immediate problem with this explanation is that it is not clear how the claim that there was a collective capitalist interest in supporting the disciplining of inefficient capitalists translated into empowering the South Korean state to carry out this disciplining.

India on the other hand adopted import substituting industrialization (ISI) and this ensured Indian capitalists had no compulsion to collectively support the disciplining of individual firms. Chibber's argument is that this was because they were each manufacturing for a protected domestic market and quality did not matter. Chibber is right to argue that the Indian state lacked the power to impose discipline on India's capitalist firms. The question is whether Chibber correctly identifies the source of this failure. While it is true that subsidized Indian capitalists resisted disciplining, it was not the case that the state lacked the ability to discipline them because other capitalists did not support their disciplining. Rather, the state failed to discipline individual capitalists because they were able to construct their own coalitions with powerful political organizations within the Indian capitalist system. This difference is critical. Political economy explanations especially from Bardhan (1988) and Khan (2010b) identify the construction of coalitions between business and the state, or to use Khan's terminology, between business and members and sub-organizations of the ruling coalition. The critique becomes stronger when we look at Pakistan. Khan points out that Pakistan also attempted ELI policies and was once considered to be a country with an economic potential greater than that of South Korea. It also grew rapidly during Ayub Khan's military regime with a growth rate of over 6 per cent from 1960 to 1970. Yet Pakistan's ELI strategy did not result in successful disciplining and the business-government coalitions that blocked disciplining within its industrial policy were very similar to those in India. As in India individual firms were able to form coalitions with individuals and organizations within the Ayub Khan administration to protect their rents and this destroyed the compulsions to raise competitiveness (M. H. Khan 1999).

Atul Kohli's arguments also highlight the importance of attitudinal shifts but unlike R&S he contends that pro-business policies were also important and some were actually implemented especially by the Rajiv Gandhi government (Kohli 2006a). Kohli identifies the easing of the Monopolies and Restrictive Trade Practice (MRTP) Act and some tax restrictions along with the liberalization of lending norms affecting large businesses as evidence of a pro-business shift. According to him this period was also marked by a move towards labour repression and increased public spending. Kohli identifies this as the beginning of a 'developmental state' in India and that these changes were responsible for India's increased growth rates in the 1980s.

However as we discuss in greater detail in Chapter Five on Gujarat, pro-business policies defined in this general way do not necessarily lead to the emergence of a developmental state as such policies could simply grant business organizations rents without achieving developmental outcomes. There is evidence from post-liberalization India that pro-business policies of this type in a context of weakened regulatory capacities has increased damaging rent seeking and created many damaging rents (Walton 2008; Bardhan 2009; M. H. Khan 2011b). Kohli's analysis of India has its origin in his analysis of the role of South Korea's colonial heritage in the construction of its developmental state. Kohli argues that Japanese colonization destroyed South Korea's older elite classes and this helped the independent South Korean state to enforce discipline without contestation from pre-existing elites and this helped the construction of a developmental state. Parts of this analysis of colonial history are consistent with our analysis of the impact of colonization on the evolution of the political settlement in South Asia which we referred to in Chapter Two. British social engineering in India, in contrast to the South Korean experience, created new groups and classes which were provided with rents and patronage in return for providing organizational support for British rule. The Indian and Pakistani states inherited this legacy and had to face successive mobilizations by new groups claiming rents and political inclusion, eventually giving rise to competitive clientelism.

A significant critique of Kohli, De Long and R&S has come from Kunal Sen whose empirical work finds that any attitudinal shift was 'second order' in terms of importance and in fact there were direct changes in economic policies that affected growth. Sen also locates the date of the growth acceleration from the mid 1970s, far before the conventional political economy explanations (Sen 2007). In his paper he adjusts for the year 1979, an outlier year when the second oil shock and a severe drought dragged GDP growth down to -5.2 per cent. Excluding 1979, he identifies that the proximate cause for the growth spurt is a growth in TFP that cannot just be the result of attitudinal shifts. He also argues that Mrs Gandhi's anti-labour policies of the 1980s (that Kohli finds significant) were not particularly new and her government's handling of the railway strike and decision not to nationalize the wholesale trade in wheat were equally significant anti-labour signals in the 1970s. Sen traces the source of the TFP growth down to three variables: financial deepening after the nationalization of India's banks in 1969, a rise in public sector investments and a drop in the relative price of equipment. All of these variables are 'policy determined' and hence does not tie in with a mere shift in government attitudes causing growth.

Sen divides India's growth from the mid 1970s to the late 1980s into two parts: from the mid 1970s to the early 1980s and then from the early 1980s to the late 1980s. Growth till the early 1980s was primarily driven by financial deepening and increased public sector investment. Growth till the late 1980s was a result of an easing of import controls in the mid-1980s whereby Indian manufacturers had access to capital and intermediate goods through the Open General Licence list. This led to a relative decline in the price of equipment for the manufacturing sector in India. It is this last factor that he submits as the reason for TFP growth in the Indian economy noted by Bosworth, Collins and Virmani (Bosworth, et al. 2007). The correlation coefficients are highest between TFP growth and private equipment investment at 0.96 while it is -0.56 between TFP growth and public equipment investment and -0.78 between TFP growth and investment in structures. We take Sen's conclusion further in our analysis of growth in the Indian economy from the early 1980s to 2013 (barring the last two years that have seen the economy in recession). We conclude with him that growth was neither due to dirigiste policies or liberalization but due to capability development in certain sectors of Indian manufacturing due to specific policies.

Finally, we refer to a different type of explanation of India's growth spurt in the 1990s that focuses on agriculture as the proximate cause. Balakrishnan (2010) provides a sectoral analysis of the Indian economy from the 1960s to (give year) and his central thesis is that high agricultural growth driven by the 'Green Revolution' and higher public investment in agriculture resulted in higher service sector growth from the 1970s. Based on an econometric study, he argues that the growth impetus moved from agriculture to services and from there to industry. He supports this conclusion with data that suggests manufacturing suffered a deceleration from the mid 1960s and did not recover till the 1980s while the services sector was seeing growth from the 1970s. He also argues that the manufacturing sector was not significantly deregulated till the 1980s while the levels of regulation were much lower in the service sector allowing for more investment. However while one cannot deny that the Green Revolution did have a role to play in Indian economic growth, agricultural growth in India since 1965 has rarely been higher than 3 per cent and the industrial growth rate has always been above the agricultural growth rate (Table 4.1). The argument that changes in growth in a sector with low growth rates drove much bigger changes in growth rates in sectors with higher growth rates has to be more persuasively demonstrated in terms of demand and supply links, beyond the sequencing of growth rate changes. For instance, the growth in services that Balakrishnan refers to is primarily in the hospitality, entertainment, private healthcare and education sectors and these were not significant sectors of spending for the rich farmers in northern India who were the chief beneficiaries of the Green Revolution.

Table 4.1 India: Historical growth rates and acceleration with 'planning'

	1901-30	1931-47	1952-67	1968-81	1982-91	1992-2001
Agriculture	0.5	0.2	1.8	3.3	3.5	2.7
Industry	0.9	1.2	6.3	4.1	7.1	5.7
Services	1.6	1.7	4.8	4.3	6.8	7.6
GDP	0.8	0.8	3.4	3.8	5.6	5.6
Per capita GDP	0.4	-0.5	1.4	1.5	3.4	3.5

Note: 1901-47: Pre independence zero tariff regime

1947-80: Dirigiste planning

1980- : Beginning of economic reforms

Source: (Acharya, et al. 2003: Table 2.1)

4.4 Paradigm of Service- led Growth?

While Balakrishnan makes a statistical case that service sector accumulation and growth in the 1970s triggered India's later growth in manufacturing there is also an analytical argument related to the liberalization process that suggests India's growth acceleration in the 1990s was the result of productivity spillovers from the service sector. Table 4.2 shows that the share of the service sector in GDP has been growing rapidly, and is already higher than what is expected in a lower middle income country (46 per cent compared to India's 55 per cent) and it is also higher than China's share of the service sector in its GDP (46 per cent). The share of manufacturing in India even after liberalization was around 2.5% lower than the average developing country at the same level of per capita income. The change in the share of services however was 10% higher than the average. This is at odds with the standard pattern of structural transformation where the secondary sector grows rapidly and the transformation process is about moving from a primarily agricultural economy to a manufacturing one. Kaldor's three laws stated that manufacturing is the engine for GDP growth in developing countries, with the growing manufacturing sector absorbing labour from the labour surplus agricultural sector, that the growth of output in manufacturing will lead to higher productivity growth in manufacturing and finally that the higher productivity growth in manufacturing will have spillovers to other sectors, driving productivity improvements through learning effects and the supply of inputs and capital equipment.

Table 4.2 Sectoral Shares in GDP in India 1980-2005

	1980/81	1990/91	2000/01	2004/05	Change 1980-2005
Agriculture	38.9	31.3	24.6	21.1	-17.8
Industry	24.5	27.6	26.6	27.2	2.7
Services	36.6	41.1	48.8	51.7	15.1

Source: (Nayyar 2013: Table 2) based on the Central Statistical Organization, National Account Statistics

This pattern is clearly not observed in India and so something else has driven productivity growth rather than high rates of manufacturing growth. One explanation could be that high value services played the role of manufacturing in India in driving productivity growth with spillovers to other sectors. This possibility goes against the persuasive arguments of Rowthorn and Wells and Baumol who argued that productivity is higher in most industrial sectors compared to services, and given the services sector's lower productivity, more people have to be employed in the sector to sustain the same level of output growth (Rowthorn and Wells 1987; William J. Baumol, et al. 1989). Thus, the idea that high growth of output in the service sector can drive high productivity growth is a problematic one. Yet economists like Nayyar and Dasgupta and Singh have argued that this is no longer true for India as high productivity service sectors like IT and communication services can drive growth with high productivity growth and spillovers along the lines of the manufacturing sector (Dasgupta and Singh 2005; Nayyar 2013). The problem with this view is that the main drivers of GDP growth have been sectors like the domestic trade sector and the share of high productivity services like software services within the overall service sector in India though growing is still below ten per cent. The software sector's share in growth of services exports is also high (Banga and Kumar 2011). However relatively low productivity service sub-sectors like trade and real estate still account for a high share of Indian GDP. The real picture of the Indian service sector emerges at the bottom end of the employment pyramid. This can be aptly described as a sink for unemployment in low value added jobs like at roadside food stalls, pop up stores and domestic services.

It is true that growth in service sector employment has been slower than service sector output and in this respect India is an outlier in South Asia. This is because some of the output growth in services has come from high productivity, human-capital intensive sectors like IT. Given the high prices of these services (because they are linked to export markets in developed economies) the share of services is also inflated in India. But this means those who do not have high formal educational competencies find no place in the high productivity segment of the service sector. The spillovers that economists expect from high productivity services are unlikely as India's manufacturing sector has few high productivity firms that can benefit from the services provided by the high-productivity service sub-sector. Significantly we will see in the next section that manufacturing in developing countries often suffers from an initial low productivity and competitiveness problem that requires learning strategies. In contrast, services that rely on high human capital often do not suffer from a similar productivity differential in the developing country. If wages are lower in India for human capital of the same quality, those services will be globally competitive from the outside and business will relocate. The transfer can be quite rapid as long as unemployed high quality human capital exists, but there is not necessarily the same learning by doing going on, and the transfer stops when the supply of underemployed high quality human capital runs out.

4.5 Capability Development led Growth in Key sectors

An alternative explanation of growth in the Indian economy from the 1980s onwards looks at how capabilities in a few manufacturing sectors were developed based on capabilities that had already been developed under the planning regime (M. H. Khan 2009b, 2011b, 2013c, 2013b). India had already developed capabilities in sectors like automobiles and pharmaceuticals, but they had not achieved international competitiveness partly due to the limitations in disciplining mechanisms discussed earlier. From the 1980s onwards, Khan argues that in some of these sectors capabilities were developed to the point that they became globally competitive using very specific financing instruments that now created compulsions for high levels of effort in the learning-by-doing process. This is also the reason why growth in the Indian economy has been apparently patchy and sector specific implying that policy responses may also need to be sector specific. Future growth strategies will have to address critical market failures and appropriability problems especially with regard to financing high levels of learning and effort as well addressing contracting failures in land markets (M. H. Khan 2009b, 2011b).

We identify the former as the key problem hindering structural transformation in most developing countries. Contemporary economies in transition have to raise their competitiveness even faster than the former Newly Industrializing Economies (NIE) due to the drastically changed nature of the international political economy, especially with the introduction of WTO and intellectual property rights norms that reduce the range of instruments that can be used to acquire new technologies and finance learning. This has not made technology acquisition for the manufacturing sector any less necessary but has meant that the process has to be carefully strategized and managed. Essentially despite low wages developing economies do not have the relevant 'organizational capabilities' in most sectors that will allow them to use known technologies to produce goods competitively for the international market. This process of building organizational capability and achieving competitiveness requires acquiring the 'tacit knowledge' of how to organize modern production, understanding technical specifications, quality control, inventory management and so on. These capabilities are not formal skills that can be learnt through formal training and require processes of learning-by-doing that in turn have to be financed. The 'learning by doing' that is required here is beyond that described by Arrow where productivity increases simply through a process of repeated activity (Arrow 1962). In the learning process through which competitiveness is achieved, the organization has to put in a high level of effort in experimenting with different organizational structures to achieve competitiveness rapidly. The compulsions that ensure high levels of effort in learning are difficult to contract and this is why private investors stay away from these investments and also why public financing needs to come with credible conditions for ensuring effort. Financing learning-by-doing is therefore both necessary and risky because it involves an unknown period of financial uncertainty and hence needs state sector support (M. H. Khan 2009b, 2013c, 2013b).

We define competitiveness in a specific way as outlined by Khan. Competitiveness is defined as the ratio between global prices and domestic cost of production for a product of a particular quality, or $\frac{P^{\ global}}{C^{domestic}}$. It is only when this index is greater than one that the domestic firm is competitive (Figure 4.2). If the technology is potentially one that the country can master, low competitiveness is usually the result of weak organizational capabilities. The financing of the learning-by-doing has to come with conditions and the credibility of enforcement for these conditions depends on the institutional rules, the organizations involved and the political settlement in the country (M. H. Khan 2009b, 2013c, 2013b). The state-led industrial policy instruments in India and Pakistan in the 1960s and 1970s did not perform too well because the firms receiving support with these institutional conditions could not be disciplined in that political settlement.

Devising financial instruments appropriate for developing competitiveness is important because free trade by itself does not provide developing economies with the mechanisms for developing new capabilities. Neoclassical trade theory establishes that free trade allows each country to specialize according to its ‘comparative advantage’ but if the developing country lacks the organizational capabilities to be competitive even in low technology activities, it can be locked into a production possibility frontier that moves outwards very slowly. Creating comparative advantage through support for developing organizational capabilities is also necessary to capture the purely technological benefits of internal economies of scale. The claim that free trade expands the ‘consumer surplus’ or the ‘consumption possibility frontier’ that is propounded by many free trade theorists have also failed to deliver growth to countries that have liberalized trade regimes to make imports freer. The so-called consumer surplus from a freer trade regime is often defined as ‘bonus ‘utility’’ and is in any case difficult to measure (Dunkley 2004) nor does increasing utility solve the imperatives of raising competitiveness in developing countries. We know that trade theory, especially those derived from the Hecksher-Ohlin model, are replete with unrealistic assumptions that make them of limited use as policy guides for developing countries.

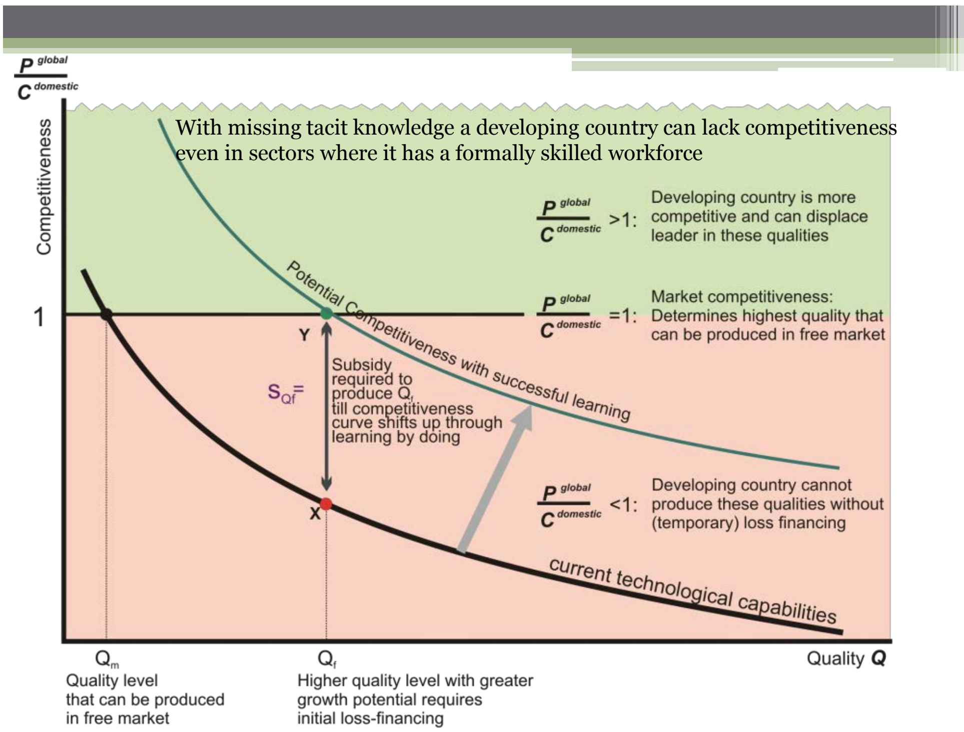

Figure 4.2 Loss financing in gaining competitiveness and learning
Source: (M. H. Khan 2009b: Figure 1)

Figure 4.2 shows a situation where a developing country is not competitive in any but the lowest qualities of a product because of missing organizational capabilities. If it wants to produce higher value products of quality Q_f a competitiveness gap of XY has to be covered by some form of loss-financing while learning-by-doing takes place. If high levels of effort are put into the learning process the competitiveness frontier curve should rise up and the country should be able to produce this product without any more loss-financing. Early industrial policy in India and Pakistan did create new capabilities (the competitiveness frontier moved up) but not by enough for most of the supported sectors to become globally competitive. When the formal structure of planning in India began to unravel in the 1970s, (long before liberalization) the availability of new forms of financing and support for learning in a few sectors allowed them to build on the capabilities they had developed in the dirigiste years and achieve competitiveness. Khan defines two types of strategies that emerged in the Indian manufacturing sector. These were 'alpha' and 'beta' strategies. In the former, organizations close to the competitiveness frontier in high technology sectors benefited from specific financing instruments to achieve global competitiveness. In the beta strategy organizations that have not managed to develop global competitiveness in the quality of products that they were initially attempting shift to lower quality products in which they can achieve competitiveness given their existing capabilities.

One of the ironies of India's growth under liberalization was not only that many of the basic capabilities in sectors like automobiles and pharmaceuticals were developed during the dirigiste period, but some of the financing instruments that were used in new ways in the 1980s to develop further capabilities were the dirigiste ones that later liberalization removed. For instance, the critical capabilities in automobiles and pharmaceuticals required policies that were not yet encumbered by the WTO and TRIPs and in the case of automobiles, relied on the existing market protection to create incentives for technology transfer. Growth in pharmaceuticals was based on India using a Patent Act that generated rents for domestic companies if they were successful in 'reverse engineering' processes for making known molecules, a process that rapidly created new technical and organizational capabilities in the pharmaceutical industry. In the auto sector the state granted huge implicit subsidies to the Japanese auto maker Suzuki in the form of conditional access to the protected Indian market if it succeeded in satisfying stringent domestic content requirements. These incentives, provided through rules that were enforceable in the political settlement, compelled Suzuki to spend resources and effort in creating organizational capabilities in Tier 1 and Tier 2 producers that eventually created a world class auto industry in India (M. H. Khan 2009b, 2011b).

The poor results with liberalization in Pakistan can also be understood in this framework. Liberalization is likely to produce good results if there are already sectors that are competitive or close to achieving competitiveness. In Pakistan's case a combination of the deindustrialization of the Bhutto years, the lack of a coordinated industrial policy under the military governments that succeeded and then the rapid opening up of the economy under the liberalization of Nawaz Sharif meant that there were no significant new manufacturing sectors with the organizational capabilities to be globally competitive. Even in the Indian case the deepening of liberalization has meant that sectors that were not close to the competitiveness frontier were unable to achieve competitiveness given global price and quality standards. The strategy followed by the auto sector is what Khan describes as an alpha strategy, and these have become particularly difficult over time (M. H. Khan 2009b). The auto and auto components sector in India today is not just India's most successful manufacturing sector but is also globally competitive having become Asia's 'small car' hub and exporting Tier 1 components to Japanese, European and American OEMs. However, the success of this sector required both the high base capabilities that were developed under dirigiste strategies and the financing instruments and domestic content conditions that allowed the further jump to global competitiveness standards in higher qualities. These instruments were available in the 1980s but are no longer there.

In the case of the pharmaceutical sector India's accession to the WTO meant it had to recognize product patents. This took away a financing instrument for capability development that had created strong incentives and compulsions in the sector given the specific design of the instrument and the political and institutional conditions that made the enforcement of the patent rule credible. Reverse engineering is no longer available as a capability development strategy for Indian pharmaceutical companies some of whom had a strong research and development pipeline but needed more investment and capabilities to come up with a patent worthy drug that could prove to be their 'blockbuster'. With the repeal of the older Patent Act Indian pharmaceutical companies no longer have the financing instrument for capability development and R&D and are instead choosing to focus on lower value generics. This is an example of what Khan calls beta strategies (M. H. Khan 2009b). It is our contention that the current slump in manufacturing growth rates in India is the result of very few firms having access to alpha strategies for new capability development, some having access to beta strategies and most having access to neither because they are so far away from the competitiveness frontier in their sectors and because liberalization has removed many likely instruments for financing capability development.

4.6 Lal's Analysis of Rent Seeking in Contemporary India

The argument that the capability development in the manufacturing sector of a developing country requires rent management strategies worries liberal economists. Some of their concerns need to be addressed if only because this school of thought has a significant influence on India's policy makers. The dominant view amongst Indian policy makers is that any form of rent management strategy is distortionary even though many types of formal and informal state created rents exist in the Indian economy. Lal in a recent article on rent seeking in post liberalization India has argued that some of these rents are part of 'the entitlement economy' or 'quotacracy' (Lal 2011). Lal's article is an attempt to explain why despite high levels of predatory rent seeking (land scams, telecommunication spectrum scams or coal block allocation scams that have notionally cost the Indian economy billions of dollars) productivity has gone up in the economy after liberalization. He differentiates between two types of rent seeking in the Indian economy and provides an explanation that is very much within the framework of Neo Classical Economic (NCE) theories of rents and their efficiency implications.

According to Lal it is important to distinguish between 'pure economic rents' and 'composite quasi rents' on the one hand and 'monopoly rents' on the other. His argument is that rent extraction by political elites from the first two types of rents has little impact on efficiency, and the preponderance of these rents explains why India could grow with significant rents after liberalization. On the other hand, if rent extraction happens by creating monopoly rents, there are the usual inefficiency effects. This was the type of rent that dominated under dirigisme, and there are still many monopoly rents as a result of labour market restrictions. A pure economic rent, according to Lal is a rent from a resource whose supply is completely inelastic, like land. In this case a tax or rent extraction by government from those who have this 'rental income' is a tax which does not cause any distortions. This is because the supply of land is inelastic and its owners cannot alter its supply in response to the tax and this ensures that there is no loss in welfare for the economy. This is like a lump sum tax of the type that is preferred by liberal economists. Lal categorizes the rent capture in the Adarsh land scam in Mumbai as an example of extraction from 'economic rents'. Adarsh was a housing project for war widows on prime land in Mumbai where flats were misappropriated by senior military officers. However to assume that rent extraction from land use allocations has no effect on efficiency is inaccurate. Land allocated to the highest valued uses may not be the most efficient allocation of land in an economy where prices are distorted. More importantly, the fact that land allocation results in rents that are captured by the powerful can induce the owners or occupants of land to refuse land sales. Land scams have played a role in raising transaction costs in land markets to the point that productive investments requiring land have been very adversely affected. Even in a state like Gujarat where the administration has high enforcement capacity, farmers have resisted land acquisition by the government and raised transaction costs for investors.

According to Lal, the second type of rent that has been important after liberalization is the composite quasi rent. Here he quotes Alfred Marshall who defines them as rents that occur when two separately owned resources came together in such a specific manner that the sum of their joint rents much exceeds the rents that each could have earned separately. The allocation of the 2G spectrum generates this kind of rents, by bringing together the investor's capital and the spectrum allocated by the government. Here the long-run supply of one resource may be affected by the price (for instance the return to the owner of capital may affect future investments in spectrum) but Lal argues that a variety of contractual arrangements may constrain the party owning "the resource with controllable flow of high alternative use value" from trying to expropriate most of the rent. In other words, within a broad range, expropriation of rents by politicians may not have a big impact on the long-run supply of investments in these areas because investors would still be earning significant rents. Again, Lal argues that such 'taxing' is not distortionary and this explains why India could grow so rapidly with so many scams. This type of predatory rent seeking does not lead to a loss of efficiency and may even increase productivity in the economy because rent seekers have an incentive to grow the pie. However, Lal's argument is not convincing in the case of India.

First, Lal's assumption that composite quasi rents can be clearly distinguished from monopoly rents is not correct. Many infrastructure contract allocations that Lal refers to as cases generating composite quasi-rents actually have elements of monopoly rents. If the rent extraction by government is excessive, private contractors have an incentive to overprice or provide substandard projects that government in turn overlooks, and this clearly has negative efficiency and welfare implications. Secondly, in situations where the bargaining position of one party (say the government) is higher, institutional arrangements might be inadequate to prevent rent extraction by that party to an extent that the other party (business) makes adverse allocative decisions, in the extreme case stopping to invest.

As examples of the first, there is compelling if anecdotal evidence about how the rent seeking process in India has negatively impacted infrastructure projects after liberalization. There has been a marked growth in outbound investments from India by Indian companies. For instance, according to the Reserve Bank of India (RBI) inbound foreign direct investment (FDI) in 2006-07 amounted to $ 19.4 billion and in the same year outbound FDI by Indian companies was $ 11.0 billion, a ratio that has been roughly maintained in most years since then. Between April 2008 and February 2012 manufacturing accounted for the largest share of Indian outward FDI ($23.3 billion) but investments in financial services were a close second at $ 17.0 billion. Most of the latter were routed through Special Purpose Vehicles (SPV) in offshore or regional financial centres. While this in itself is not out of the ordinary with many companies worldwide using SPVs in offshore financial centres to avoid taxes in a legal manner, in the Indian case a number of large infrastructure companies have sizable financial investments through SPVs. Media insiders believe that much of these external financial investments by infrastructure companies are a mechanism for routing pay-offs to politicians in order to secure contracts. The scale of these pay-offs has arguably made infrastructure projects increasingly inefficient in India, contrary to what Lal's efficiency hypothesis for India's liberalization might suggest. Another externality is that many of these infrastructure investments including the rent seeking costs were funded by India's banking system increasing the economy's vulnerability. It would be difficult to find a paper trail for these investments given their sensitive political nature but enough anecdotal evidence of the change in the nature of rent seeking exists in the Indian media.

Secondly, the adverse effects of post-liberalization rent seeking processes on investor decisions are also very visible. The high rent extraction by politicians has created uncertainty as investors have become wary of *ex-post* revelations about irregularities in government contracting leading to contracts later being cancelled. An investigative media and social activists have not found it difficult to find repeated examples of significant rent capture by politicians. This has not resulted in a reduction in corruption, but the legal cases that have sometimes followed, as in the 2G scam case, have resulted in revocations of contracts and business confidence in government contracting has suffered.

Lal's claim that these types of rent capture are compatible with sustained growth is therefore not credible. Indeed, India's growth rates have been wobbly after 2010. While it is difficult to link this to the patterns of rent seeking, and global economic conditions have undoubtedly played a role in the downturn, it is plausible to argue that the types of rent extraction outlined above have not been neutral in their effects. A recent report by the 'City of London' corporation outlined bureaucratic wrangles and difficulties in land acquisition as being the chief constraints for development of infrastructure in India. It quotes figures from the GoI's Economic Survey of 2011-2012 which state that out of the 583 mega projects in India 235 have been delayed. It also cites a McKinsey report that states that infrastructure bottlenecks could result in a loss of US$200 billion. In terms of GDP growth rate, this would amount to a loss of 1.1 per cent. The report goes on to state that given the current state of the Indian and global economy these projections could well be valid (City 2012).

Finally Lal identifies a third type of rent as 'monopoly rents' which are distortionary interventions by the government. In the past monopoly rents were created by the licensing system, but after liberalization Lal argues monopoly rents exist mainly in factor markets, especially labour markets. His concern is that labour market restrictions affect marginal decisions of producers and consumers and hence ends up being allocatively inefficient and damaging to the growth prospects of India's economy. We have already outlined why distortions in India's labour market are unlikely to be the primary reason holding back India's growth. Moreover, it is hard to argue that labour market rents (to the extent they exist) contribute anything at all to India's huge problem with predatory rent capture by politicians. Lal's allocative efficiency analysis of the impact of rents and rent capture is in very different from the interest of classical political economists like Adam Smith, David Ricardo or Karl Marx in the relationship between the economic surplus and investment and growth. As Khan outlines in 'Rents Efficiency and Growth' (M. H. Khan 2000b) classical political economists, unlike NCE theorists were concerned about the size and allocation of the economic surplus which could be used for investment and accumulation in society. According to them the allocation of the economic surplus is influenced by the interaction between distributive conflicts and the evolution of property rights structures (institutions). Lal's analysis entirely misses out the organization of this distributive conflict and how this affects the incentives for different types of investment. The rents that he describes as 'economic rents' and 'composite quasi-rents' are not rationally created by strong institutions with lump sum rent extraction by politicians. Rather, they are the outcome of shifting contests between economic, political and bureaucratic organizations, which in turn drive institutional change and informal modifications of institutions. The likelihood of adverse outcomes emerging is very great, and the evidence suggests this is exactly what has happened.

Finally, Lal like other neoclassical economists focusing on allocative efficiency sees no role for rents creating dynamic efficiency. The Indian economic story cannot be understood without an analysis of its successes and failures in capability development in particular sectors. In turn, these were influenced by rent creation processes under very specific balances of power that allowed or prevented the appropriate 'rent management'. To assert as Lal does that '(t)hough the immorality of rent seeking associated with pure 'economic' and 'composite quasi' rents may be reprehensible, it is less damaging to growth than the continuing 'monopoly rents' generated in the labour market' is missing the real point about growth being constrained by the lack of capability development strategies. There is merit in his argument that programmes like the Food Security Bill as they are currently designed are based on unsustainable subsidies and threaten to increase the fiscal deficit in untenable ways. The missing link is that India needs to devise an industrial policy to facilitate a broad based economic transition so that it can enhance its targeted subsidy based programmes for its poor. As matters stand now, populist programmes of poverty alleviation will do little in terms of employment generation which is the only way the country can sustainably reduce poverty.

4.7 'Reversible Patron-Client' Transactions and the Implications for Growth

An important contributory factor for the poor performance of the Indian manufacturing sector and the downturn after 2010 has been a significant change in the political settlement of India since liberalization. This changed the nature of business-government relationships and the relative bargaining power of political organizations relative to business organizations. The pre-liberalization era between the 1950s and the 1970s was characterized by patron-client relationships between business and government that were long-term in nature. Most important for the industrial sector were the long-term relationships between the dominant Congress party and the larger industrial houses. Two significant changes could be observed in India by the late 1980s and early 1990s. The first was the increased political fragmentation at the central level but more significantly at the state level. The organizational proliferation and the failure of accommodating them within the Congress Party led to the breakdown of the dominant party system. The second was a growing number of new capitalists who benefited from liberalization and emerged as a new group of large Indian corporations replacing older companies which could not adapt to the changes taking place in India's political economy.

These two factors were closely related. The regional political parties increasingly running state governments were no longer dependent on the centre in Delhi for industrial licences and could use their own agency to create rents for attracting industry to their state. These were parties organized by political entrepreneurs who had broken away from pre-liberalization parties like the Janata Dal. On the one hand they did not have established networks with the old corporate giants with links to the Congress. On the other hand they needed resources for developing their political organizations further. This coincided with the rise of regional capitalists who had developed some productive capabilities to serve regional markets in the 1970s and especially in the 1980s but who could not yet scale up to serve national markets. This was because their businesses were not large enough to generate the informal political transfers that would have interested the dominant Congress to develop relationships with them. Some of these firms were near to achieving significant competitiveness but this was not enough to be successful within the centralized planning system where getting licenses and other rent-generating instruments required expensive relationships with the dominant party. The main beneficiaries of that system were large incumbent capitalists like Birla, Tata and Bajaj.

A conjunction of these two factors meant that regional parties that were now in power were free to forge their own relationships with these rising business groups. Indeed they had strong incentives to do so both to get access to the informal resources they needed for their political survival and also to increase industrial investment in their states. By supporting the smaller regional capitalists they could forge new links bypassing the established capitalists and achieve these objectives. The collapse of the Congress as the dominant party in the 1980s and the transition in the political settlement from constrained patrimonialism to competitive clientelism was a critical factor allowing this change in business-government relationships and the liberalization regime proved to be the catalyst enabling the emergence of these regional capitalists. The new business-government relationships in turn strengthened the regional parties and led to a further entrenchment of competitive clientelism. Of course some of the older corporations survived the liberalization reforms and in time learnt to navigate the new political system successfully.

The Adani Group, an energy and infrastructure conglomerate in Gujarat is a prime example of this kind of new group which emerged from nowhere to achieve annual revenues of $7.8 billion in 2012. Some other groups like OP Jindal (energy, steel and power with group revenues of $ 18 billion) or Sunil Mittal's Bharti Enterprises (telecom and retail with revenues of $8.3 billion) were medium sized players in the 1970s (though the Jindals are an older industrial family) but they became powerful national level conglomerates only after liberalization. Other regional groups like the Jaypee Group in Uttar Pradesh (infrastructure and energy with revenues of $2.4 billion) and GMR (Revenues of $ 4.4 billion), GVK (Revenues of $ 4 billion) and Lanco (Revenues of $2.38 billion) in Andhra Pradesh (all with a focus on infrastructure and energy) also came into prominence at the same time. These companies forged close links with regional political parties in their home states. Ironically, the political fragmentation at the centre increased the bargaining power of regional parties who were by now key coalition partners with the Congress or the BJP in elections to the national Parliament. This allowed the new business organizations to benefit from their links with powerful regional parties like the Telegu Desam in Andhra Pradesh or the Bahujan Samaj Party in Uttar Pradesh. These links now gave them access not only to state-level rents but also to national-level rents through the allocation of infrastructure projects like power or airport development that they would probably not have been awarded in the earlier political settlement. Of course there were also some prominent industrial houses that emerged at this time that maintained close links with the Congress or the BJP.

The change in the macro-political settlement resulted not just in a shortening of the time horizon of political organizations discussed earlier. The changing nature of the business-government relationships just described led to significant changes in the relative power of economic and political organizations over time. The relative positions of 'patron' and 'client' in the business-government relationship began to change and in many critical cases the client became the patron in a new type of patron-client relationship. The conventional literature from political science and sociology tends to describe patron-client relationships as an exchange between two agents differentiated by the superior power or status of the patron (Schmidt, et al. 1977). In Khan's framework patron-client relationships are characterized by a difference in the relative power of the two groups involved in the relationship but the most important characteristic is that the resource exchange in the relationship is mainly based on informal negotiations and rent allocations that can be described as informal rent seeking (M. H. Khan 1998). Patron-client relationships of this type are particularly important in the construction of political organizations where higher levels are involved in some level of informal rent distribution to lower levels to sustain their organizations. The analysis of patron-client relationships in the case of business-government negotiations does not prejudge who is the patron and who the client is in each of the transactions within a business-government relationship. The normal assumption in the days of state-led development was that political organizations were typically the patrons. Patrons were always weak in South Asia, relative to the strong patrimonialism in East Asia, and business clients (and lower-level political sub-organizations) could capture rents without meeting the conditions of the higher-level patrons. However, in post-liberalization India, the picture has become more complex and in some cases, economic organizations are not just distorting the conditions of allocation of state-created rents but are driving rent creation strategies. A careful analysis of changes in holding power and the implications for rent-creation strategies has therefore become critical in post-liberalization India and needs to be taken further in future research.

Harris-White and Jenkins have done significant work outlining the intermeshing of formal political structures with informal networks of patronage in India (Harriss-White and White 1996; Jenkins 2000). However, the focus of their work has been to understand political processes affecting policy outcomes. Given the significant importance of the private sector in the patron-client relationships that affect significant national-level rent policies and investments, these relationships need to be looked at in their own terms. We observed in our field work and in our critical reading of credible media sources that the conventional understanding of politicians as patrons in business-government relationships was being increasingly challenged at higher political levels in India.

The fragmentation of political organizations in India's political settlement has meant that political parties, whether regional ones or the Congress and the BJP at the state level face more competition on the political front than ever before. This has weakened not just the enforcement capabilities of political organizations but also their bargaining power in determining the rents that are beneficial for their own interests. Greater political fragmentation allows economic organizations to credibly threaten to shift their relationship to other political organizations if they do not get their way. The relationship can still be described as a 'patron-client' one in the sense that business wants things that only the state can deliver and is willing to pay for it through its informal relationships. However, the balance of power in these negotiations has shifted to the point that it is useful to identify a qualitative and not just a quantitative change. We use the term '*reversible patron-client relationship*' to describe this phenomenon. The relative power in a patron-client relationship can shift along a continuum till the patron is no longer a patron but has effectively become a client. Beginning with a weak patrimonial relationship between business and political organizations, as business organizations become more and more powerful they can begin to dictate the types of rents they want and the terms as well. At this point they are effectively the patrons in the relationship, which can begin to resemble state capture. Relationships between business and government have many dimensions and the same organizations are likely to be engaged in multiple transactions. In some of these transactions the political organization may still be defining the available types of rents and the parameters of the negotiation, in others they may be negotiating within parameters dictated by economic organizations. The extreme end of this spectrum is state capture by economic organizations though India is unlikely to go too far in that direction because of the weight of many powerful political organizations that will prevent the rents agenda being entirely or largely set by economic organizations.

What has emerged is therefore a transformation of patron-client relationships in some cases, with the relevant capitalists and politicians still engaged in repeated and multiple transactions but in these cases capitalists are identifiably in the driving seat. These cases reflect that political organizations have become weaker because of changes in the macro-level political settlement. Politicians are aware that relationships are not necessarily permanent given that rival political powers exist. Capitalists in these situations can dictate the creation of particular rents that benefit them but on the other hand they still have to defer to a balance of power with political organizations collectively because the numbers and the informal political power of emerging political organizations is also growing. Moreover, business has to operate within a formal democracy in India where the executive and legislature have formal powers of rent creation and management. This is a particular form of 'checks and balances'. Capitalists have greater bargaining power because of increased political fragmentation. But politicians retain the formal power to pass laws and award contracts though they desperately need the informal kickbacks from capitalist organizations. These changes in the political settlement are important for understanding why even in the cases where capitalists were driving rent creation, they were typically not creating value-enhancing rents. Economic organizations faced similar constraints as political organizations in these relationships: they too could not make long-term calculations because their political partners may not survive long enough; they too could not devise value-enhancing rents that had strong enforcement requirements and so on. However, because they are engaged in business activities their rent creation strategies had a different dynamic that sometimes resulted in new investments being facilitated in areas where returns were quick and assured, but also resulted in major scams on a scale that political organizations driving rent creation may have been unable to manage.

The rise of the Adani Group in Gujarat is an example of the development of a reversible patron-client relationship of this type that is discussed in the chapter on Gujarat. Another variant of business capture is when capitalists directly became politicians and used their political organizations to support their business interests. One of the best known cases in South Asia is Nawaz Sharif in Pakistan. In India Naveen Jindal, a scion of the industrial family of OP Jindal, chairman of Jindal Steel and Power Ltd. is also an elected Member of Parliament belonging to the Congress. Jindal stands accused of involvement in what has now come to be known as 'coal gate', a corruption scam unearthed by India's federal auditor in 2012 that involved the misallocation of lucrative coal blocks. The founder of Lanco, Lagadapati Rajagopal, is also an elected Member of Parliament with the Congress and his company too was found of guilty of financial irregularities in deals involving public sector insurance companies.

These changes in the political settlement can help to explain the unprecedented levels of unproductive rent creation and capture in many areas of the economy, for instance in allocations of natural resources, land or telecommunication spectrum. Lal claims many of these were productivity enhancing rent extraction because the outcome was not allocatively inefficient. However, efficiency cannot be measured simply by the fact that new resource uses increased the price of assets and allowed business and politicians to extract rents. The result of these rent extraction strategies was to slow down investments in productive areas such as capability development and created strong incentives for taking some of the tens of billions of dollars of illicit gains in some of these transactions out of the country. The dynamic efficiency implications were therefore extremely serious. We know that outbound FDI by Indian companies has been growing but the outflow of informal and undeclared illicit capital flows may be much greater. Even the formal flows are troubling for a low wage economy with large pools of under-employment. A 2013 article in the Economist magazine estimated that for every dollar of FDI in Indian manufacturing from 2007 to March 2012 Indian firms invested 65 cents in manufacturing abroad (Economist 2013). For a country that aims to increase the share of manufacturing in GDP from the current 15 per cent to at least 25 per cent this does not bode well.

In part the low investment and growth of manufacturing reflects the fact that competitive Indian manufacturing firms are reluctant to invest in an economy where politics seems to generate more constraints (in finance, infrastructure and the credibility of contracts) than incentives. But in addition, the reversal in patron-client relationships also meant that political organizations had access to large rents by allowing businesses to act in predatory ways. This not only reduced their own incentives to create value-enhancing rents, they also had even less capacity to create rents with enforceable conditions to assist capability development. India's inability to coordinate investments in the semiconductor sector or to create supportive rents in the sector despite having many of the requisite technical capabilities is an indicator of this situation. Given the contracting failures affecting investments in capability development and achieving competitiveness in new products, it would be unrealistic to expect potentially competitive Indian companies to invest in the last mile of capability development on their own. Effective learning rents with 'carrot and stick' conditions that are enforceable could have resulted in new sectors like electronics or even semiconductors emerging. Unfortunately, after the takeoffs of the 1980s in sectors like automobiles, no significant sectoral strategy has emerged. Instead competitive manufacturing groups like the Tata Group, the AV Birla Group or Suzlon Energy have started moving more operations abroad in the 2000s with corporate groups without this option either struggling given the adverse systemic conditions or developing relationships with political organizations that facilitate the sort of predatory rent capture we outlined earlier. The areas where an entrepreneurial private sector does engage with short-term government incentives include PPP projects that are largely in infrastructure projects or service delivery projects (like airport modernization) that do not call for investments with long and uncertain gestation, which is the case with capability development investments. It is interesting to note that the only countries outside of the developed west that have managed to foster home grown semiconductors sector have been China, South Korea, and Taiwan, each with high enforcement capabilities on the part of its ruling coalition and compatible with their political settlement. This combination of incentives and compulsions set out by the respective states ensured their success.

India's growth rates in manufacturing TFP have been trending downwards. The growth rate of manufacturing TFP declined from 2.6% in 1988-94 to 2.2% in 1994-2000 (Virmani 2004: Table A2). In fact we can see from Virmani's Figure 9 that after 1990 the growth rate of manufacturing TFP declines further to around 2 per cent, much below the growth rate of TFP in the economy as a whole, estimated to be higher than 3 percent in the early 2000s (Virmani 2004: Figure 9). We know that states that were closer to the technology frontier in 1991 have seen larger increases in productivity and regional differences still persist (Aghion, et al. 2006). There have been several significant studies and surveys of TFP growth in Indian manufacturing published from 2000 onwards using firm level data from the Government of India's Annual Survey of Industry, National Sample Survey Organization (NSSO) as well as from the CMIE (Balakrishnan, et al. 2000; Virmani 2004; Kumar 2006; Kathuria, et al. 2010; Mohommad 2010; Deb and Ray 2013). While most report an upward trend two of the studies flag problems. Using firm level data from the NSSO, Balakrishnan et al (2000) find no link between trade liberalization and TFP growth as opposed to studies using growth accounting (Kumar 2006; Deb and Ray 2013). The Kathuria et al study is also significant as it highlights that while TFP grew in the organized manufacturing sector it declined in the unorganized manufacturing sector which provides the bulk of employment in the manufacturing sector in India. The study records the increasing capital intensity in the organized sector along with decreasing labour productivity in the unorganized sector between the periods 2000-01 and 2005-06. The paper also concludes that growth in gross value added across both sectors was mostly productivity driven as opposed to input driven. This could be either because of efficiency gains or technical progress. This data is consistent with a small and competitive organized manufacturing sector making steady progress but most of the employment-generating manufacturing in the unorganized sector is excluded from this and the growth of the organized manufacturing sector is slow (Kumar 2006; Kathuria, et al. 2010). Significantly the different methodology that Balakrishnan et al (2000) use seems to suggest that productivity growth after liberalization even in the organized sector has not been as high as other studies suggest. More research needs to be conducted at the micro level to unpack the process behind TFP performance in the Indian manufacturing sector.

Neoclassical economists like Baumol have long recognized that innovation and productivity growth have been the driver of prosperity in capitalist economies (William J Baumol 2004). In developing countries, the process of productivity growth through learning is as important if not more important than innovation (M. H. Khan 2000b). Both strategies require a productive capitalism. However, as Bardhan has put it, one of the features of Indian capitalism today, especially in the manufacturing sector is the growing weight of 'rentier capitalism' relative to 'entrepreneurial capitalism'. There are still several sectors dominated by entrepreneurial capitalism but they are increasingly struggling. After the revision of the Indian Patent Act to make it WTO compliant, the pharmaceutical sector is making profits by manufacturing generic products and many have sold out to foreign pharmaceutical companies. Innovation in most other manufacturing sectors apart from the auto sector is also limited. There is an emerging electronic hardware industry that is manufacturing based on designs from China but these occupy the lower end of the mobile phone market, though predictably India is one of the leaders in developing 'apps' for mobile platforms. The high value adding service sector firms in software in this area tend to be individual driven firms with limited employment generating opportunities and low productivity spillovers for the larger economy. This situation has come about because the gains of the 1980s and 1990s were not primarily driven by liberalization but because untapped high capabilities existed and financing mechanisms emerged to further enhance capabilities and create a few globally competitive sectors. Liberalization that allowed access to capital and technology more easily helped this process but was not its primary driver. As easy catching-up opportunities were used up, for most sectors the gap with the competitiveness frontier was too great for private investments to rush in, and the policy instruments still available in the 1980s and the early 1990s were slowly being phased out. It is not surprising that powerful economic organizations that could increasingly call the shots in rent creation strategies began to look for quick rents in speculative sectors.

Much the same story would apply for Pakistan but in a somewhat more adverse form. It did not have sectors close to global competitiveness when it started liberalizing and its political settlement had a higher level of political fragmentation earlier on enabling the damaging type of reverse patron-client relationships to emerge. Identifying policy options for moving South Asian firms closer to the competitiveness frontier is not directly the subject matter of this thesis. However, by identifying the importance of changes in the political settlement, combined with policy changes driven by the global shift towards liberalization, the thesis can inform the debate on capability development. At a minimum, it establishes that policy for capability development has to be designed keeping characteristics of the political settlement in mind. We do not discuss bureaucratic reforms in this thesis as a solution to India's sclerotic growth in manufacturing. Bureaucratic capability development is important but its success presumes that the more powerful political and economic organizations are interested in particular types of bureaucratic capability development and will support its implementation. Generally, bureaucratic organizations in South Asia are not dominant, except the military in Pakistan in some periods. The central bureaucracy in India is a co-opted player in the current competitive clientelism.

Bureaucratic organizations in a competitive clientelist political settlement tend to display signs of fragmented bureaucratic authority but our assessment is that the bureaucratic organization in India is still a divided bureaucratic authority where potential lead agencies, like the Planning Commission, have little authority over other departments or ministerial bureaucracies but the latter still have enough control over their junior levels. One reason for this is historical in that over the years the Indian Planning Commission has been stripped of much of its powers over ministries and now largely survives as an institution that provides recommendations for India's growth targets, though it is still influential in formal policy setting. The other reason is that although the political settlement in India is becoming increasingly fragmented, different state level agencies responsive to the party in power have enough internal control over their own lower levels to implement reasonably effectively but only in line with the interests of that political organization and its client capitalists.

Our research suggests that India's liberalization has helped strengthen the bigger capitalist players. Contrary to liberal economic theory, opening up markets very often has a tendency to strengthen those with stronger initial capabilities and assets, rather than levelling the playing field. Those who are behind have a harder job of catching up. The Indian liberalization process was no exception. Under India's closed economy, some organizations and sectors like auto and pharmaceutical built up capabilities that enabled them to become bigger players in the 1980s and beyond. A few 'entrepreneurial capitalists' also gained in the new political settlement by cultivating relationships with regional political parties. While the earlier regime of central planning had its inefficiencies as capitalists could capture licences and thereby informally modify the allocation of rents, the rents were nonetheless formally created by the state. The new political settlement and the liberalization that it ushered in gradually dismantled much of the formal rent creating instruments like licences and economic subsidies. With the reversal of patron-client relationships in a few areas and the emergence of new types of business-government relationships, the result was the growth of informal rent capture that took the form of scams. The holding power of these capitalist organizations was now high enough in their bargaining with political organizations to get massive informal rent allocations that were often blatantly in violation of the law.

The critical bottleneck remains the financing of capability development and this is where future research on industrial policies in South Asia needs to be targeted. But the instruments and institutions of financing in our framework have to be designed keeping the political settlement in mind. Acemoglu et al have argued that for countries far from the technology frontier innovation was not the key constraint while financing was (Acemoglu, et al. 2006). We agree with the contention that financing is a most important constraint. However, just providing financing, for instance through development banks is unlikely to provide firms much benefit, and indeed the experience with many development banks in South Asia is mixed at best. For financing to create the right incentives and compulsions for capability development at the micro level, the financing instruments have to be designed such that the enforcement and informal modifications that are expected in that political settlement will still produce desirable outcomes. This calls for an innovation in the design of the industrial policy architecture, an exercise very few developing countries have attempted but one we feel needs to happen to tackle afresh the challenges of the capitalist transformation.

Chapter 5 . Gujarat: The Political Economy of Authoritarian Growth 2001-2013

SUMMARY:

The political settlements framework focuses on the interdependence of institutions and the organization of political power. This is particularly interesting in the case of Gujarat. The state is industrially advanced and has often led in terms of growth rates but it has also been associated with high levels of political and communal violence. Some of the violence also appears to have had at least the tacit approval of the ruling party in the state and its controversial but influential chief minister. These features of Gujarat are usually seen as interesting but largely unconnected. However, we argue that aspects of Gujarat's institutional performance, and in particular the enforceability of some types of executive decisions, were indeed connected to the organization of power in the state. The particular years of interest to us are the years that chief minister Narendra Modi was in power, 2001 to 2013 the year at the time of writing, though his terms extends till 2018. However we provide substantial historical analysis of the period since independence to establish the distribution of power already in place when Modi became chief minister. The communal violence of 2002 was used (if not orchestrated) to consolidate the centralized authority that makes Gujarat different from other Indian states, and this in turn allowed a particular pattern of institutional interventions that had implications for patterns of industrial growth. This analysis has significant implications for the replicability of the Gujarat model in other parts of India.

A historical analysis of Gujarat reveals how its specific configuration of caste and the regional strategies of British colonial policy helped to create a mercantile class that later dominated Gujarat's intermediate classes. It was the political dominance of this class that eventually allowed Gujarat's current ruling party, the Bharatiya Janata

Party (BJP) to create conditions that fostered growth but also an atmosphere of communal tension that subsequently led to organised violence against the state's Muslim minority. We argue that this was 'soft violence' because it was used by the dominant party against a section of the population that was organizationally weak and unable to react. The violence could therefore be expected to be limited and with limited direct effects on the growth process. Nevertheless, the ability of the political regime to control and direct violence at will 'signalled' enforcement capabilities that in turn had implications for strategies of economic development. In terms of our framework the violence had significant implications for the political strategies followed by political organizations within and outside the ruling coalition, and helped to establish an authoritarian version of clientelism dominated by the ruling BJP. Investors reacted positively to this and the state received high levels of investments in infrastructure. The chief minister was aided by the fact that Gujarat was already an industrially advanced state with significant oil and gas reserves. However though Gujarat has sometimes been described as a developmental state, our analysis also shows that Gujarat's current political settlement is significantly different from the developmental states of South Korea or Taiwan, and the developmental institutions and strategies it has implemented are likewise significantly different.

Section 5.1 provides a brief history of Gujarat from the ancient period to the coming of the British and how colonisation led to the creation of an intermediate class in the state. Section 5.2 outlines the years of the Congress after independence and traces the rise of the BJP. Section 5.3 outlines how the BJP came to power and section 5.4 provides an analysis of the consequences of the new political settlement. Section 5.5 concludes.

Introduction

Chapters Two and Three laid out why the organization of power was critical for understanding the emergence of particular institutions and the types of enforcement and modifications these would be subject to. The configuration of power in the ruling coalition is an important component of the overall distribution of organizational power in a political system with important effects on strategies of political competition, the time horizon of the ruling coalition and its ability as a principal to impose particular institutions and to enforce them. This is particularly important for understanding the enforcement of conditional rents. Weak enforcement capabilities of the state as the principal when it uses institutions and policies to create rents for capitalists can lead to rent capture by capitalist agents or the informal avoidance or modification of conditions. These in turn have an effect on the kind of technology adopted and consequently the nature of industrialization in the country.

Gujarat was created in 1960 with the bifurcation of the former state of Bombay Presidency into Maharashtra and Gujarat (Figure 5.1). While the economy of the state was ranked eighth at that time it is today one of India's top three economic performers with per capita NSDP (Net State Domestic Product) far higher than the Indian average (Table 5.1). Its current chief minister Narendra Modi has been able to achieve significant control over the state using a combination of populist communal (religious-sectarian) politics and discretionary administrative policies. The ruling party in Gujarat is the Bharatiya Janata Party (BJP) or the 'party of the people of India'. It is also India's second national party along with the Congress and is a conservative right wing party mobilized around 'Hindutva' or an ideology of Hindu awakening.

Figure 5.1 International and national borders of the state of Gujarat.

Source: www.dailyherald.com/.../side_gujarat_map.gif (downloaded 27/10/2010)

The key to understanding the developments in modern Gujarat is to identify how Modi was effectively able to avoid competitive clientelism by building a particular type of coalition that enabled the enforcement of a greater range of institutions and policies compared to other Indian states. He was able to do this because of the specific social and political history of Gujarat, a factor that is often overlooked by observers. Critical features of the pre-existing configuration of power in Gujarat enabled Modi and the BJP to construct a 'dominant party' with a long-term time horizon that allowed his administration to offer long-term rents. He decided which organizations could invest in Gujarat (with respect to the large, critical investments) and gain access to these rents on the basis of informal assessments like who would be most beneficial for party funding, their legitimacy etc. This accelerated industrial investments in particular types of technologies and sectors, but Gujarat's political and administrative structure did not have the critical conditional rent management capabilities along the lines of South Korea and Taiwan. Modi's role was not confined to creating an authoritarian dominant party in a democratic set up, using selective violence to create an effective coalition with significant powers of implementation in specific areas. Taking advantage of the opportunities created after liberalization he has also been responsible for creating a system of industrial subsidies that have helped Gujarat gain a lion's share of investments in India, both foreign and domestic.

Here too, implementation capability was the key factor, assisted by already well-organized Gujarati bureaucratic organizations. The anti-Muslim violence of 2002 played an important if indirect role in the processes of consolidating the ruling coalition in Gujarat and for signalling to other constituencies, including political organizations and businesses, that Gujarat had a ruling coalition and a leader with strong implementation capabilities.

Table 5.1 Gujarat: Economic Characteristics

Population (2011)	60.43 million (India 1.24 billion)
Gross State Domestic Product 2011-12 at current prices	USD 100.15 billion
Per capita Net State Domestic Product at current prices 2010-11	USD 1632 (India USD 1509)
Capita Output Ratio (2009-10)	3.11 (India 2.32)
Gross Fixed Capital Investment as % of GDP current 2004-05 prices (2011-12)	37.7 % (India 32 %)
Net Value Added Factory Sector 2009-10	USD 19.57 billion
Share in All India Employment 1980-81 to 2007-08	9.5 %
Percentage of population below poverty line (2012)	16.6 % (India 22%)

Source: Various (GoI Census 2011), (MoSPI), (CSO, Respective State Governments), (ASI 2009-10), (ASI 2009-10), (CSO), (NSSO 66th round), (Planning Commission of India).

Our aim is not to provide a comprehensive analysis of growth drivers in Gujarat. Rather, it is to examine how an analysis of political power and institutions can explain how some market failures affecting development were addressed and the outcomes that were achieved. We are also particularly interested in the growth outcomes in industry, specifically the manufacturing sector. We examine how Modi constructed his ruling coalition through the distribution of both formal and informal rents and how that impacted technology adoption and growth in the industrial sector in Gujarat. Under Modi the BJP's rent management created a caste/class combination that combined 'upper caste's like Brahmans and traditionally 'lower caste's like the Patidars who since the early 20th century made the transition from being a lower agricultural caste to gaining acceptance as a higher caste (though not with the same 'status' as Brahmans). The Patidars have become the predominant capitalist and political class in Gujarat. The BJP's coalition also includes the Adivasis or the indigenous population of the state who straddle both the lower class as well as the 'lower caste' strata of the state. As we will analyse later, the castes that made up this coalition had contradictory class interests but like most clientelist coalitions, they had a joint interest in enjoying privileged access to rents. Historically Brahmans and the 'lower caste's and Scheduled Castes in India (Adivasis belong to the latter) have rarely shared political agendas. Modi was also helped by the fact that for various historical reasons the BJP in Gujarat had emerged as a disciplined party that could serve to construct a ruling coalition in a variant of 'patrimonial' clientelism with repressive features. The successful creation of the coalition of upper Brahmans, Baniyas (the traditional trading caste), Patidars and Adivasis achieved an organizational coalition with significant holding power relative to other groups and allowed the BJP in Gujarat to implement a particular type of growth-enhancing industrial policy that did not face significant contestation for a long time.

The coalition was constructed in a manner that allowed the inclusion of a disparate and wide base of constituencies but also successfully excluded a number of other groups and castes including the state's Muslim minority. The episode of a short and extremely sharp coordinated violence against the Muslims in 2002 served not only to signal to the Muslims the costs of any mobilization against the BJP, but perhaps even more importantly signalled to other groups and castes that the ruling coalition had the capacity to take measures against 'disruptive' forces. The outcome was a ruling coalition that had characteristics of a dominant party (a party that is electorally difficult to dislodge) without having to include all potentially powerful groups within it. It was also a dominant party that had considerable internal hierarchy because the executive had relatively high enforcement capabilities over lower party levels, which is not the typical case in a dominant party. This is because as we summarized in Chapter Three the typical dominant party achieves its dominance by including all powerful organizations within it, and this achieves a 'constrained' patrimonialism where the enforcement capabilities are limited by the need to include the interests of many diverse organizations within the ruling coalition (M. H. Khan 2010b). The selective use of violence in Gujarat achieved a distribution of power across organizations that created a different type of a dominant party ruling coalition, with greater enforcement capabilities for some types of institutions and policies.

The violent events of 2002 targeted the state's Muslim community and resulted in the loss of between 1,500 to 2,000 (mostly Muslim) lives. Muslims made up just fewer than ten per cent of Gujarat's population in 2000 but a large section of the population was concentrated in a few cities making them easier to 'target'. The manner in which the violence was organized has implications for our analysis of the political settlement in Gujarat because it signalled a particular type of informal executive authority, and this in turn affected the strategies of organizations within and outside the ruling coalition. The effects of the 2002 events in terms of our analysis were repeatedly supported by respondents in our interviews even though these connections are typically not made in the literature on economic growth in Gujarat. Gujarat's growth rate fell in the year immediately after the riots but then recovered from 2004 (Table 5.2). An efficient administration is always welcomed by industry and the violence allowed the consolidation of a political settlement that underpinned Modi's ability to project an efficient, and even an authoritarian administration with respect to the enforcement of some types of executive decisions (G. Shah 2010). It needs to be noted here that economic performance is very different in another BJP-ruled state with a high proportion of Adivasis in its population, which also has a BJP government. This is the state of Chattisgarh where the political configuration is quite different from that of Gujarat. Our argument is that the distribution of organizational power is the critical variable for understanding institutional performance.

Even though politics in Gujarat since India's independence always supported pro-business policies, under Modi the Gujarat state established a formal policy of promoting itself as India's best investment destination with Modi positioning himself as the CEO of Gujarat. There are other Indian state governments who from time to time organize conferences to liaise with business but the biennial 'Vibrant Gujarat' summits organized by the Modi government since 2003 are yet to be replicated by other state governments in scope and scale, let alone in attracting genuine business interest. Many studies have shown that Gujarat displays one of the most favourable relationships between business and government (Sinha 2005; Massilano, et al. 2009). Modi has been particularly successful in attracting large investments and overseeing their implementation which has earned him the label of India's most business-friendly chief minister. The growth in per capita income in the state reflects this success (Table 5.2). The success of governments, in this case the BJP government in Gujarat, can be evaluated in terms of its particular methods of overcoming market failures affecting investments in industry, in particular the allocation of land and the financing of technology acquisition. The efficacy of particular policies and institutions in turn depends on the choice of particular solutions and their implementation in the specific political settlement.

As we will show later in the chapter Modi was able to portray himself as a CEO for reasons less to do with his own personality and more to do with the socially and historically unique factors that allowed the construction of a particular type of ruling coalition in Gujarat. The construction of the ruling coalition gave his administration and the bureaucratic organizations involved high enforcement capabilities for some types of institutions and policies. Agencies like state industrial development bodies have existed within the Gujarat government since the 1960s. But the nodal agency, the Gujarat Industrial Development Corporation (GIDC) was now able to turn around approvals for projects faster than in earlier decades. Obviously something had changed that allowed the GIDC to push through projects with fewer delays and less opposition, and this is what the analysis of the changes in the political settlement in Gujarat can help to elaborate.

Table 5.2 Gujarat: Growth Rates of Net State Domestic Product per capita

(at constant USD year 1980-81)

Years	NSDP per capita growth rates
1961-70	0.2
1970-80	2.0
1980-90	2.6
1990-2000	5.6
2000-2010	7.4

Source: Based on EPW Research Foundation Statistics, State Level Domestic Product Data, 1960/61 to 2007/08.

The overall political settlement in developing countries has (as we discussed in earlier chapters) significant features of informality and informal arrangements with powerful organizations that make it non-Weberian. We described these non-Weberian political settlements as 'clientelist' in a broad sense and then classified clientelist settlements in a number of broad sub-categories. The authoritarian sub-variant corresponds to what we described as vulnerable patrimonialism. While there were elements of an authoritarian regime in Modi's patrimonialism, nevertheless the Modi BJP was not a true authoritarian regime as it was able to win elections to stay in power. Nor was it a strong patrimonial regime of the East Asian variety because it did not necessarily have the capacity to impose institutional conditions on all organizations in that society. In particular, we shall see that business organizations could not be disciplined in the way they were in East Asian strong patrimonial regimes.

Thus, the Modi ruling coalition had interesting 'mixed' features: it was a dominant party that was broadly a variant of constrained patrimonialism but located in an area overlapping constrained patrimonialism and competitive clientelism. It had stronger implementation capabilities than the typical dominant party. It used violence occasionally, in the way that authoritarian regimes did in vulnerable patrimonialism but did not need to use violence to win elections. It was thus a dominant party system that we describe as 'Authoritarian Clientelism' (see Figure 3.2 Chapter Three). This configuration of power cannot be defined as vulnerable patrimonialism as excluded groups like its Muslim minority were not strong enough to require frequent repression. Given the distribution of power the one time shock that the BJP inflicted on Gujarat's Muslim community was enough to signal its authority and obtain an uneasy quiescence from the community and other excluded groups. This ensured the ruling coalition did not have to use the permanent threat of violence against excluded organizations. The enforcement capabilities of the ruling coalition were also high enough to be close to strong patrimonialism and the BJP arguably had a greater capacity to impose discipline on its lower levels compared to the Congress: the dominant party of the 1950s and 1960s. However, despite often being called 'developmental' or what in our framework is strong patrimonialism; our fieldwork suggests that it was not. Modi could not discipline business organizations despite providing them with critical incentives like land at subsidized prices. The BJP's power to discipline its own supporters was also considerably less would be the case in strong patrimonialism because the ruling coalition had to include many disparate groups within it.

Our description of the political characteristics of the settlement in Gujarat is based on our fieldwork and interviews that are summarized later. In addition, we find that the structure of bureaucratic organizations in Gujarat corresponds to a constrained bureaucracy in that the lead agency could coordinate across other agencies and strong implementation capabilities in some areas but not others. Implementation capabilities were strong in some areas of industrial development but weak in other areas, including social welfare. Both politics and bureaucracy reflect the distribution of power across organizations. Granting subsidies to specific industries is only likely to be resisted or blocked by well-organized interests operating at the political level of the state, and these were not strong enough to challenge these policies. On the other hand welfare policies are implemented through a chain of party and bureaucratic organizations where lower-level organizations within the ruling coalition may have interests opposed to the allocation of resources according to formal policy targets or at least do not have the similar incentives that providing subsidies to business organization provides.

Nevertheless, the authoritarian clientelist structure provided the Modi administration with enforcement capabilities to push through decisions on industrial projects favouring specific capitalists with little effective resistance and this helped to overcome some of the coordination problems in the area of infrastructure investment. Examples include the administration's ability to provide large areas of land for land intensive projects with relative ease at a time when one of the key constraints faced by Indian industry in other parts of the country was the scarcity of land available through normal market processes for setting up new industrial or infrastructure projects. Apart from the allocation of land the administration could also provide significant subsidies to industry in the form of land allocations at lower than market prices or Power Purchase Agreements that favour the private power company rather than the state grid. This configuration of power thus helped to address some of the market failures in credit and land markets. Significantly, while these capabilities attracted investment into the state, they are not sufficient to sustain growth over time as the ability to get subsidies without conditions can create perverse incentives for business. It is at the level of institutions that enforce conditions on business that evidence is weak, and there are reasons to believe that the Modi political settlement has weak enforcement capabilities in these critical areas.

The configuration of power in Gujarat allowed the implementation of institutions and policies favouring investments in large infrastructure projects, like ports, power stations and SEZs with much lower levels of resistance to particular projects from affected groups than elsewhere in India. These types of projects have long gestation periods and require high capital expenditures. Modi's marketing of an efficient, centralised and stable administration is likely to have helped in attracting such investors who have a low appetite for risk given the nature of their investments. Solving specific coordination and appropriability problems along with the granting of long term rents to such investors has given Gujarat an industrial profile but also one that is skewed towards infrastructure projects (as well as oil and gas since Gujarat is rich in both natural oil and gas). For instance Gujarat has the highest number of private sector ports in the country—35 per cent of India's exports are routed through Gujarat. The state has the only chemical terminal port in India and the country's two LNG terminals, one of which is in the private sector. One third of the total installed capacity in power generation in the state is by the private sector. By way of contrast at an all-India level the Indian private sector had contributed to only 20 per cent of capacity addition under the 11th Five Year plan (2007-2012). In the last decade heavy chemicals, ports and other related offshore infrastructure have been the sectors with the highest growth in Gujarat (Malhotra 2008). The state along with Tamil Nadu has the highest number of PPP investments in the country. Just under 50 per cent of FDI that Gujarat received between 1991 and 2011 was in the chemicals and petrochemicals sector (Gujarat 2013b).

The pro-business political settlement is also aided by the fact that Gujarat was already one of India's most industrialized states with a relatively efficient bureaucracy by the 1980s (Sinha 2005; Kohli 2012). As we see later in the chapter Gujarat experienced another high growth phase under Congress chief minister Madhavsinh Solanki, also credited with running an efficient bureaucracy. The difference is that during Solanki's tenure the bureaucracy was closer to good governance norms of transparency ensuring that most of the time incentives were provided according to formal rules. Modi's Gujarat was different, partly because of the changed nature of business-government relationships at the national level as outlined in Chapter Three and partly because authoritarian clientelism allowed the Modi administration to use discretionary industrial policy with much greater informality in its allocative rules. For instance it was able to exercise discretion in favouring some investors like the Adani Group over others, or in providing specific rents to investors like Tata motors when they relocated their investment from West Bengal to Gujarat. But we are careful to identify that its enforcement capability only extended to the exercise of discretion in terms of rent allocation and not to the enforcement of conditions on rent recipients. This was the chief limitation of the Modi political settlement in terms of industrial growth. There were other limitations of this political settlement in terms of social exclusion and repression but these issues are not directly the subject matter of this thesis.

Gujarat is not the only Indian state that had features of informal authoritarianism within a dominant party system. One could conclude that West Bengal under the Trinamool Congress or Bihar under the Rashtriya Janata Dal also had these characteristics. However there were two crucial differences in Modi's Gujarat. First, the BJP was able to control intra-party contestations that are the hallmark of clientelist political parties and so achieve high levels of enforcement, at least for major allocative decisions that were of significance to the leadership. Secondly, the much higher levels of capabilities of business organizations in the state and their greater collective and individual political power meant that the state leadership could engage in discretionary allocation to business and reap immediate benefits in pay-offs in terms of revenue and employment generation. The critical limitation was that the political settlement did not achieve the degree of enforcement capability required for conditional rent allocation that is required to create opportunities for new capability development. While other states also had leaders and parties with authoritarian characteristics, they were either in power in states with high levels of political competition so that the time horizon of the rulers was limited, or their own parties were highly mobilized and lower-level members demanded constant pay-offs making implementation difficult, or they lacked a sufficient business base to achieve quick pay-offs by allocating rents to economic organizations.

This configuration of power in Gujarat led to the rapid growth of sectors like infrastructure and power that did not need to achieve new organizational capabilities to become internationally competitive and which had large markets in India. There is no doubt that India needs more ports and roads and far more capacity in electricity generation and in this Gujarat and Tamil Nadu have done well (with the exception of power generation in Tamil Nadu). The other sector that did well in Gujarat is petrochemicals and related chemicals which enjoy their own natural resource rents and because the state granted specific subsides for say LNG terminals. The allocation of subsidies has also succeeded in attracting investments from high capability firms like Tata Motors who may otherwise have invested in other parts of India. There is much less evidence of investments in new capability development.

Gujarat's share of industrial output is an impressive 17 per cent of India's industrial output. Yet the industrial sectors that make the biggest contribution nationally are sectors like soda ash (90 per cent of India's production), plastic industry (65 per cent of India's production) and petro chemicals (62 per cent of India's production) (Figure 5.4). This skew in development has led to environmental externalities arising from environmental hazards which could be steeper than expected for the 'normal' developing economy facing an environmental Kuznets curve. So far however learning strategies that ensure high levels of effort and compulsion are not in evidence in Gujarat even though the state seems better placed to implement a developmental rent management strategy that could develop new capabilities and comparative advantages. However a deeper analysis demonstrates that given the features of the political settlement in Gujarat and the reverse patron-client relationship developing at the all-India level between businesses and political organizations that we outlined in Chapter Four, a developmental rent management strategy would be difficult to enforce even for Modi and the BJP in Gujarat. For instance, in 2005 Modi demonstrated his strengths relative to the West Bengal administration by providing

Tata Motors with all necessary clearances within a couple of days for its relocation from West Bengal, rescuing the company from a dire situation. Tata Motors had already set up part of its plant and was close to beginning manufacturing its much touted 1000 dollar car in West Bengal when opportunistic but successful political opposition to the project stalled it. Ratan Tata the chairman of Tata Motors was losing face and money when Modi stepped in to the rescue. However despite the impressive implementation of clearances and the provision of land and subsidies, there was little effort to negotiate desired outcomes or monitor the consequences of that investment for Gujarat. The plant at Sanand has run far below capacity and raises questions about the return Gujarat got from significant subsidies for Tata Motors which are discussed later. In general there is no evidence of negotiation or enforcement of conditions and this is consistent with our analysis of the configuration of the political settlement in Gujarat.

There are several elements that explain these limitations of authoritarian clientelism in Gujarat. First, the relative power of the ruling coalition in Gujarat is limited by a number of critical factors. The BJP in Gujarat is part of a large national party that needs funds to contest elections and has to appear to work with different combinations of castes in other states. Like with the Congress leaders from Bombay in the 1960 and 1970s who were important to the national party as treasurers raising funds for the party, the BJP in Gujarat has to play a similar role for the national BJP. In addition, the BJP has to work with businesses with significant holding power, which can relocate to other states. This makes the relative power of the ruling coalition in Gujarat very different from that of South Korea and Taiwan during the early stages of their growth. In the latter the ruling coalition was able to provide conditional support to industry in a way that accelerated learning in high productivity sectors. While learning might still take place in industries attracted by Gujarat’s infrastructure and government subsidies, their compulsion to develop capabilities in new sectors is likely to be limited.

On the one hand there are indigenous Guajarati business organizations like the Adani Group and the Mehtas of Torrent. But they have yet to make significant moves into productive manufacturing. The Adani Group (AG) is one of India's largest infrastructure and energy conglomerates and the Mehtas have a pharmaceutical subsidiary but so far this has remained a medium-sized generics producer in the country. Yet both groups, especially AG have very specific clientelist ties with the Modi government which provides them with privileged access to rents but without the compulsion associated with developmental rent management strategies. A senior bureaucrat with many years of experience in policy making told us "All state leaders have to forge close relationships with local capitalists for reasons of patronage. However, the close interface between the Modi administration and some capitalists who have become recently successful points to a very exclusive sort of business-government relationship".

As we have outlined in Section 4.8 of Chapter Four in some of these relationships, business appears to be the patron rather than the client, with implications for the developmental implications of the types of rents they can access. The specific distribution of power in the state makes the political settlement in Gujarat less conducive to capability development than the developmental states in East Asia and there is a potential danger of damaging rent capture by business interests at an early stage of development.

5.1 History of Gujarat: Indus valley to the Coming of the British

Historically Gujarat had sea links with Mesopotamia as early as 1500BCE through Lothal which was one of the urban centres of the Harappan civilization and its chief port. This port town was part of the Indus valley civilisation. These links continued with trade being conducted even after and Arab geographers mention Muslim trading settlements in south Gujarat in 951CE. The trading community in the region at the time was largely made up of Hindus and Jains (a religion closely connected to

Hinduism and pre-dating Buddhism in India) and were later joined by the Zoroastrians who left Iran after Arab conquests. This trade with the Middle East helped southern Gujarat develop a mercantile class, especially the Baniyas, a caste common to both Hinduism and Jainism.

Mahmood of Ghazni made his famous raid from the west in 1051 and it is an unfortunate testament to the power of historical interpretation that his sacking of a prosperous temple in Somnath, western Gujarat, is still a rallying cry for right wing Hindu elements in India today. In what probably was an overzealous conqueror's attempt at subjugation, they see a symbol of an enduring Islamic threat to Hindu India. However mainland Gujarat was annexed and incorporated into the Tughlaq dynasty of the Sultanate in Delhi only in 1298. The governors of the Tughlaq dynasty declared independence from Delhi in 1407 and established the independent Sultanate of Gujarat with Ahmadabad as its capital. Gujarat was annexed as a part of the Mughal empire in 1572. A sociological phenomenon that was to have an effect even in contemporary times was the inter-marriage of Muslims with Hindu Rajputs, a warrior caste. This took place during the reign of the independent governors of Gujarat just before the Mughal conquest and gave rise to a class of Muslims who followed a mix of Hindu and Muslim customs (Schimmel 1980). It was this section of Gujarati society that was to become a focal point for Hindu 'reformers' in the early 20^{th} century. These reformers wanted to bring back the converts into the Hindu fold and led to a worsening of communal relations in pre-independent times and finds repercussion even today. However at the time a syncretic form of Islam, akin to Sufism was widespread in the region and these converts were not looked upon as out of place in Gujarati society by Hindus and Muslims alike at that time. Later Hindu reformers tried 'reconverting' this group with varying degrees of success. Gujarat is also home to the some of the largest communities of Shia Muslims in India, like the Khojas and Bohras, whereas most of India's Muslims are Sunnis. Along with the Sunni Memons the Shias constituted a crucial part of Gujarat's commercial classes. The three were supposed to have been converted to Islam from Hindu trading communities and hence maintained their entrepreneurial abilities (Engineer 1989).

While many Bohras and Khojas opted to stay on in India after partition a substantial number of Memon families migrated to Sindh, with which province Gujarat always had close links. In fact the Memon community was largely responsible for setting up the Karachi Stock Exchange and controlled the exchange's brokerages for a substantial period in Pakistan.

Around the time that the Portuguese were making their forays on the Gujarat coast the Marathas (originating from what is now modern day Maharashtra in India), a rising regional power, started attacking the borders of the kingdom and plundered its major cities like, Surat and Baroda. By the beginning of the 18th century Mughal rule started declining and the Marathas were collecting revenue from the governor of the province as a sign of their growing dominance. These political upheavals however did not unsettle the Gujarati business community enough to cause a decline. In fact once significant portions of the province became a part of the British Empire Gujarati capital flourished.

Gujarat's business communities experienced a dip in their fortunes when the Portuguese and Dutch started controlling the sea trade routes to the Middle East from 16th century. Consequently they started investing their surpluses in inland trade. Some of these investments were initially taken over by the British (Hein Streefkerk 1997). But as British presence in Gujarat deepened so did their need for intermediaries. This gap was filled by the Gujarati Baniyas and to a lesser extent the Muslim trading classes. The Muslim trading communities could not hold on to their businesses as successfully as they were largely involved in shipping and transportation to West Asia. As trade collapsed in West Asia and the shipping industry got taken over by the English, Muslim business fortunes in western India faltered (L. Subramanian 1991).

British investments eventually made their way into transport, communications and agricultural markets providing further trade and investment opportunities for the already well-established Gujarati business community. Trade in agricultural produce and money lending became the chief occupations for many of them (Lamb 1958).

The development of Bombay (now Mumbai) as a port and a trading centre helped crystallise the interests of this community further. The opening up of the Suez Canal and the disruption of cotton supplies from America due to the Civil War helped establish Bombay as India's premier port city. Cotton was a principal crop of Bombay's hinterland and Gujarati businessmen were already involved in its inland trading. With the American Civil War they now developed international markets. From the trading of cotton to establishing textile mills seemed like a logical extension. Till World War I a majority of the Indian owned textile mills in Bombay and western India were run by Parsis, Khojas and Gujarati Baniyas (Lamb 1958). Entrepreneurs like Walchand Hirachand and Jamsetji Nusserwanji Tata were two pioneering industrialists who hailed from the Gujarat region. Tata spawned a conglomerate that is now one of India's first multi-national corporations. Hirachand's legacy is in the form of one of India's foremost construction engineering companies.

The establishment of the Gujarati business community however, came at a cost to communal relations. It led to the establishment of what Subramanian calls the 'Anglo-Baniya order'. By 1810 when Gujarat had been annexed into the empire the East India Company was actively enlisting the help of the Gujarati Baniya community to transfer money from Bengal, its richest province, to the western coast. This was done through the famous 'Hundi' system, or an informal system of bills of exchange, developed by these businessmen. By the 1850s the Company had moved on to using public loans but the political and commercial order that was created by this relationship endured (L. Subramanian 1996). She also documents evidence that one of the first instances of communal clashes in Surat, an important Gujarati town, was a result of the creation of this order. In fact this riot in 1788 was first between Parsis and Muslims as Parsis were also beneficiaries of this order. In 1795 another violent riot took place in Surat between the Muslims whose power was declining in Gujarat, and the Baniyas whose fortunes were definitely on the ascendant (L. Subramanian 1991). She indicates that the riots were not purely communal but they were symbolic of the 'dying throes of the older indigenous political and social order'.

By the early 19th century the political settlement in Gujarat had changed completely as a result of the arrival of the English. Under the English the Baniyas acquired new privileges that gradually resulted in the emergence of a new political order. In terms of our framework of political settlements the distribution of benefits changed, and indeed, increased for this community. By the beginning of the 20th century the largely agricultural Patidars or Patels had also accumulated enough agricultural surplus to invest in industry and trade. Together this laid the base for the construction of an emergent intermediate class that was to direct the course of Gujarati politics in the modern era, one in which the BJP found a receptive constituency.

Another contributory factor that helped create a Hindutva constituency in Gujarat was the work of a late 19th century/early 20th century reform movement called the Arya Samaj. The movement though started by a Gujarati gained popularity first in Punjab where it campaigned against conversions of Hindu 'lower caste's by Christian missionaries. The Samaj or association was also engaged in bringing about a more egalitarian structure of Hinduism by campaigning against the caste system and for allowing widow remarriages. However by the time the movement reached Gujarat it had assumed deeper communal overtones with Samajis trying to reconvert both Christians and to a larger extent Muslims to Hinduism, though Hinduism does not have principles of conversion or reconversion (S. C. White 1999). A deeper analysis is not necessary here except for the fact that in Gujarat the Samaj for a while worked in close association with the Hindu Mahasabha, another right wing Hindu organisation which found some favour with the more right wing Congressmen across India and in Gujarat. At this time Gujarati popular literary works especially from the noted writer and politician Kanaiyalal Maneklal Munshi were also helping to build this incipient Hindutva in the state. Munshi's writings were generally based around themes romanticising the early Vedic period in India. A second important and popular theme was woven around Mahmud of Ghazni's attack on the borders of Gujarat with Munshi's heroes being Hindu kings who were protecting Hindu subjects from the alien aggressor. This ensured a political form of Hindutva existed among the intermediate classes within the state some time before Hindutva become a political project across India much later in the century. Of course as Hardiman says, this is not to say that the politics of the 1920s was in all ways similar to the manner in which Hindutva was defined post-independence in the 1980s. However the idea of constructing a nation state with reference to Hindusim did have its roots in such early political movements (S. C. White 1999)

5.2 Independence to BJP Rule: Creation of a New Political Settlement

5.2.1 Creation of Gujarat from Bombay Presidency: The Congress dominant party system and the expansion of industrial growth

When India gained independence in 1947 Gujarat did not emerge as a separate state in India but the region was amalgamated into Bombay Presidency. The region existed as part of the state of Bombay in which the northern part was dominated by a Gujarati speaking population and the southern part by a Marathi speaking one. Bombay, already the commercial capital of independent India was the capital of the state. Due to the authority of Patel, a Gujarati, Gujarati politicians came to dominate the state, much to the consternation of the Marathi speaking population. The two states of Maharashtra and Gujarat were finally created in 1960 with Bombay remaining the capital of Marathi speaking Maharashtra and Ahmadabad becoming the Gujarati capital. Most of the negotiations behind the scenes during state formation were being orchestrated by the Congress in collaboration and sometimes in confrontation with smaller regional groupings. But the Congress remained the dominant party in the region and later the state. It won resoundingly in both national/parliamentary elections and in state-level assembly elections. It would be worth noting here that in their quest for a separate state the elites of Gujarat had rallied behind the Congress. This was due to the fact that only the Congress could deliver the political and economic rents an emerging capitalist class in newly independent India could make use of. The appeal of popular Congress leaders like Morarji Desai also ensured support. The Hindu Mahasabha won less than five per cent of the votes in many constituencies across Gujarat during elections in the early

1960s. The communal violence of the earlier periods seemed to be have been subsumed in the politics of state reorganisation, especially the privileges the new Gujarati elite could extract.

However Gujarati politics remained limited to mobilisation among the upper and middle castes, specifically the Patidars or Patels, a name many might recognise as belonging to India's chief diaspora community. Within their home state the Patidars, once a 'lower caste', had gained entry into the upper sections of society due to upward economic mobilisation based on its agricultural surplus (G. Shah 1994). This was a significant feature in Gujarat and other states in India like Tamil Nadu where indigenous formerly agricultural communities had accumulated enough surplus to make the transition to industrial investments. Where this was disrupted the transition to industry became difficult even when the region had a high industrial base because future investments could not be sustained. This was at least one of the reasons why despite its high industrial base West Bengal found it difficult to make the transition. Here the process of agricultural accumulation itself was disrupted due to the partition of British India.

The Patidars did not have to face such concerns. This community was a traditional supporter of the Swatantra Party, a rightist party in opposition to the Congress in the 1960s. As a result the Congress also had to ensure some of its key policies were targeted at the rural and urban rich (Sinha 2005) as well as being explicitly pro industry (Dholakia 2000). In fact unlike most other Indian states political mobilisation in Gujarat has seldom included the working class or poor peasants (Breman 1985; Hein Streefkerk 1985; G. Patel 2002). Even some of the state's most charismatic leaders like Patel and Munshi have often been identified as conservative politicians who did little to make political mobilisation in the state more inclusive (Mukta 2002; G. Patel 2002). Trade and entrepreneurship have historically been the main basis for Gujarati society. The state was in fact one of the losers of the Licence Permit system as the engine of Gujarati growth was entrepreneurship (Sinha 2005). A possibility of a backward caste mobilization was also kept in check by the popular Swaminarayan sect of Hindusim in Gujarat. The sect has been active among Other Backward Classes (OBCs) and it promotes a philosophy keeping in line with the RSS's Hindutva (G. Shah 1994; G. Patel 2002).

Soon after the creation of Gujarat the state discovered oil and gas reserves. The state accounts for 54 and 39 percent of India's onshore crude and natural gas reserves (KPMG 2007). As a result Gujarat has very quickly developed into the oil and gas hub of the country. This helped catalyse the industrial process in a state that had already benefited from being part of Bombay state, in terms of investments in infrastructure. By 1979-80 the state was ranked second both in terms of value of gross industrial output per capita and industrial employment per thousand (Paranjpe 1988). In the initial years the Congress in Gujarat encouraged and invited investments to locations close to its border with Maharashtra as that put Bombay within easy reach of investors. Bombay was western India's premier city and India's commercial hub, so it was hoped facilitating clusters close to the city would encourage investors to move across the border to Gujarat (Paranjpe 1988). This has resulted in the corridor between Ahmadabad and Mumbai (formerly Bombay) becoming one of India's foremost industrial clusters. Many of Gujarat's policies initially mirrored Maharashtra's (formerly Bombay state) including the structure of the state industrial development facilitator, the Gujarat Industrial Development Corporation which was modelled on the Maharashtra Industrial Development Corporation (Sinha 2005). Some of its bureaucrats had served as part of the Bombay state administration too. A senior bureaucrat from Maharashtra who went on to senior positions in Delhi told us "This ensured continuity and a familiarity with industrial policy making and implementation and can certainly be identified as one of the reasons why the state did well from the start in the industrial sector". Sinha contends that Gujarat did not receive as many industrial licences as did states like West Bengal in the 1960s and hence most of its industrial success was due to the dynamism of its bureaucrats and a recognition by the administration that

Table 5.3 Industrial Rank of Gujarat in 1980.

State	Industrial Employment per '000 Population	Gross Industrial Output per Capita (Rs)
Industrially Backward States		
Andhra Pradesh	8.72	392.97
Assam	5.48	285.95
Bihar	4.43	370.26
Madhya Pradesh	4.88	331.80
Orissa	3.80	318.52
Rajasthan	4.39	298.04
Uttar Pradesh	5.49	254.36
Industrially Advanced States		
Gujarat	**15.45**	**1382.05**
Haryana	10.30	983.34
Karnataka	7.73	492.22
Kerala	8.9	537.97
Maharashtra	17.14	1638.73
Punjab	10.76	833.86
Tamil Nadu	**11.95**	**922.6**
West Bengal	15.88	820.42
Average of all States	9.02	657.54

Source: (Paranjpe 1988: Table 1)

Note: based on Annual Survey of Industries, Census Sector, 1979-80 and Census of India, 1981

industrialisation was necessary (Sinha 2005). This was certainly true. Gujarat however saw significant public investments in industry and it is a well-known fact that capital formation in India during the 1960s and early 1970s was driven by the public sector. For instance state owned Indian Oil Corporation's refinery in Baroda, Gujarat was commissioned in 1965-66 and still remains the corporation's largest refinery. Till 2002 three of the state's five petrochemical complexes were state owned and all six of its major chemical fertilizer complexes remain state owned. The fact that a Congress government was also ruling in the centre helped locating critical investments in Gujarat. Hence the base for Gujarat's impressive industrial performance (relative to the rest of India) was laid during this period of Congress rule. By 1980 Gujarat was already one of India's most industrialized states ranked second after Maharashtra (Table 5.3). It's pro-active policies with respect to monitoring the status of licences granted by the central government also ensured Gujarat saw greater industrial success in the 1960s and 1970s (Sinha 2004b).

In 1969 the Congress Party underwent a split with one section accepting the leadership of Prime Minister Indira Gandhi and the others opposed to it. Most senior Congress leaders defected to form Congress-O but Indira's Congress or Congress-I was able to form a government soon after in Delhi. Gujarat was not unaffected by this change and the new chief minister Chimanbhai Patel faced increasing opposition from within Congress-I ranks which later developed into the 'Nav Nirman' (New Foundations) movement in 1974 where students were protesting against a 20 percent hike in hostel bills. The movement however was soon hijacked by the urban middle class in the state that started protesting against unpopular policies of Patel that led to price rises. The movement was essentially against Patel's attempts at intervening in deciding university level positions in Gujarat but snowballed into protests led by groups he had left out while manoeuvring for chief ministership. Many analysts have also traced the roots of modern Gujarat's social mobilisation to this movement. However what emerges from an analysis of this movement as scholars like Shah have shown is that the Nav Nirman Movement was prescient of the right wing turn Gujarati politics was to take. There are several reasons for this. The movement saw heightened tensions between Muslims and Hindus leading to riots between the two even though the movement was ostensibly about price rises. The Jan Sangh, the immediate predecessor of the BJP was one of the chief organizers of the movement though for a while parties like the Congress-O and the Communist CPI-M also participated. Finally Modi cut his proverbial teeth in mobilizing as a young leader of the Nav Nirman Movement (G. Shah 1994).

After a few precarious Congress governments in the 1970s the party regained stability under Madhavsinh Solanki who devised the famous KHAM alliance in

Gujarat. Solanki who was from a 'lower caste' devised an alliance of Kshatriyas (a lower intermediate caste involved in agriculture in Gujarat, though elsewhere in North India they are the upper warrior caste), 'Harijans' or Scheduled Castes ('untouchables' who are outside the caste system), Adivasis (indigenous tribes) and Muslims, collectively known as the KHAM alliance. This alliance was supposed to counter the forces of the 'upper castes. While it is not the scope of this paper to review the literature available on caste and its relationship with class in India, at least in Gujarat the parallel is noticeable. Solanki's calculations were based on the fact that the KHAM alliance made up over 50 percent of Gujarat's population and he hoped this constituency would produce the right electoral result for the Congress. Having created this constituency it was now incumbent upon Solanki to provide it with incentives. With an eye on the elections in 1985 his government announced reservations for jobs in government institutions and higher academic institutions for the SCs and STs. The SCs and STs were a part of the KHAM alliance.

The 'upper castes, namely the Baniyas, Brahmans and Patidars in the state rose in protest and riots broke out between members of these castes and Dalits. Matters took a turn for the worse when Solanki pressed on and announced further reservations for the OBCs in the state. This turned out to be the beginning of the end for the Congress dominant party system in Gujarat. Solanki had sought to build a ruling coalition with the marginalised in Gujarat but he had not bargained for the sustained holding power of the 'upper caste's that saw their interests hurt especially with the introduction of reservations in educational institutions. The impetus to maintain the social status quo assumed greater strength than a coalition which had few commonalities to begin with apart from being in opposition to the 'upper castes. The violence escalated to an extent where the centre, also ruled by the Congress had to intervene and ask Solanki to resign. Escalating violence in a key Congress-ruled state was too high a cost for the party to absorb.

It has to be noted here that Solanki's tenure as chief minister is associated with one of the highest growth rates that Gujarat has experienced, higher even than under

Modi. Sectors like electronics were given encouragement under Solanki and new industry friendly policies were announced (S. Patel 1988). Earlier investments in the state were coming good and Solanki himself was seen as a pro-industry chief minister. The chemical industry featuring home grown names like Tata Chemicals and Nirma consolidated their businesses during his tenure. Operation Flood, the programme to make India self sufficient in milk production was launched in Gujarat in 1970 but became self sufficient in the 1980s. Pharmaceutical companies that are now some of India's largest like Lupin and Sun Pharma were already a large presence in the state's manufacturing sector. Finally, the state's diamond cutting industry was making a dent internationally much before Modi's tenure. By the time the Indian economy was liberalised in 1992 the state was well poised to leverage on the competencies it had built up during the years of protection and as a result Gujarat was one of the states that benefited most from liberalisation. "Given the current hype about how Modi has transformed Gujarat people tend to forget Gujarat was always an industrially advanced state and especially that Madhavsinh Solanki ensured high levels of productive investment that Modi could build upon", said a retired member of the senior management of a Gujarat-based electronics company.

Yet industrial growth did not stop Solanki's tenure from being marked by some of the highest levels of violence in Gujarat since the Nav Nirman movement. His attempts at rewarding the constituency of the marginalised in Gujarati society was met with stiff resistance despite the state's positive economic performance. We will draw attention to the use of the word 'constituency' to describe Solanki's alliance and the fact that the term ruling coalition has not been used. Solanki attempted to bring together a number of communities who were bound together only by the fact that they were marginalised and would have little to lose if matters didn't go their way. The Kshatriyas were not natural allies of either the Dalits or Muslims but they had been historically involved in a power struggle with the Patidars and this is what influenced their decision to join Solanki's alliance (Sheth 1976; G. Shah 1985). However the 'upper caste's had a *coalition* and were joined through various clientelist networks to state patronage. This coalition had far more to lose if Solanki's alliance succeeded in changing the distribution of benefits. Violence against his decisions on affirmative action was an attempt by this coalition to keep the political balance from changing. Again most of the violence was not spontaneous and had elements of deliberation (J. R. Wood 1987). Solanki was attempting to create a new political settlement that was not compatible with the underlying distribution of power, in particular the holding power of the ‘upper castes. The experiment proved to be unsustainable. The holding power of the excluded organizations in Gujarat at this time was too strong and the motivation to rally against the KHAM alliance was also high given that the alliance struck at the material interests of the ‘upper caste’s. The exclusion was marked and visible in that for the first time in Gujarat’s history there was not a single Patidar who was a cabinet minister in Solanki’s ministry between 1980 and 1985, and nor has this feature been subsequently repeated. A similar and more detailed history of this period is provided in (Kohli 2012).

Any benefit the Congress’ received from asking Solanki to resign proved short lived. More critically it created a political opportunity that was effectively exploited by the Hindutva wing of Indian politics, namely the BJP, its patron the RSS and a sister organisation called the Vishwa Hindu Parishad (VHP) or the World Association of Hindus (Engineer 2002; Lobo 2002; G. Patel 2002; Mahadevia 2005). The caste riots of Solanki’s term had also degenerated into communal riots between Hindus and Muslims when the latter community had no role to play in caste politics. Communal politics was once again making a comeback to mainstream Gujarati politics as the BJP realized alienating the Dalits and Adivasis was proving to be costly for them. It is an unfortunate irony that Muslims and Dalits sheltered each other during the riots of 1981 and 1985 but this empathy was to change dramatically in the 1990s once the VHP made significant inroads into the Dalit population of Gujarat. While it is very difficult to find proof in such matters many analysts argued that these communal riots were part of a deliberate strategy of escalating tensions between the two communities (Engineer 2002; Shani 2007). The situation in the state was effectively mirroring the communalisation of Indian politics on the whole, a process we have summarized briefly in Chapter Seven section 7.2. With the ‘upper caste’s in Gujarat definitively against the Congress, events in the state provided the best platform for the BJP. In fact the Congress has effectively not been able to regain Gujarat since Solanki's ouster.

Communal politics is not new to India. All parties, national and regional, have at various points used populist right wing agendas in electoral politics to gain either the majority Hindu vote or used 'secularism' to appeal to Muslim voters (Chatterjee 1995; Hansen 2000; Engineer 2002; Palshikar 2004). Muslims are the most significant minority in India, making up close to 17 percent of the population or over 170 million Indians. Significantly despite its Hindu majority, India is one the largest Muslim countries in the world after Indonesia, Pakistan and Bangladesh. However the Muslim population in the country is dispersed unevenly and they make up a majority in only very few regions. This makes them especially vulnerable when parties have agendas that specifically appeal to the Hindu voter. For instance while the BJP does not have an explicit electoral agenda of violence against Muslims its vision is to see Muslims and indeed other minorities merging into a Hindu belief system that is a throwback to a time before the coming of Islam in India in 7 CE: the Hindu 'golden age'. However the party does not shy away from violence against Muslims, and sometimes, other minorities like Christians, where it thinks it is necessary for electoral advantage. Violence against members of Gujarat's Muslims and Christian communities in the late 1990s and early 2000s are testament to this.

5.2.2 The Changing Political Settlement and a BJP Government

The BJP and its allies adopted a two-pronged strategy to upset the Congress coalition. It decided to reach out to the 'upper caste's in the state by providing a politics of identity, distinct from the Congress' attempts at election-driven inclusiveness. This was in line with its strategy across India. The second was to carefully construct a strategy to co-opt the Adivasis into its fold, similar to its strategy in the Indian state of Chattisgarh. The party had already won municipal elections in key Gujarati cities through the 1980s. As the need for mobilisation grew with these successes the BJP gradually started dispersing positions within its party organisational structure to the OBC population of Gujarat that numbered over 30 percent of the state's population. However the principle beneficiaries were the Patidars who were 'rewarded' for their fierce opposition to Solanki's policies of reservation. As Patel says, although a 'lower caste', this constituency did not want to be associated with the KHAM alliance because of its association with marginalisation. With the BJP giving it the opportunity for upward mobilisation this constituency became a loyal one for the party (G. Patel 2002). Such a strategy could not be adopted in Uttar Pradesh, a state that has led backward caste mobilisation in India, because an equivalent of the Patidar caste does not exist in that state. The Patidars were a 'low' agricultural caste who could make the shift to being recognized as an 'upper caste' after the success they had in investing their agricultural surplus in trade. No 'lower caste' had made such a decisive shift in UP and given how successfully mobilized the political organizations of the 'lower caste's are now in UP it might be safe to say that a significant shift in their allegiance towards the BJP will be difficult in the next few years.

The other strategy adopted by the BJP was to co-opt the indigenous population (close to 15 percent) of the state into the Hindutva fold. For the indigenous population, assimilation into the Hindu 'fold' held more benefits than support from the Congress which came with little social recognition. The rents that were distributed to allow for this assimilation were not all economic. It also included a subtle but insidious combination of appealing to a specific ideology of superiority in the case of certain groupings and in the case of others it was simply an assurance of social security (Thapar 2007). Hence apart from a chance at economic advancement this constituency also got a chance to enter the Hindu 'mainstream', an opportunity that traditional Hindu social structure did not provide. This is what Shani calls 'from the politics of redistribution to the politics of recognition' (Shani 2005). Seen as practicing a 'primitive' kind of Hinduism because of the preponderance of animism among tribal groups the Hindutva parties never really concentrated on them till they realised Christian missionaries were converting them through their work. It should be noted that where even the state hadn't reached at least some of these missionaries reached deep into tribal areas to provide them with basic services like primary health care and education. Since the 1980s the RSS and its sister organisations, especially the VHP have been trying to counteract the missionaries by reaching into the tribal areas with attempts to 'reconvert' them. The VHP's association with the tribal population of Gujarat was initially linked to an anti-conversion agenda. Increasingly though the RSS and its associates used the tribals in a huge mobilisation against Muslims. In some areas where Muslims happened to be moneylenders in tribal villages the RSS incited the population on grounds of oppression. Historically the tribal population in the state was never a significant part of any political mobilisation process, even during the height of the KHAM alliance. This sort of sectarian mobilization of the tribal population though was unprecedented (Pinto 1995; Lobo 2002). However it led to disastrous consequences for the community and Indian polity in general. The real result of this mobilisation became apparent in the riots of 2002 when large tracts of Gujarat's tribal population rioted with the VHP against the Muslim community. "Co-opting the indigenous population of Gujarat against the state's Muslim community was the real master stroke of the BJP's Gujarat strategy", said a senior academic and policy adviser to the central government.

This is not to say that the other national party, the Congress has no communal agenda. The Congress' attempts at coalition building had at first tried to include all major interest groups (Chatterjee 1997) but increasingly relied on a large chunk of India's Muslim population and the 'lower caste's that together make up over 50 per cent of India's population. That did not stop the Congress from pursuing populist identity politics from time to time that would appeal to Hindus. In order to keep its primacy the Congress realised that appealing to Hindu 'sentiments' could provide it with a tool to cut across regions and languages. One such instance was a contentious move by the Prime Minister Rajiv Gandhi to open the lock of the Babri Masjid built by the first Mughal emperor and claimed by Hindutva activists to be built on the birth place of Ram, a Hindu deity. It was easy for the BJP to pick up where the

Congress left and carry it forward successfully. By 1990 the BJP had formed four state governments and it had much to thank the Congress for.

In Gujarat's case the BJP along with the Vishwa Hindu Parishad (VHP) or the 'worldwide association for Hindus' and the Rashtriya Swayamsevak RSS (RSS), Modi was able to build a relatively homogeneous coalition that overcame barriers of class and caste, the latter being a critical variable in Indian politics. Both the VHP and RSS are ideological sister organizations of the BJP though neither fights elections. The RSS is in fact the parent organization of the BJP and is the source of the philosophical roots of the BJP's politics as well as providing critical organizational support today. This coalition was positioned against the Muslim minority population of the state. The closest English translation for the RSS would be 'National Association for Promoting Self Reliance'. 'Swayamseva' or self-reliance does not translate very well but it invokes a sense of pride through independence. Modi is known to be well liked by most senior functionaries of the RSS who play a very vital role in the appointment of senior BJP leaders not just for executive positions within the party but also for legislative candidates. This gives Modi both formal and informal authority to ensure his writ runs without significant opposition.

The organisational muscle to engineer the riots came from the intermediate and lower levels of the BJP, but more so from the VHP, especially in Ahmadabad. Local 'goondas' or lumpen foot soldiers were recruited by politicians to conduct terror campaigns (Berenschot 2009). These foot soldiers are used during elections to garner support for the politicians at the grassroots. In return the goondas get patronage from politicians, which involve protection from the law and sometimes monetary compensation. This system of patronage is also similar in broad respects to what Khan describes for political mobilisation in Bangladesh but the differences in the way the coalitions were constructed have important economic and political consequences (M. H. Khan 2010a). The BJP at the time of the 2002 riots was also the single largest party in the ruling coalition in the national government at the centre and the fact that Modi and his state government were able to get away unscathed was in no small way linked to this fact.

The language of ‘experimentation’ and ‘laboratory’ frequently finds its way into critical discourses on why the riots happened in Gujarat (R. Ahmad 2002; Engineer 2002; Lobo 2002; Mukta 2002; G. Patel 2002). These well-orchestrated mobilisations gave more credence to the fact that the BJP was indeed using Gujarat as an experiment in developing Hindutva though the social conditions necessary for this remain as yet specific to Gujarat. Whatever the party’s aims it won the state level assembly elections with a majority in 1995. However the party had still not come to grips with being in power and its organisational hierarchy was uneven. This resulted in significant infighting within the party and between 1996 and 1998 a breakaway group of the BJP formed the government. By 1998 the mainstream BJP was back in power. As Table 5.4 shows Gujarat’s manufacturing performance was still impressively high. In fact the years from 1981 to 1994 saw the state achieve growth rates that have since not been replicated on the back of investments in the power, infrastructure, synthetic textiles and petrochemicals sector and the manufacturing sector grew faster than the national average through most of those years (Awasthi 2000; Menon 2008). The diamond processing industry also posted its highest growth in the 1980s (Lee 2008). However the incumbent chief minister faced severe criticism

Table 5.4 Manufacturing growth in Gujarat in 1980-96

Years	**Gujarat**		**Rank**	**All India**	
	Mfg NSDP	Share*		Mfg NDP	Share
1980-81					
NSDP from Manufacturing (Rs crore)	1354	20.7	4	18698	16.9
State Share in NDP (%)	7.2				
1985-86					
NSDP from Manufacturing (Rs crore)	2228	27.1	3	26413	18.8
Change over 1980-81 (%)	12.9			8.3	
State Share in NDP (%)	8.4				
1990-91					
NSDP from Manufacturing (Rs crore)	3128	28.1	***1***	39408	20.7
Change over 1985-86 (%)	8.1			9.8	
State Share in NDP (%)	7.9				
1995-96					
NSDP from Manufacturing (Rs crore)	4804	33.81	***1***	52969	21.7
Change over 1990-91 (%)	10.7			6.9	
State Share in NDP (%)	9.1				

Source: (Awasthi 2000: Table 3) Note: NSDP- Net State Domestic Product, NDP- Net Domestic Product * Share of manufacturing in NSDP or NDP from within the BJP and outside for his handling of the relief efforts after a massive earthquake killed close to 20,000 people in the state. This mishandling caused the BJP to suffer severe losses in local by-elections (elections held mid-term when the constituency loses its elected representative) and the BJP responded quickly by asking him to resign and appointed Modi as chief minister in 2001.

5.3 A New Ruling Coalition and Authoritarian Clientelism

Gujarat's politics took a new turn with the appointment of Modi as chief minister. Modi came into prominence while he was still with the RSS and only joined the BJP in 1987. He swiftly rose through the ranks by organising party workers at the grassroots and successfully mobilizing them. Within a year he was made the general secretary of the party in the state and gained the attention of national level leaders when he successfully oversaw successful BJP mobilizations in Gujarat. By 1995 he was made a National Secretary of the party in charge of five states at the relatively young age of 45, by Indian standards. Modi's proximity to many RSS leaders also ensured his passage through the ranks of the BJP was unhindered. One of the first events that marked the beginning of the Modi government was the aftermath of what is now known as the Godhra incident in 2002 where a Muslim mob allegedly set fire to a train carriage carrying Hindu pilgrims. This has yet to be conclusively proven and an independent report by the Central ministry of Railways of the time concluded that the fire was an accident. However the violence that followed, which included outright killings of Muslim citizens and selective targeting of Muslim commercial and residential establishments in cities like Ahmadabad and Surat, seemed to be pre-meditated and well-planned. Informal reports spoke of Muslim-owned shops that did not pay sales taxes (and hence were not on any official list) being spared only because rioters had no information on them. This pointed to the possibility of significant collusion between so-called spontaneous rioters and the administration (Brass 2003; Shani 2007). Significantly the army was called in to quell the violence only after 32 hours of violence. While few accuse Modi of being actively involved in the riots, as head of the government the blame for inaction can squarely be kept outside his door. The sectarian violence was a manifestation of what Paul Brass calls 'institutionalised riot systems' where specialists indulge in 'riot production' (Brass 2003). Godhra was certainly not the first time this system was used and nor was this the first time that Godhra witnessed riots. However the meticulousness with which the riots seem to have been planned are unprecedented. Riots in India become a way of political mobilisation based on deeply ideological moorings of identifying a mythical 'other'. This 'other' in India has over the years come to mean Muslims for Hindutva activists and sympathisers.

One significant feature of the BJP is its deep links with the RSS. Not only does the RSS provide the ideological roots for the BJP it also strongly influences executive decision within the BJP for appointing internal office bearers and critically has a strong voice in suggesting even prime ministerial candidates. There have been instances in the BJP where the RSS has disapproved of an emerging leader and such opinions have the potential to derail or further his or her political career. Thus when Modi became chief minister in 2001 he had both formal authority (as a member of the executive) and informal writ by dint of being close to the RSS. This ensured he was able to execute governance without encountering significant hindrances. It is significant that Modi now is a key contender for the BJP's prime ministerial candidate when elections are held to India's parliament in 2014. That Modi still maintains close contacts with the RSS is clear from media reports and interviews conducted during this research. Senior RSS functionaries were staying in the same government accommodation at the same time as this researcher was while on field work in Ahmadabad. They had been invited by Modi to observe first-hand the progress Gujarat had made under him. The RSS is not known to have any political ambitions and nor do its leaders court the limelight in a country where politicians and ministers are known to go home to change before appearing on TV even in the time of a significant crisis. It is a combination of this moral standard (a morality at odds with its exclusionary philosophies) and the philosophy of a canonical Hinduism harking back to a Vedic past that provides the RSS with credibility within the BJP. Such authority does not always make it popular among ambitious BJP leaders. However given that the Hindutva ideology has salience among a sizable section of the Indian population the BJP-RSS relationship will remain an enduring one.

What this means in our analysis is that both formal and informal distribution of power in Gujarat are aligned in a manner that led to a growth-enhancing political settlement that nonetheless allows for a significant amount of violence. In other words the operational equilibrium between formal and informal organizations in the state is strong. We identify the RSS as an informal political organization with significant holding power that it draws not on the basis of from economic power but on the basis of its mobilizing ideology. We know from our framework that once a political settlement emerges the distribution of benefits across organizations has to be in line with the relative power of organizations. If this does not happen organizations with high holding power will mobilize till they have brought the distribution of benefits in line with their real relative power. In the case of Gujarat however the distribution of benefits is in line with the relative holding power of its key organizations. The RSS is not anti-industry and more importantly believes Modi is best placed to deliver its Hindutva agenda. For the RSS the benefit or pay-off is ideological. As we have discussed in Chapter Three mobilizations can also be based on ideology and not all benefits are necessarily economic in nature. This is an important feature of patron-client relationships that conventional analysis misses. In Chapter Seven we analyse how the Pakistani Taliban is mobilizing on the basis of a worldview that is based on rational assumptions of pay-offs, however irrational we might think their mobilization is. For now at least any power sharing arrangement with the incumbent government is not likely to stop mobilization by the Taliban.

The RSS' mobilization is much less adversarial to the established state and nor is their mobilization as violent as the Pakistani Taliban. But for one its agenda of Hindutva is not to supplant the state but to recast the state in a Hindutva mould even if not constitutionally. Secondly the RSS has as an ally a formal political party that already reflects their agenda and has successfully formed the central government in Delhi once as well as many state governments, unlike the Taliban. The other important coalitions are of the 'upper caste's and the Patidars all of whom are now part of the organizations of the ruling coalition and for whom the pay-off is a business friendly administration. Though ideology is not as important for these caste groupings as it is for the RSS it nonetheless it is an important reason for their support of Modi. This would be in line with our framework which says a political settlement that best mirrors the real distribution of power is most likely to have high enforcement capabilities. This is what we see reflected in the current political settlement in Gujarat. All organizations that have significant holding power have been incorporated in a form of constrained patrimonialism providing Modi with the enforcement capability he needs to make his policies growth-enhancing in terms of industrial investments. That he is able to leave out a significant portion of the state's Muslim population is to do with the fact that the community has almost no holding power in Gujarat during the period under consideration. In the political settlement that has now emerged there is no other significant group left that an opposition party like the Congress can possibly ally with along with the state's Muslim community in order to mobilize against the state's ruling coalition.

Hence what is often projected as Modi's charisma or singular ability to lead is essentially a function of the fact that the ruling coalition that has now emerged in Gujarat's political settlement is a variant of patrimonialism with repressive features within the institutional framework of a democracy. We cannot identify this as a variant of strong patrimonialism because we contend violence was used to *create* this distribution of power rather than a situation where power was distributed such that the ruling coalition did not have to use political repression (M. H. Khan 2012f). It is not vulnerable patrimonialism because the ruling coalition does not have a limited time horizon and in order to define it as constrained patrimonialism the ruling coalition would have to be more inclusive. As highlighted in the introductory section while there are elements of authoritarianism in Modi's patrimonialism it has identifiable features of clientelism in that the levels of monitoring over capitalists by the Modi administration are low. In fact the political settlement in Gujarat is best summed up as Authoritarian Clientelism that at least for now seems to co-exist well with democracy. We define this is as such because the informal institutional features in Gujarat resemble an authoritarian regime though in reality Gujarat has an elected government and power is shared among the ruling coalition in a clientelistic manner.

Modi has often been credited with being the efficient administrator responsible for steering Gujarat towards heightened prosperity. In the earlier paragraphs we outlined how this was because of the particular configuration of the ruling coalition that was in turn dependent on specific historical and social factors like caste configurations and historically conservative political mobilizations in the state. Another reason that helps Modi project himself as efficient is his ability to able to 'signal' more effectively to investors that he was able to deliver specific and targeted rents, rather than creating an investment climate conducive to investments across the board. We have established Gujarat had a history of an efficient bureaucracy and preponderance of a manufacturing base relative to Indian levels. The difference in Modi's case was that apart from sustaining Gujarat's investment climate he was also able to deliver credibly on the specific rents he had promised investors. Successive Gujarat governments have held up business interests through various industry development bodies like Gujarat State Finance Corporation, Gujarat Industrial Development Corporation or INDEXTb. The Modi administration has continued to promote such organizations to aid the interface between business and government. GIDC today is considered one of the best facilitators for industrial investments especially in matters like land allocation to industry, an area where other states are facing increasing difficulty. Modi's personal involvement in GIDC and his ability to enforce decisions relatively rapidly on both the party and the bureaucracy are reasons for GIDC's success. According to an investor with significant interests in Gujarat "Whatever criticism might be levelled at Modi's administration the fact still remains that they, thanks to Modi, are able to deliver what they promise to their business investors. At a time when other states in the country are unable to do so this singles Modi out as an effective administrator". This however stems directly from the fact that the ruling coalition is configured in a way that heightens Modi's enforcement capability. Hence the Modi administration is able to provide investors including members of the Gujarati diaspora host of incentives especially if the incentives are in preferred industries.

One notable feature of post Godhra Gujarat is the construction of 'Gujarati asmita' or Gujarati respect, by Modi. The term was coined by Munshi the popular Gujarati leader referred to it Section 5.2 but Modi has popularised it since then. The term is meant to provide a sense of heightened identity to all Gujaratis (even Muslims according to the BJP) and bring them together on a common platform of belonging. While this would have been difficult for the victims of the riots in 2002 it seems to have appealed to a broad cross section of Gujaratis and ties in with the BJP's strategy of providing a separate Hindu identity. In neighbouring Maharashtra nativist populist parties have also made the Marathi identity an overtly political project. In Gujarat's case 'asmita' is a more subtle concept. It ties in facts like Gujarat being one of India's most developed states, is home to some of the country's most successful entrepreneurs and that the people have a rich culture; all of which is true and accepted relatively unequivocally in India. Yet in this case Gujarati pride is evoked by suggesting Gujarati pride is somehow being questioned and a criticism of the political establishment is considered counter to the spirit of 'asmita'.

Modi's ability carry the party with him was a key factor in signalling that he was the de facto and de jure leader and there were no other power centres to contend with. Haren Pandya a key critic of Modi within the RSS and BJP, and an ex-home minister in the BJP government in Gujarat was murdered in 2003. Speculation remained rife about the reason behind his death with opinion divided into two camps. The first was that this was one way of dealing with a Modi rival who was also testifying against him during the investigations into Godhra. The second theory is that Pandya paid with his life for his own involvement in the anti-Muslim violence after Godhra. The prosecution pressed for this latter option and won the case but doubts continue to be raised about the manner in which the investigation was conducted. While this is not the first or last time that an Indian politician is caught in a controversy that concerns a political rival the speed with which the case was 'solved' was suggestive of a desire to close the Pandya chapter as quickly as possible. During his second term Modi had a small cabinet and kept key portfolios like the home ministry in charge of law and order to himself. Also he did not appoint elected BJP members to head state owned boards and corporations. This ensured he had his supporters who possessed little political currency in key positions effectively stifling opposition (Mahadevia 2005). Scholars like Sinha have contended that sub-national states in India like Gujarat became developmental after liberalisation because the new competitive atmosphere meant industry needed more interaction with the state to streamline investments than before (Sinha 2004a). However we will see later that this parallel while true to some extent cannot be drawn to the full length of the developmental logic. The signalling on the part of Modi was enough to be interpreted positively by investors hungry for investment opportunities in a liberalised economy (Mahadevia 2005).

It is when one relates the translation of this ideology to political mobilisation that the BJP's strategy in Gujarat becomes apparent. The majority of the state is Hindu and most of the industrial interests are controlled by Hindus as well. Violence against Muslims would do no significant damage to the state's economic base. Unlike the current Maoist insurgency in India which has deep and historically socialist roots and seeks to strike at symbols of economic inequity, like factories and mines, violence by Hindutva activists does not affect large industry and capital. It is a violence that can be calibrated at will using patron-client networks and is within an established political system, unlike the Maoists who are beyond the pale of the state or political authorities within the establishment. Hence this sort of violence can ironically be dubbed 'safe' for dominant economic interests. Of course there is a danger of both oversimplification and contradiction in defining any violence as 'safe' because violence can escalate in unplanned directions. However given that as a consequence of partition the Muslim population in India has shrunk relative to the total population and is widely dispersed across the country it has become increasingly common to use this asymmetry to target the community. This does not mean that the community is always at the receiving end of violence but that it is easier to exclude the community in certain regions. In the case of Godhra, the rioters work was made easier as the union government at that time was a coalition led by the BJP and did not react in time either. Despite its communally expedient politics the Congress' given its history cannot resort to organized violence of this sort and indeed depends on Muslim votes for electoral victory across many states, though for reasons analysed cannot do so in Gujarat.

Various political parties demanded Modi's resignation as chief minister after the Godhra related violence but the BJP stuck to its ground and let Modi continue. This is where his RSS support base was critical. All sections of the BJP are not united in favour of this sort of violent political mobilisation but given that the ideological roots of the party are within the RSS the moderates within the party had little say. Ironically Modi's grip over the state machinery and the party only deepened after the riots. To be sure, investments in 2002-03 did see a drop but this was a minor blip when compared to the gains the state made in later years. This is where the BJP's strategy of what we call 'safe violence' has succeeded. It is doubtful if a similar theatre can be replicated in other Indian states simply because they lack the distribution of power among castes and economic interests that allowed such a strategy of violence in Gujarat. For instance in neighbouring Maharashtra the BJP and its local ally tried to follow a similar strategy and almost succeeded with the state getting violently communalised in the 1990s and the two parties coming to power on the basis of Hindutva. However politics in Maharashtra is extremely fragmented and caste configurations do not add up very neatly making mobilisation only on the basis of Hindutva an unsuccessful electoral strategy. The Congress and its allied party could construct new alliances to resist the BJP combine. More importantly the coalition created by Congress in Maharashtra distributed significant rents to particular intermediate classes and castes and it was difficult for the BJP to bypass these groups entirely. The system of banking, sugar, and agricultural cooperatives that the Congress had created from the 1950s provided rents to a broad range of Maratha leaders, the dominant caste in Maharashtra (M. H. Khan

2008b; P. Roy 2008, 2012). Hence opposition to the BJP combine was strong. Violence in Maharashtra also threatened to affect productive investments as all communities were significantly present in Mumbai where violence had high economic costs. The distribution of holding power in Maharashtra has so far at least ensured that Hindutva does not become a sustained mobilising ideology. Of course the BJP in Gujarat no longer uses Hindutva explicitly but frequently evokes 'asmita' as a proxy.

5.4 A Political Settlement of Growth with Exclusion

The controversy surrounding Modi's legacy in Gujarat will keep sections of Indian society deeply divided but very few will deny that Gujarat's growth has been consistently high and accelerated somewhat under Modi. Earlier regimes had even higher growth rates, for instance under the administrations of Solanki or Patel (Table 5.5). However, Gujarat under Modi saw a level of political consolidation unprecedented even under the Congress dominant party rule. Growth under other chief ministers saw large spikes and troughs but consistently high growth was achieved under the three Modi administrations. As we saw earlier the state saw very high investment levels and high levels of growth in the four years from 1981 to 1985 under Solanki. But as a retired bureaucrat who has worked for many years in the state's senior administrative ranks said during an interview for this research that both chief ministers provided industry with incentives. The difference was that in Solanki's case senior bureaucrats were more involved in the decision making while Modi was likely to use discretion on his own initiative. Paradoxically this meant while decisions taken during Solanki's tenure were relatively more transparent, and closer to effective governance consistent with 'good governance', decision making was also relatively slower. "It's an irony", says a retired bureaucrat who has served in various senior positions across the central government and states, "but everyone thinks the Modi administration is successful because it is implementing good governance. If anything it is the level of discretion used that actually enables this ease of doing business. Sometimes dealing with serious bottlenecks needs to be handled with discretion rather than transparency".

Table 5.5 SDP growth rate of Gujarat under various chief ministers

Period	**Chief Ministers**	**Annual Rate Growth**
1961-71	Jivraj Mehta, Balwantrai Mehta, Hitendra Desai	4.70
1972-80	Hitendra Desai, Ghanshyam Ozha, Chimanbhai Patel, Babubhai Jashbhai Patel, Madhavsinh Solanki	3.89
1981-85	Madhavsinh Solanki	16.29
1985-90	Madhavsinh Solanki, Amarsinh Choudhary	13.63
1990-94	Chimanbhai Patel, Chhabildas Mehta	16.73
1995-2001	Keshubhai Patel, Suresh Mehta, Shankarsinh Vaghela, Dilip Parikh	8.82
2001-09	Narendra Modi	10.30
2005-11	Narendra Modi	09.35
Note: The growth rate of 2001-09 is at 1999-2000 prices and the growth rate of 2005-11 at 2004-05 prices. Growth rates for 1980-81 to 1993-94 are based on 1980-81 prices. Rates for 1994-95 to 2008-09 are based on 1999-2000 prices.		

Source: (H. Shah 2012: Table 4) based on Socio-Economic Review: 1998-99, 2006-07, 2009-10, Budget Publication No. 30, 32 and 34

The changes in Gujarat's political settlement under Modi meant that his institutional rules for rent allocation were more informal and discretionary, and he was able to rapidly allocate targeted rents to selected capitalists. The speed with which the Modi administration was able to roll out clearances for Tata Motor's Nano project, even providing funds for the relocation from West Bengal to Gujarat bears this out. The Gujarat government agreed to provide a soft loan of USD 1.95 billion at an interest rate of 0.1 percent per year and allowed a deferred payment of the interest and principal amount over 20 years. A similar deal was offered by the West Bengal government to Tata, but Gujarat was in a stronger position to pay it (Guha Thakurta 2009). These were significant rents that Tata Motors captured from Gujarat and it was Modi's capability to make quick discretionary allocations that enabled this. Despite the fact that significant agitations against government land acquisition for business were holding up significant investments in many parts of India, the allocation of land for Tata Motors in Gujarat was a non-issue. Even in other pro-business states in India, opposition parties would at least have made a statement on the largesse laid out by the government. Not so in Gujarat.

The speed with which the Adani Group (Revenues of $7.8 billion in 2012) has seen both its fortunes and assets grow is another instance where Modi has used his discretion to assist a particular group. From 2006 to 2013 Adani's revenues nearly trebled. While there are other industrial houses in Gujarat that benefitted from this form of targeted rent allocation, the relationship of the Adani Group with Modi is exceptional. Adani provided Modi with credibility after the riots after India's premier corporate association, the Confederation of Indian Industry criticized Modi's role in the riots publicly. Adani and a clutch of other Gujarati capitalists stood by Modi. This was serendipitous for Adani as the group had been trying to enlist Modi's support but the chief minister was not keen to be seen as being close to industrialists. While the events of 2002 allowed Modi to consolidate his control over his political organization, his national political reputation was flagging and he was keen to seek legitimacy from all sources. Once Adani made his way into Modi's key inner circle what unfolded was an example of an inverted patron-client relationship. A senior national level journalist told us "Adani has brought in the best brains in port management into Gujarat but this has come at the expense of other possibilities for private ports and even at the cost of the publicly owned Kandla port which is suffering because of Adani's links with the state's administration".

As described in Chapter Four, the relationship between government as patron and business as client can vary along a spectrum and in specific cases the relationship can be inverted so that business is effectively the patron. Modi's relationship with his closest business supporters is best defined in these terms, despite his authoritarian control over his own organization and his ability to override political opposition from other groups in the state. Although a major beneficiary of Modi's Gujarat, we outlined how in Chapter Four Section 4.8 Adani had forged political relationships beyond Gujarat. This makes Modi the more vulnerable partner in the relationship. At the same time, the resources that Adani made available were important for Modi. Only the more visible aspects of Adani's support are reported even anecdotally. For instance, there are reports of Modi having used Gautam Adani's (the chairman of AG) private plane when official transportation was not available. In a public show of support in 2013 the Adanis withdrew their support from a programme at the University of Wharton because the University had withdrawn an invitation to Modi based on his human rights record.

However, Adani is arguably the bigger gainer in this relationship. Without the informal rents the Adani Group received from the Modi administration it may not have made the transition from a company that was an oilseeds trader to an energy and infrastructure conglomerate in the span of a decade and a half. Founded in 1988 the Group operated India's largest private sector port in Mundra in Gujarat. The company also had concessions for other ports and terminals in other Indian locations as well as a coal terminal in Australia. The Comptroller and Auditor General (CAG) of India pointed out irregularities in 2013 in the implementation of a power purchase agreement that favoured Adani Power (PTI 2013; Standard 2013; TOI 2013). The CAG report indicts other corporate houses too (and that is line with Modi's business-friendly policies) but the Adani Group seems to have gained the most. A second CAG indictment for gas pricing in 2009 reports that a state-owned gas utility sold gas to the Adani Group at a price lower than the utility's purchase price. Credible media reports point to the Adani-run Mundra port being granted favours over the public sector Kandla port which till 2013 was India's largest in terms of tonnage but was then overtaken by Mundra (Rajshekhar 2013). It is perhaps for this reason that despite the Government of Gujarat projecting itself as transparent and accountable, in a survey in 2013 in the Indian daily *The Hindu* almost similar numbers of respondents in Gujarat believed the Congress-led UPA government at the centre and the BJP-run state government were corrupt –76 per cent and 72 per cent of the respondents respectively (Rukmini 2013).

The discretion that Modi can use in providing incentives for business is often perceived as an opening up for business. A recent ADB report cited Gujarat as the 'best destination' in India for PPP projects placing it above even Japan in terms of the environment for PPP projects (ADB 2012). Infrastructure projects have long gestation periods and require high capital expenditures. Modi's ability to effectively enforce discretionary land acquisition through state-run institutions like the Gujarat Infrastructure Development Board or GIDB is a key factor in attracting investors who have a low appetite for delays given the nature of their investments. It is not surprising that Gujarat has the highest number of private sector ports in the country—35 per cent of India's exports are routed through Gujarat. As noted earlier heavy chemical industries, ports and related offshore infrastructure have seen the highest growth in Gujarat in the last decade (Malhotra 2008). The state along with Tamil Nadu has the highest number of PPP investments in the country. As we will see in our next chapter the competitive clientelism of Tamil Nadu is far removed from the authoritarian clientelism of Gujarat yet both states have managed to solve what can be described as the 'credibility problem' in politics where investors cannot trust a state's ability to protect their investments over time.

Given Gujarat's otherwise impressive performance the state does not do as well as competitors Maharashtra and Tamil Nadu in terms of attracting foreign direct investment (FDI). Even though its share of the total FDI coming into India was 10.35 per cent in 2012 and the state registered the second highest growth rates for FDI, the share of FDI in Gujarat is just 3.6 per cent of total investments. Indian investors on the other hand made up 49 per cent of the total investment in Gujarat. The joint sector (joint state and private) remains a large part of investments in the state. The showcasing of Gujarat during the biennial Vibrant Gujarat Global Investors Summit is one way the Modi government tried to attract FDI by promoting the state as one of India's leading FDI destinations. A combination of liberalized policies in oil and gas exploration and consistent marketing by Gujarat has made the state one of the top destinations for FDI in these sectors from 1991 to 2011. The chemicals and petrochemicals sector contributes as much as 47 per cent of the state's manufacturing sector as we see in Figure 5.2 (Gujarat 2013b). Foreign direct investors prefer investment destinations where politics does not get in the way and Modi, with his authoritarian clientelism has ensured at least that.

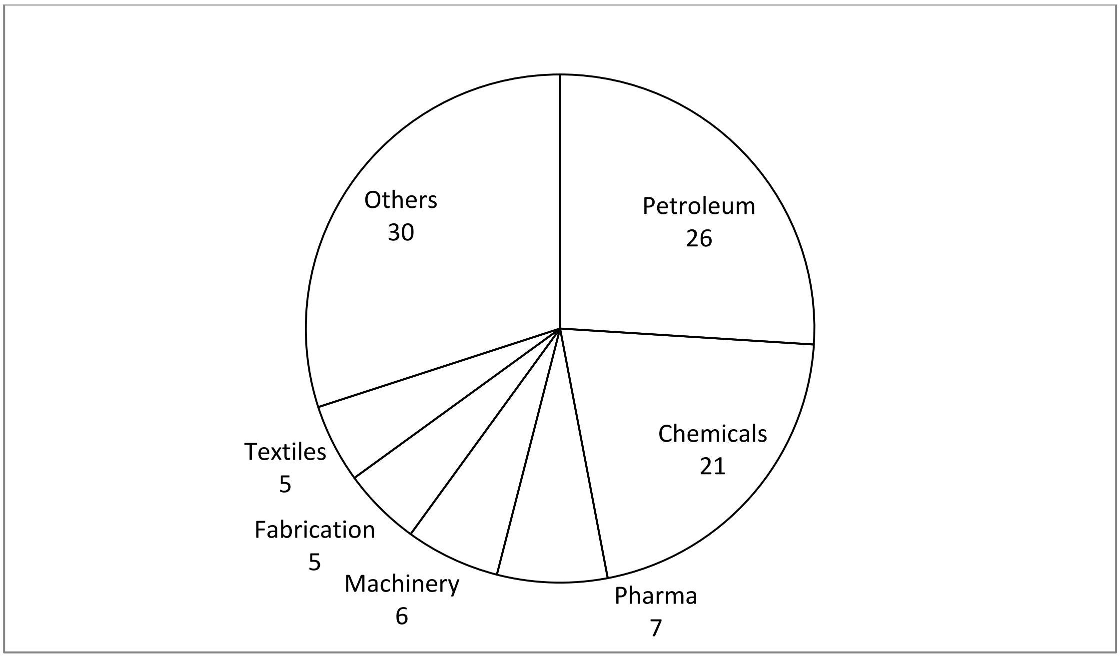

Figure 5.2 Break-up of the manufacturing sector in Gujarat
Source. (Gujarat 2013a: Pg 66) (figures in percentages)

However the state does not get as much FDI in areas like engineering, electronics and pharmaceuticals, unlike Maharashtra and Tamil Nadu. We will see in Chapter Six that this can be traced to specific institutional features of Tamil Nadu. In fact there was a time when companies like Torrent, Zydus Cadila and Paras were well known success stories in pharmaceuticals and the state was a leader in bulk drugs but has since been affected by strong competition Chinese drug manufacturers (though they are still large producers) with little understanding on the part of the Modi administration in terms of how to reverse these trends. As we see from Figure 5.3 Gujarat's manufacturing is concentrated in areas that are somewhat protected from fierce competitiveness requirements. They are dominated by sectors like soda ash or salt that are low-value bulky products servicing the domestic market, sectors like diamond processing or plastics that do not require high technical or organizational capabilities, or petrochemicals and crude oil which are natural resource based industries.

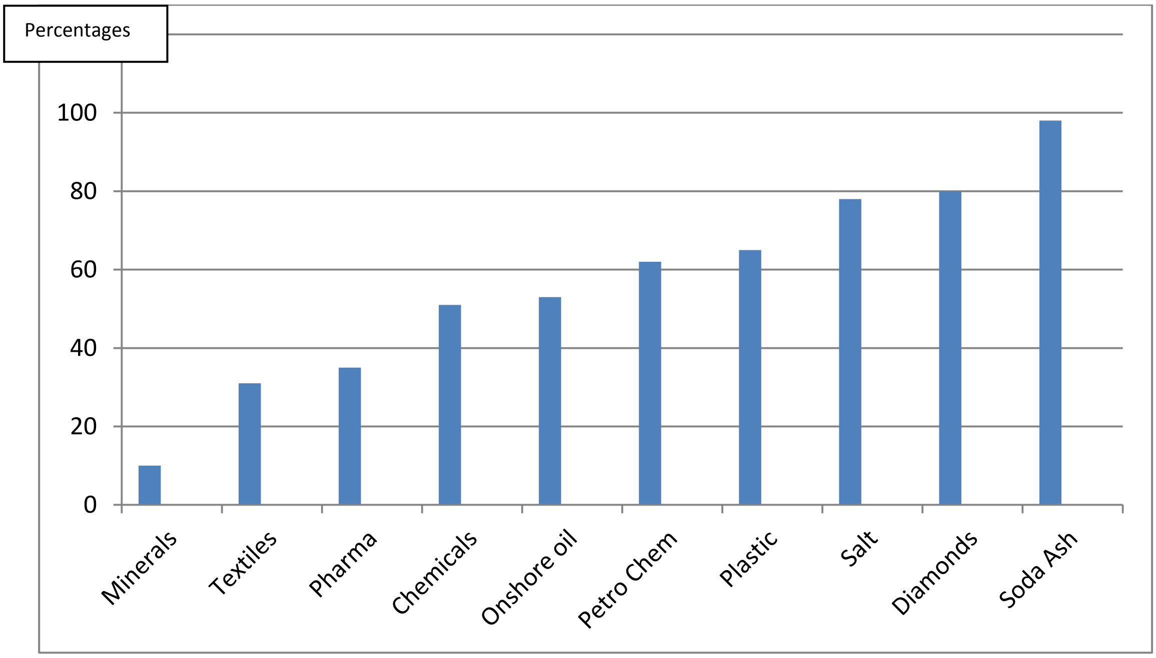

Figure 5.3 Percentage contribution of Gujarat to the Indian manufacturing sector

Source: (Gujarat 2013a: Pg 148), Note- Diamonds is processed diamonds

The pro-business rent allocations in Gujarat do not necessarily imply sustainable growth if rents get captured by business groups that have little incentive to engage in productive investments. "While this trend of making real-estate related investments and inflating the project cost of capital lasts, with the administration looking the other way, the state will see high growth. Once this starts getting rationalized Gujarat will have to focus on increasing productivity", says one of India's leading industrialists with interests in Gujarat. In Gujarat's case this has certainly been the trend yet industrial growth has also been rising indicating that at least some of the rents have attracted productive investments and allowed some privileged groups to invest in limited capability development and learning. This helped privileged business groups to achieve quicker turnaround times for their investments, critical for their profitability and stock market performance. Thus, Modi's ability to make these allocations was at least partly behind Gujarat's higher growth rates as seen in Table 5.2 in this chapter.

Gujarat's industrial success is often attributed to its efficient bureaucracy, especially under the Modi administration. Gujarat has been described as a developmental state by authors like Kohli and Sinha largely on the back of its effectiveness in promoting business. Kohli in particular categorizes Gujarat as a developmental state because of its pro-business policies. A large chunk of Gujarat's public expenditure was channelled into providing policy incentives to business and Kohli argues the state picked 'winners' by defining certain investments as 'premier' or 'prestigious' in sectors like electronics, auto and engineering (Kohli 2012). However a developmental outcome is not guaranteed simply because there are state-led policies. To some extent the debate hinges around the definition of a developmental state. If a 'developmental state' is to achieve developmental outcomes we can engage in an economic analysis of what that entails. Being business friendly without conditions does not ensure developmental outcomes because business can capture the state. Outcomes may be developmental for a while and then suddenly stop being so. A state is likely to be developmental on a sustained basis if it has the capabilities to enforce developmental outcomes, and this may often involve disciplining capitalists receiving assistance as was the case for instance in South Korea under Chung Hee Park (M. H. Khan 2012e).

In Gujarat as in the rest of India there is significant evidence of state capture by business, especially with regard to land. For instance Gujarat is so far the only state in the country that has passed a Special Investment Region Act (2009). The Act allows companies to set up commercial and industrial units, residential developments and logistics projects within any notified area. The Special Economic Zone or SEZ Act of 2005 enacted by the government of India is similar but the difference is that only 100 per cent export-oriented units are allowed in areas notified under the SEZ Act. The SEZ Act itself has come under attack for letting companies grab land on the pretext of setting up export units. The SIR Act makes it even easier for companies to capture land. By 2013 the Adani Group had announced that it plans to develop two waterfront cities under the SIR Act. A third announcement under the Act is for an investment by India's largest car maker, Maruti Suzuki India, though there are signs villagers in the notified area have opposed this move. The principal criticism against the SIR Act is that the state already had an agency called the Gujarat Industrial Development Corporation (GIDC) which allowed it to acquire land under the GIDC Act of 1962 for industrial purposes. It had been highly successful in setting up industrial estates with facilities similar to those offered under the SIR Act. This raises questions about the need to duplicate the GIDC Act but the latter would have been insufficient to allocate land on the scale required for the city development projects by the Adanis.

Another state-run corporation that is responsible for successfully facilitating infrastructure projects is the Gujarat Infrastructure Development Board (GIDB). One of our interviewees, a senior journalist who had extensively covered politics and business in Gujarat for over a decade told us that one reason the new middle class supported Modi was that real estate valuations had been driven up by the Modi government's pro-business policies making members of this class very wealthy. Modi's pro-business policies combined with the BJP's ability to rally the Hindu 'upper caste’s served the party well (R. Desai 2011). Jaffrelot provides the same reason for Modi’s continued success combined with his ability to play on Gujarati pride (Jaffrelot 2008). One of the state’s most senior journalists who was interviewed for the thesis described the process as similar to the primitive accumulation that took place in Gurgaon, a now flourishing urban agglomeration near New Delhi. As he said, “Most of Gujarat is like Gurgaon in the 1990s—booming real estate development and land prices”. Only three decades earlier, Gurgaon was an underdeveloped area with land owned by small and marginal farmers. The Indian government started providing incentives to attract companies wishing to develop the area and the Haryana Urban Development Authority started buying land from small farmers at very low prices and selling them on at very high prices. In many cases land was simply grabbed. The process led to Gurgaon becoming an urban centre with one of India’s highest per capita incomes.

Some of this evidence supports Kohli’s argument that Gujarat is a developmental state because it is able to provide discretionary benefits. However, there is little evidence of any attempt to introduce any institutional arrangements to discipline business or to grant conditional rents to business under the Modi administration. These types of strategies are essential if business is to be supported to enhance their technological and organizational capabilities to compete in international markets. Given the Modi government’s aim of attracting investments in fields like high-tech engineering and with an R&D orientation, we do not see an attempt by the administration to direct indigenous investors who have benefited from their ties with the state to move into such areas. While many companies in the state oversee some social sector activities as part of their Corporate Social Responsibility (CSR) initiatives this is no different from many other large corporations across India. If the Modi administration really did enjoy effective implementation capabilities when negotiating with business, we would expect to see conditional support for business to establish centres for R&D and establish new sectors where comparative advantage would have to be established through rapid capability development.

Gujarat enjoys a high share of tertiary level academic centres of excellence. However most if not at all were set up by the central government or were set up before Modi came to power. Plans announced in the Vibrant Gujarat presentations focus on the initiatives of the state government with little involvement from the state's private sector players. Industrially advanced states like Maharashtra, Karnataka, Tamil Nadu and Gujarat have crossed the stage where they need to establish themselves as attractive locations for industry. They need to look increasingly towards developing an environment that can attract investors to develop new comparative advantage through technology acquisition and learning, or to foster R&D to support innovation. Of these states, Modi's Gujarat projects itself as the most successful. However we were not able to find any evidence in our field research of policies or conditional informal rent allocations that aimed to support investors in learning and innovation. This is where the developmental capabilities of the Modi administration can be questioned. Interestingly Tamil Nadu with a different structure of business-government relations that are discussed in our next chapter was able to address some learning and innovation issues in its auto and engineering centres. The auto industry successfully lobbied the state government to set up a Testing Laboratory for the sector in the state while Gujarat as yet only has plans to do so.

Being pro-business in a state that was already relatively industrialized and urbanized (Gujarat was one of India's most urbanized states over the last two decades) when the Indian economy as a whole was performing well after the liberalization reforms of 1992 was a strategy that could not go wrong for Modi. His cooption of a large section of the state's intermediate classes at one end and indigenous people at the other was achieved by allocating a mix of formal resources through public goods programmes and informal resources through the party organization. The formal and informal rent allocations required for maintaining political stability were lower in Gujarat relative to other states as a result of the Hindutva ideology providing ideological pay-offs for some groups and the display of strength and violence potential reducing or suppressing demands from other groups. The costs of maintaining the ruling coalition were significantly higher in Tamil Nadu, an equally successful state, but one with aggressive competitive clientelism. To the extent that Gujarat performs better than other states in providing discretionary subsidies to business, these political features offer a more compelling explanation for Modi's performance, rather than his forceful leadership.

A limitation of a strategy to attract investors with implicit subsidies is that in a context of inter-state competition for a pool of investments, this can result in a race to the bottom (Sachs, et al. 2002). States like Gujarat, Maharashtra, Tamil Nadu, Haryana and Karnataka have provided significant incentives for businesses to locate there at the expense of states that found it more difficult to organize equivalent subsidies, like Bihar, Orissa and West Bengal (M. H. Khan 2011b). This competition has strengthened the bargaining power of business relative to that of state governments. The failure to control speculative acquisition of land for non-industrial purposes can be understood in this context, as well as the huge subsidies that companies like Tata have been able to bargain for locating in one state rather than another. Gujarat has benefited for the time being. Compared to the Indian average, Gujarat's poverty levels are impressively low (A. Shah and Sajitha 2008). It is currently down to 17 percent from 31 percent in 1983. But as is usually the case some groups in the state suffer from poverty levels close to the average Indian levels. It is the tribal constituency in the state, the one that the BJP and its allies mobilised against Gujarat's Muslims during the riots who still suffer the highest levels of poverty. As many as 34.5 percent of Gujarat's tribals live below the poverty line and though they make up just 15 percent of the population, 43 percent of the rural poor are to be found in this group (A. Shah and Sajitha 2008).

Gujarat has recently also become one of India's commercial agricultural success stories. But the state of its small farmers remains precarious. Small farmers make up 55 percent of Gujarat's farmers and yet they operate on only 2.13 percent of the total cultivated area (Mahadevia 2005). The Modi administration has been proactive in anticipating criticism of its pro-business policies. In his second term his administration announced a number of welfare policies targeting Gujarat's rural communities. The state has also encouraged investments in solar energy and has a department of climate change to deal with environmental sustainability issues after being criticized by environmental groups in the country for encouraging industry without due regard to sustainability.

The crucial gap therefore is in the missing capabilities to engage in developmental strategies that require the disciplining of capitalists. As in the rest of India, the onus in Gujarat is on attracting investment rather than enhancing productivity. Sinha has called the Gujarat government 'statist' (Sinha 2004a). While she is right in that after liberalisation 'subnational institutions' have become more important it is largely to ensure that industries find their respective states attractive to invest in (Sinha 2005). Unlike South Korea where Park Chung Hee could withdraw subsidies from chaebols if they did not meet performance targets, no Indian state, including Modi's Gujarat has demonstrated the capability even to retract an invitation to invest if a company does not agree to particular conditions. It is worth considering a counter-factual scenario. Would Tata Motors have chosen Gujarat over other states like Maharashtra and Tamil Nadu, both popular with auto investors, if Gujarat had attached significant conditions about production, employment or exports to their subsidy to attract the investment to the state would Modi's administration have been able to enforce these conditions? It is an interesting development that the private sector in India continues to need the help of the state after liberalisation but in terms of meeting developmental conditions (such as technological progress, exports, employment, backward and forward linkages, or welfare conditions) there appears to be even less of a willingness or capability to enforce than before.

Describing Gujarat as a 'developmental state' is questionable if we use the conventional definition of such a state as one that has the capacity to both support and discipline its emerging capitalist sector. Gujarat offers many incentives to its manufacturing sector, but there is no indication of any formal or informal targets for investment in capability development (learning) or in R&D. For instance, in the early 2010s, 28 percent of India's pharmaceutical exports originated in Gujarat.

Pharmaceutical units in Gujarat accounted for 40 percent of the Contract Research and Manufacturing Services (CRAMS) from India. These are impressive figures in their own right and Gujarat is home to many large domestic pharmaceutical companies like Sun Pharma, Torrent and Cadila and Contract Research Organizations (CRO) like Lambda Therapeutics and Synchron. However in all these cases, and this would be true for most of India's large pharmaceutical companies and CROs, production is restricted to generics and for the CROs their activities are restricted to providing clinical and pre-clinical research services to the pharmaceutical industry. Both sectors need high R&D expenditures to move further up the value chain for new drug development or proprietary research. However domestic pharma companies spent just 4.5 percent of their sales on R&D, much lower than the global average of 15 percent and far lower than developed country averages of 20 to 45 percent. Neither the central government nor any other state government had policies compelling pharmaceutical companies to increase their R&D intensities (percentage of sales spent on R&D) and this includes the apparently developmental Modi administration. Moreover, given that the owners of the large drug companies in Gujarat, especially Torrent, had close links with the Modi government, the absence of any policies to steer the pharma sector to higher value products or research is noteworthy. In fact Torrent was provided discretionary support when it moved into power generation with an over 1000 MW power project near Surat in Gujarat, a diversification with little link to pharmaceuticals. The Group has since had to make for the Adani Group but remains one with close links to Modi. Given the nature of business government relationships in India as outlined in Chapter Four it would be difficult, indeed foolhardy on Modi's part to attempt any disciplining.

Modi is arguably even more limited in his ability to discipline the larger industrialists in the state like Adani and the Mehtas of Torrent as they provided invaluable support to Modi in the immediate aftermath of the riots in 2002. This was explicitly mentioned by all the sources interviewed in Gujarat. The premier national industry association in India the Confederation of Indian Industry (CII) had condemned the riots and the role of the Modi administration in the strongest terms when the

Gujarati capitalists came to Modi's aid threatening to form a rival regional association. For all its good intentions CII could not afford to lose a state chapter which was one it's most dynamic and important and had to make its peace with Modi. A senior journalist when questioned about the evaluation of Modi's administration as a developmental one replied it was not possible for Modi to be developmental (the reference being the South Korean type of developmental state). He argued that despite his outer image of strength at one level 'Modi remains beholden' to these industrialists, especially Gautam Adani, and it would be almost impossible for him to impose any productive compulsions on them or impose any conditionalities attached to the support they were receiving from the state. The rise of the Adani Group bears this statement out. According to one of our other respondents, a businessman with interests in Gujarat, large tracts of land near Mundra port were allocated to the group with little or no compensation for villagers losing the land. This is also mentioned in the Economic Times report on Gautam Adani referred to earlier in the Chapter. The SIR Act (referred to earlier) helped Adani amass large tracts of land at throwaway prices with little indication of any productive investments being made on them. In fact most of the investments (to develop a mega city) are in the nature of large real estate projects. This relationship, which could be characterized as a reversible patron client relationship, can scarcely be described as being conducive for capability development. There were no conditions or end results that were identified by the state or that were credibly monitored with plausible sanctions for non-performance. This is important because it is the capacity to support capitalists with effective conditions to achieve capability development that defines a 'developmental state', like South Korea under Chung Hee Park. Modi's policy of providing incentives to his chosen businesses was effective in attracting investments to Gujarat from other parts of India, but this support did not come with conditions and governance capabilities that could ensure new capability development in key sectors like automobiles and pharmaceuticals. On the contrary, Gujarat offering incentives to businesses to relocate to Gujarat is closer to the 'race to the bottom' identified by Sachs et al (Sachs, et al. 2002) as this type of support without conditions had a largely relocating effect within India than one of net capability development for India.

Modi's carefully projected image of bureaucratic competence and leadership is based entirely on being investment-friendly. That is not likely to be sufficient to make the state a growth model along East Asian lines. It is also worth noting the status of Gujarat's Muslims at this juncture. The Sachar Committee set up by the government of India to assess the status of Muslims in India mentions Gujarati Muslims as having one of the highest per capita incomes among Indian Muslims. The average is affected by the incomes of a section of prosperous Gujarati Muslims. However, the vast majority of Gujarat's Muslims live in ghettoes that have become even smaller and more disconnected since the riots. They have access to few economic opportunities and would certainly be reluctant to become part of the Gujarati 'asmita' movement given their recent memories of being targeted by the BJP. The BJP government in Gujarat and Modi still have some way to go before they can be labelled developmental, if at all.

5.5 Conclusion

Gujarat's progress from a region that was mainly a rag tag bunch of princely states at the time of independence to become one of India's most industrially developed states has been remarkable. The legacy of colonialism in the region was to create a well-defined business-oriented intermediate class. The leadership of Patel also ensured that the various parts of Gujarat were relatively smoothly merged after independence. In its early years the region remained a part of Bombay state but a linguistic movement by Marathi speakers ensured that the state got bifurcated into Marathi speaking Maharashtra and Gujarati speaking Gujarat in 1960. The initial reaction of most Gujarati businessmen was not in favour of the bifurcation as their commercial interests still lay in Bombay. However the prospect of a state that they could now exclusively call their own soon saw them in favour of the separation.

The early Congress years laid the base for Gujarat's current industrial growth. The Congress government's focus on developing the Bombay-Ahmadabad corridor ensured the creation of significant industrial clusters in the area. Again being a Congress-ruled state Gujarat had good relations with the Congress ministers at the centre. Leaders in the late 1960s like Morarji Desai were influential both at the state and central level and helped the state get significant public sector investments. The discovery of oil meant the state got investments in refineries and petrochemicals projects. This ensured the state reaped the benefits of developing the manufacturing capabilities required for heavy chemical-based industries. Downstream industries like chemicals and fertilisers made the state's industrial base richer. Initial investments by the public sector started delivering results when some of the more successful corporations like the Indian Petrochemicals Company Ltd were privatised after liberalisation. In power generation significant capacity addition occurred during the last years of Congress rule. In agriculture, investments in the dairy sector in Gujarat were driven by a cooperative movement that saw India achieve self-sufficiency in milk production. In terms of political mobilisation the state did not see much 'lower' caste mobilisation though a sizable community of 'lower' castes, the Patidars, gained upward mobility through agriculture. The Patidars were never in tune with the Congress' socialist policies preferring the Swatantra Party's more conservative programmes. This was the reason why the BJP found it easier to co-opt the Patidars into their fold. Communal tensions had always run high in the state and sporadic clashes or riots were common. Ahmadabad, with its specific Muslim localities was more susceptible to riots. If initially the violence was instigated by both communities in the later years there are far more instances of Hindu aggression, especially with the growing strength of the BJP.

An unsustainable alliance of caste groupings that was not compatible with the actual distribution of power in the state led to a Congress defeat and the vacuum was filled by the BJP which was waiting in the wings. The communal politics being played out in most of the country had its effect on Gujarat as the BJP and its allies started pushing their Hindutva agenda in an already receptive state. Their master stroke was to co-opt the tribals in a mobilisation against sections of the Muslim population. The display of control over violence in a context where the distribution of power across organizations was already very favourable created a cohesive ruling coalition facing weak opposition. In Gujarat Modi's writ within the BJP and over the administration was supreme but as we have seen, he lacked the ability to impose the same strictures on business in his negotiations with them.

It would not be farfetched to say that championing industrial growth and making sure industry received the best possible support was partly Modi's answer to his detractors. While Modi can take credit for running a superficially non-corrupt, streamlined bureaucracy that investors find easy to deal with, giving his administration much of the credit for Gujarat's industrial growth is to ignore the historical trajectory of Gujarat. The Congress had already laid the basis for this growth and Modi added to it through his own policies, but he was not solely responsible for Gujarat's strong industrial performance. Creating the enforcement capability that allowed pro-business rent allocations to be implemented was Modi's main contribution. Yet Modi's dependence on prominent Gujarati business groups was also a feature of the new inversion of patron-client relationships between business and government in India.

Finally, Gujarat was also a huge beneficiary of liberalisation. The decision of the union government to privatise some utilities helped the state's exchequer as did the central government's decision to allow private and international companies to bid for the exploration and production of oil and gas. Gujarat's natural endowments have played a vital role in ensuring its investment rates remained healthy. The Godhra incident is not central to our analysis as much as the process that led to it and the signalling effect it had in establishing the enforcement capability of the ruling coalition. By targeting a section of the population that was weak to begin with, Modi achieved the *projection* of authority at relatively low cost to his coalition. But it was only possible for him to do so because the distribution of power in the state was already conducive. Other BJP ruled states have not attempted anything quite as sinister. Perhaps the true test of the sources of Modi's enforcement capability will only come if he is tested in governance outside his own constituency in Gujarat.

Chapter 6 . Tamil Nadu: Growth in the Time of Clientelism

SUMMARY:

Tamil Nadu enjoyed high rates of growth both before and after liberalisation due to a combination of factors that allowed its two main political parties to create and allocate rents in ways that enhanced productivity and competitiveness. Tamil Nadu's populist redistributive politics has its roots in a nativist ideology. The competitive clientelism in the state keeps within the bounds of broadly 'live and let live' strategies because both parties share a common ideology and mobilize almost identical social groups. The result is a form of competitive clientelism that achieves a cycling in and out of the two parties in successive elections. The paradox of Tamil political economy is that despite its competitive clientelism, it remains one of India's most industrially advanced states. We argue that while their common ideological history appears to make the competition between the two parties intense, their common ideological ancestry and the similarity of their constituencies means they do not have widely divergent policies. Their rent creation strategies included support for industrialisation and these strategies remained stable despite parties cycling in and out of power, allowing a steady rise in industrial investment and capability development.

The challenge for Tamil Nadu is to sustain its industrial growth as political competition leads to the risk of its two party system fragmenting and even the possibility of increasing violence affecting stability. We focus on the state's auto component manufacturers who grew under India's former dirigiste regime by establishing links with the ruling parties and continued to grow after liberalization by upgrading productive capabilities. This required policies to promote learning and technological upgrading and entrepreneurs played a proactive role in driving this industrialisation. Tamil Nadu's experience shows that capability development strategies for manufacturing are possible in the context of competitive clientelism.

Section 6.1 provides a history of Tamil Nadu focusing on the 'Self Respect' movement that led to the creation of the two Dravidian parties. Section 6.2 outlines the circumstances under which the Dravidian parties won elections in the state and came to stay in power. Section 6.3 analyses how the two parties negotiated with the Congress/BJP ruled centre to consolidate their hold over the state. Section 6.4 outlines how the political configurations and rent management within the state affected growth outcomes. Section 6.5 provides an explanation of the how the political settlement in Tamil Nadu helped capability development. Section 6.6 concludes.

Introduction

Tamil Nadu (Figure 6.1) along with Maharashtra and Gujarat is one of India's top three states in terms of economic performance. It was formed in 1950 and was once part of the erstwhile British province called the Madras Presidency. Even at the time of India's independence Tamil Nadu had a well defined 'national' identity based on a culture distinct from the rest of India. This identity still plays a part in the politics of the state. The state's highly mobilized and competitive politics is based around a nativist ideology promoted by political leaders who have been 'stars' in the state's thriving film industry. Anecdotally, the state is also known to be one of the more corrupt of the larger states in India. As a retired senior bureaucrat who has worked both at the state and at the national level says "Politics in Tamil Nadu is big business". Given this profile one would not expect this state to be one of India's best performing states in terms of economic performance. In terms of its HDI it equals Gujarat and betters it in terms of attracting FDI. As in the Gujarat chapter, we discuss how the ruling coalition was constructed in Tamil Nadu and the types of rents it used as a survival strategy, which consequently impacted investment and technology adoption strategies in the state.

Tamil Nadu's fragmented political organizations are typical of the competitive clientelist variant of patron-client politics described in Chapter three. The state's political settlement has evolved into one where two large parties cycle in and out of power in successive elections. The party that wins has also done so with a substantial majority since 1989. The avoidance of political logjams due to disputed elections and the emergence of a 'live and let live' policy between the ruling coalition and opposition organizations have contributed to high levels of growth. These features make Tamil Nadu untypical as a competitive clientelist polity. The configuration of power and the allocation of rents that contributes to this are therefore of significant interest, with implications for other developing countries. Indeed understanding these processes may be very useful for identifying vulnerabilities in Tamil Nadu's own growth strategy in the future. Whichever party is in power, the management of a large industrial investment is looked upon as a channel through which to create rents for political parties and key individuals within the parties. The assurance of cycling reduces the incentives for the opposition to block these investments or to overturn them when they come to power. At the same time the fact that this cycle has continued since 1989 without the incumbent reneging on any large industrial investment negotiated by the previous government seems to have provided investors with the confidence that their property rights will be protected. This is one of the reasons why the state sees a high level of industrial investments despite the clientelistic nature of the political settlement.

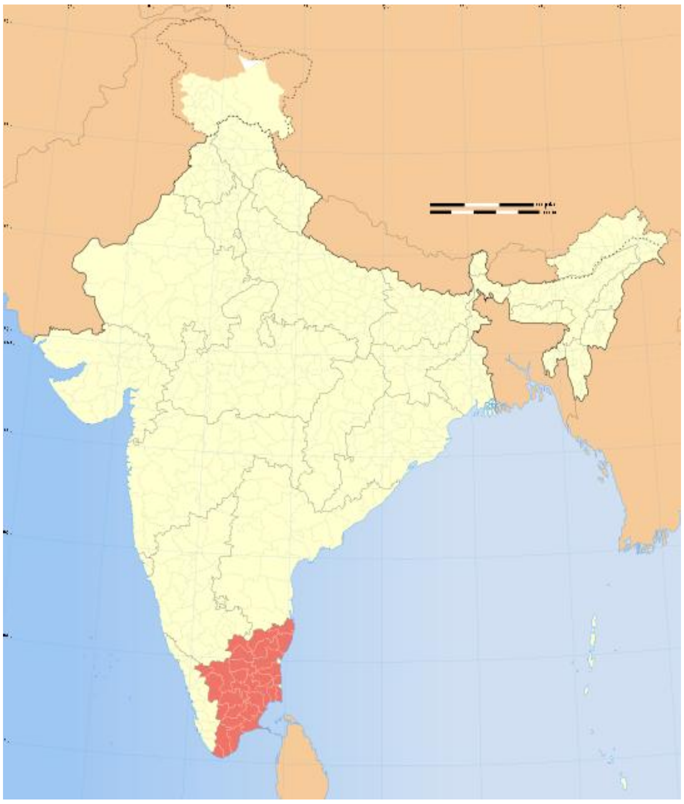

Figure 6.1 Tamil Nadu- one of India's southern-most state

Source: http://commons.wikimedia.org/wiki/File:India_Tamil_Nadu_locator_map.svg

The configuration of power that allows a cycling in and out of two alternative ruling coalitions has not just led to high investments but also affected the kinds of technologies the state has acquired and strategies of capability development. This is particularly interesting because the link between competitive patron-client politics and reasonably well-working government agencies dealing with critical market failures to support a growing business sector is rare in other developing countries and regions within India. What then were the critical features of Tamil Nadu society, politics and institutional structures that help to explain the emergence of these arrangements? Specifically, what institutional or political factors allow relative policy stability in a context of clientelist cycling?

Our focus on political settlements brings to the fore the organization and distribution of power between the major groups and class organizations in Tamil Nadu, and how this affected the efficacy and sustainability of different growth strategies. What makes Tamil Nadu especially interesting is that the two main parties, the Dravida Munnetra Kazagham or DMK (Dravidian Progress Federation) and a later offshoot the All India Anna Dravida Munnetra Kazagham or AIADMK (All India Anna Dravidian Progress Federation) have roots in the same decidedly anti-North Indian, anti-Brahman movement, which in its early stages was also a Rationalist movement. Brahman is the highest 'caste' in Sanskritic Hinduism and its members have historically been implicated in the suppression of lower castes. Caste identities still have deep resonance in Indian electoral politics. Approximately three per cent of Tamil Nadu's population is Brahman while almost two-thirds are 'backward castes' (Wyatt 2002). While backward castes in Tamil Nadu have historically been subservient to the minority Brahmans the social order saw significant changes from the early 20th century and specifically from the 1960s, with significant mobilizations by lower castes and episodes of anti-Brahman violence. These movements led to the rise of the DMK and AIADMK which came to power as backward caste parties. Neither party could ideologically wipe out the other given the similarities in their ideological positions and the relatively small differences between them. This actually helped to moderate the intense competition for rents between these political organizations by ensuring that the party in power did not have the legitimacy to take the battle against the opposition too far. The rivalry between the two parties was therefore focused on the redistribution of largesse to similar constituencies (Ambirajan 1999; N. Subramanian 1999).

This does not mean that political competition in Tamil Nadu is always peaceful. The state frequently witnesses violence between competing segments of the backward castes. Tamil Nadu has the inglorious reputation of witnessing a high degree of violence against 'Dalits', the caste group supposedly below the Hindu caste system and therefore the lowest strata in this ideological system who are often the poorest groups in society. Ironically this violence is often perpetrated by groups belonging officially to the Most Backward Caste (MBCs) denomination in India which is designated just above the Dalits. These conflicts are directly driven by the competition over rents. Dalit mobilization has often posed a threat to the privileges of the MBCs apportioned under affirmative action programmes for disadvantaged castes. In particular, the Indian government uses 'Reservations' to protect a fixed share of public sector jobs for particular backward castes. The mobilization of new groups demanding reservations threatens the share of existing groups.

However Tamil Nadu's Dalits are a more significant proportion of its population compared to Gujarat's Muslims. In Gujarat Muslims are just less than 10 per cent of the population. The percentage of Dalits in Tamil Nadu's population is double that at 20 per cent and have the holding power to pose a credible threat to any ruling coalition that excludes them or uses force to repress them. As a result, violence against them from any quarter is not welcomed by the leadership of political parties, though sporadic and sometimes serious violence does take place against the Dalits, as a segment of the MBCs is a major constituency for the AIADMK. But both parties remain culpable with the violence usually perpetrated by Backward Caste leaders from the two main Dravidian parties contesting the gradually growing material power of sections of the Dalit community. However, the 'growing' power of the latter is relative and has to be seen in the context of the historically abject socio-economic position of the Dalit community. Yet the politics behind the violence in Tamil Nadu is also quite different from that underpinning the violence in Gujarat. While violence of any kind is unacceptable what one observes in Tamil Nadu is a conflict between groups in the lower strata of society whereas violence in Gujarat is 'informally institutionalized' and indirectly supported by the Hindutva ideology of the ruling party as we have described in Chapter Four. Tamil Nadu has never witnessed violence on the scale of the Gujarat riots of 2002. Violence here is the outcome of competitive strategies to establish relative power of evenly balanced groups contesting the distribution of rents. This is a commonly observed feature of contests over the distribution of benefits in clientelist political settlements (M. H. Khan 2010b, 2012f). In Gujarat the violence against Muslims was not directly driven by competition over the relative distribution of rents. Rather, violence was unleashed against a much weaker group in society precisely because it would not be able to retaliate, allowing the ruling party to signal its control over violence that helped it to consolidate 'authoritarian clientelism' as discussed in Chapter Five.

Table 6.1 Tamil Nadu Economic Characteristics

Population 2011	72.14 million (India 1.24 billion)
Gross State Domestic Product 2011-12 at current prices	USD 104.6 billion
Per capita Net State Domestic Product at current prices 2010-11	USD 1640 (India USD 1509)
Capita Output Ratio 2009-2010	2.25 (India 2.32)
Gross Fixed Capital Investment 2011 % GDP 2004-05 prices	19.8% (India 32%)
Net Value Added Factory Sector 2009-10	USD 12.9 billion
Share in All India Employment 1980-81 to 2007-08	13.1%
Percentage of population below poverty line (2012)	17.1% (India 22%)

Source: Various (GoI Census 2011), (MoSPI), (CSO, Respective State Governments), (ASI, 2009-10), (NSSO 66th round), (Planning Commission of India)

Tamil Nadu is one the leading industrial states of India along with Maharashtra and Gujarat. One of the country's three main automotive manufacturing hubs is based in the state capital Chennai (the other two being with Pune in Maharashtra and the National Capital Region around New Delhi) and the state was ranked fourth in terms of attracting FDI between 2000 and 2012 (Figure 6.3). While Maharashtra and Delhi historically attracted over 50 per cent of FDI flows in India Karnataka was also attractive for high quality IT-related investments around Bangalore, which had emerged as a global IT hub. Though the FDI figure for TN over this period is relatively low (USD 9.72 billion) its position in fourth position remained consistent. The FDI it received was also in manufacturing sectors with spillovers for employment and skill development. As we see in Table 6.4 later in this chapter, over 30 per cent of the FDI in Tamil Nadu was in high productivity sectors like auto, IT-related and pharmaceuticals, in contrast to Gujarat where chemicals and petrochemicals accounted for just under 50 percent of FDI between 1991 and 2011. FDI in Gujarat over this period totalled USD 8.53 billion placing it in fifth position behind Tamil Nadu.

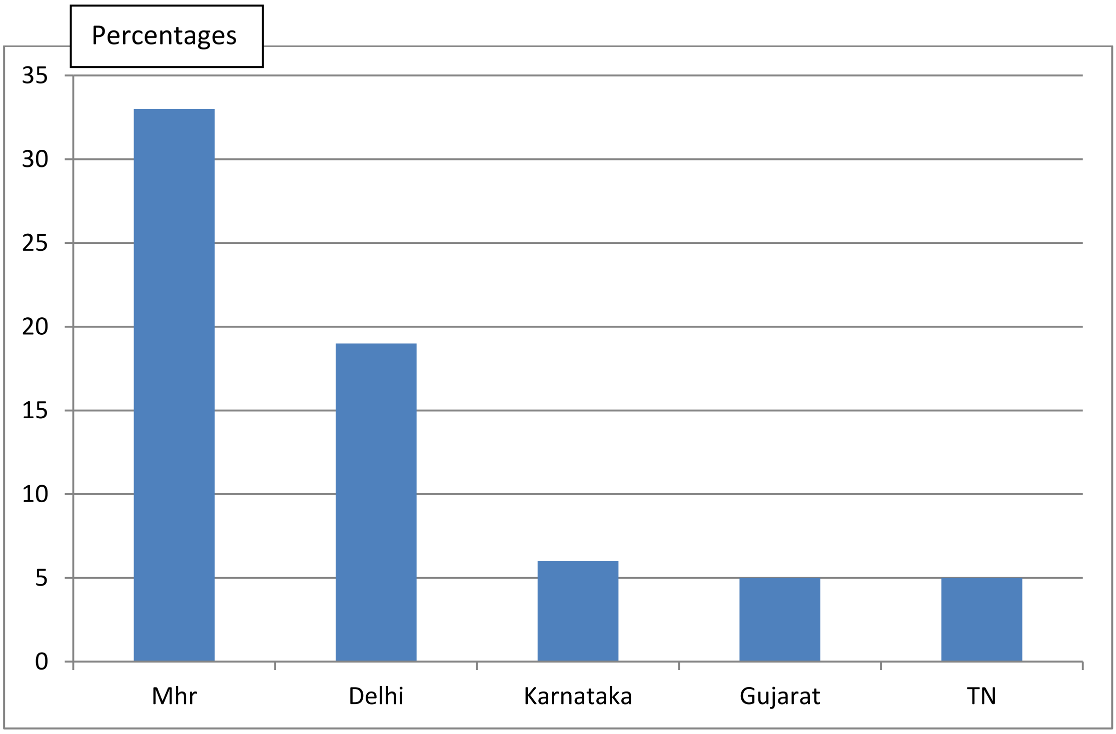

Figure 6.2. FDI in Indian states 2000-2011

Source: (Mukherjee 2011: Table 2)

Note: Mhr is Maharashtra

The growth rate of per capita incomes has been consistently trending upwards (Table 6.2) and per capita incomes have been higher than the Indian average (Table 6.1 for the 2013 figures). While Gujarat has been described (misleadingly in our opinion) by some Indian commentators as a model of good governance, it would be even harder to make that claim for Tamil Nadu. The Tamil Nadu case is interesting for examining the relationship between institutions and political configurations driving growth in a context of high levels of corruption and clientelism. Liberal economics models applied to India often miss the critical differences between states and attribute national growth outcomes to economic liberalization and India's somewhat higher than average scores on good governance for its level of development (Basu 2003; Panagariya 2005; R. Rajan 2006). In reality, growth across states in India has varied widely and has been driven by very different factors in each case. In particular, political and institutional arrangements have varied significantly across Indian states.

Table 6.2 Tamil Nadu Net State Domestic Product per capita growth rates at constant 1980-81 USD

Years	NSDP per capita growth rates
1961-70	0.0
1970-80	1.6
1980-90	2.9
1990-2000	4.6
2000-10	6.2

Source: Based on EPW Research Foundation Statistics, State Level Domestic Product Data, 1960/61 to 2007/08.EPW data

Tamil Nadu's political settlement contrasts with that in Gujarat along a number of dimensions. In contrast to the dominant party in Gujarat, over the last two and a half decades the ruling coalition in Tamil Nadu has been one or other of the two main parties in short-lived governments that have always been thrown out at the next election. The two principal parties, DMK and AIADMK, are divided by their claims of being closer to their shared founding ideology. In reality they are of course clientelist political organizations based on the informal distribution of rents within their organizations. In a competitive clientelist political settlement, there are too many political organizers with powerful organizations and rent demands to be incorporated within a single party. This makes the levels of contestation and competition for recruiting organizers within the party organizations more intense. The intensity of the conflicts over interpretations of their founding ideology reflects this, but the similarity of their ideologies also moderates their strategies because neither party has the legitimacy to try and wipe out the other. Indeed the intensity of the ideological conflict between the two parties has decreased dramatically over the last three decades. Says a senior academic based in Chennai “Nativist politics did make this state initially but the contemporary adversarial nature of politics is largely about posturing and populism”.

We will see that the roots of the shared ideology of the two parties are in a pre-Aryan Tamil nationalism that was also violently anti-Brahman. Over time this has morphed into a more anodyne populist and left-of-centre politics. Politics therefore frequently has a populist colour in the state, as in many other Indian states perhaps with the exception of Gujarat. This is not to say that there are no populist schemes of the BJP in Gujarat but most of them have now become formal state-sponsored welfare schemes whereas in other states including Tamil Nadu, some or much of the populism works through informal rent distribution processes. In Tamil Nadu’s case populist schemes include the distribution of gold ‘thalis’, which are traditional symbols of marriage for Hindu women in south India, and free rice and mineral water to families living below the poverty line, over and above formal welfare schemes. Given this background it would not have been surprising if the state’s industrial trajectory had been similar to West Bengal where the Communist-populist ruling coalition sometimes adopted populist polices in the 1980s and 1990s to the detriment of industrial growth. So it is interesting that Tamil Nadu despite its competitive clientelism and populist politics including informal rent allocations managed to sustain high levels of industrial development. The key to this has been the relative stability of policy due to the specific distribution of power between the ruling coalition and currently excluded political organizations in the state. It is this configuration that we will analyse more deeply in the chapter.

In Figure 3.2 in Chapter three we located Tamil Nadu in the quadrant for competitive clientelism. This reflects the fact that political organizations outside the ruling coalition are strong and as related to that, the lower level organizations within the ruling coalition are also strong because they always have the credible option of leaving and joining the opposition. Compared to Pakistan with its increasingly powerful and fragmented excluded organizations, Tamil Nadu is not as far to the right in the diagram, implying that excluded organizations are only moderately strong and in any case use 'acceptable' mechanisms of political competition. This is one reason why the state maintained relative policy stability despite electoral cycling and competitive clientelism. This feature of Tamil Nadu's political settlement also ensured that successive governments would not overturn contracts and investments agreed upon by the previous government. As a result, large Indian industrial houses and multinational corporations flocked to the state over the years. Historically, when Congress was a dominant party in the 1960s, the state had already been pro-business in its development policy. With the rise of the more populist Dravidian parties (Dravidian refers to a pre-Aryan indigenous culture in the Indian peninsula) industry did not retain its primacy, but policy did not become anti-business either. As a result investors were confident of bringing in and investing in technology-intensive sectors despite their long gestation periods of investment and learning. In particular, business organizations that needed policy stability but were already competitive and needed relatively little government support to become profitable were attracted to the state. For instance, in the mid-2000s, Tamil Nadu accounted for 21 per cent of passenger car production in India and 33 per cent of commercial vehicles (Aya and Siddharthan 2007). It also had a significant electronics industry. Clearly, the state has the policy credibility to attract moderately large, high technology investments even though it did not have the reputation of having a centralised administration as in Gujarat run by an 'efficient' leader.

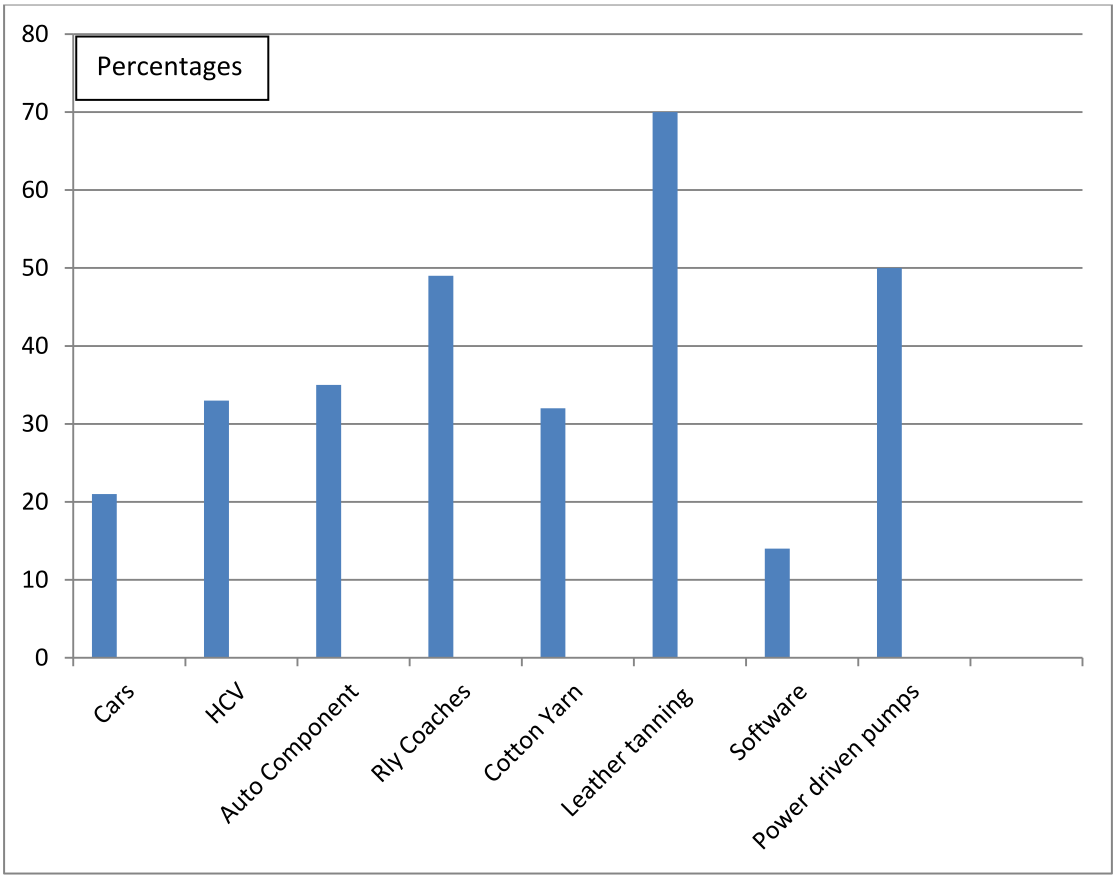

Figure 6.3 Contribution of some significant sectors in Tamil Nadu to the Indian manufacturing sector in 2008 (all figures in percentages)

Note: HCV stands for Heavy Commercial Vehicles
Source: (IBEF 2008)

Gujarat scores higher than Tamil Nadu in attracting even longer gestation projects like infrastructure projects, power generation and private ports. The time horizon for recovering investments in infrastructure projects like ports is typically much longer than that required for investments in electronics or autos and therefore the former require the state to credibly honour contracts over a longer period. Hence we do observe a significant difference in the sectoral industrial profiles of the two states. During the course of our fieldwork interviews a common response was that whichever party was in opposition was careful not to damage investor confidence. A number of significant respondents reported a tacit agreement between the two parties whereby the opposition would get a portion of the rents coming from new investments. Secondly opposition to projects or changing contracts *ex-post* would threaten investments when that party expected to be in power, thereby affecting the flow of rents.

his implicit contract between the two parties in the competitive clientelist political settlement solved a number of credibility problems facing investors about the predictability of policies and the enforcement of their own contracts with the state over time. The live-and-let-live compromises in the organization of political competition and the informal rent sharing arrangements between the political parties at the highest level therefore served as an informal institutional structure that guaranteed continuity and provided credible commitments about contract enforcement to investors. However, the time horizon of credibility in contracting was limited to confidence that the next government was unlikely to make fundamental changes but the system itself faced vulnerabilities. This meant that the rent management institutions in Tamil Nadu could not offer very long-term contracts with high levels of credibility. This can help to explain why in the case of infrastructure investments, Tamil Nadu did not perform as well as Gujarat. Nevertheless, the informal rent management institutions offered sufficient stability and credible short-term rent allocations that were sufficient to attract high capability companies that were already close to the competitiveness frontier in sectors like automobiles and later electronics. Capability development in the former had largely happened in the industrial policy era when Congress was the dominant party, and then in the 1980s in the early stages of the transition to competitive clientelism when the Maruti-Suzuki venture was organized (M. H. Khan 2009b).

In 2007 Tamil Nadu's share of installed capacity in the auto components sector in India was 32 per cent and three Chennai based groups TVS, Amalgamated and Rane accounted for 22 per cent of India's auto component production. Chennai has also emerged as India's electronics hardware manufacturing centre with companies like Nokia and Flextronics setting up some of their biggest manufacturing units here. It is particularly significant that Tamil Nadu achieved these levels of industrial concentration in relatively high technology sectors without the natural resource base of Gujarat and without the centralized political administration that a dominant party can offer. As we see in Figure 6.2 Tamil Nadu's share of engineering based industries like cars, Heavy Commercial Vehicles (HCVs) and auto components is substantial given that its population in 2011 was 5.8% of the Indian total (Table 6.1). The presence of industrial clusters in Tamil Nadu for small engineering (power pumps), ready-made garments and cotton yarn is also substantial providing broad-based employment opportunities. In contrast, in Gujarat relatively largest sectors are in capital-intensive activities like chemicals, petro chemicals and energy much of which also exploits Gujarat's natural endowments and particularly oil reserves (Figure 5.2, Chapter Five).

As in Gujarat, the ruling coalition in Tamil Nadu was able to offer incentives to particular investors by offering a series of upfront rents. The difference with Gujarat was in the nature of the business-government relationships through which large business houses maintained close links formally and informally with the government. As Gujarat had a dominant party system for over 15 years, links between privileged business houses and the Modi administration were uninterrupted and therefore deeper. In Tamil Nadu business houses have had to deal with a different ruling coalition every five years since 1989 and therefore did not have the kind of uninterrupted access to the administration as in Gujarat. Nevertheless, credible relationships that provided upfront rents to attract investments, followed by enough of an assurance that policies and contracts would not be immediately challenged by a new government attracted high capability companies that were already competitive or close to achieving competitiveness. These were precisely companies in sectors like autos, auto components, textiles and leather where capabilities had already been developed in the pre-liberalization years and in the 1980s when liberalization was in its very early stages.

The roots of the original Dravidian movement in the region in the early 20th century were in an emancipatory politics based on rationalism and an attempt to redress the exclusion of backward castes in Tamil society. However, the politics of the two large political parties that claim their descent from this movement have evolved to become largely populist and clientelist. Leakages of public resources are used by both parties as informal rent allocations to support large party organizations. In fact industry and employment generation stagnated under the Dravidian parties, especially under the DMK (from which the AIADMK later broke away) in the 1980s as a result of these populist strategies. Some of the redistribution happened through formal populist schemes like the Mid-Day Meals scheme which we will discuss later. This scheme became one of India's most successful redistributive welfare programmes. Implementation of such schemes encouraged even greater mobilizations of the state's already relatively well-organized lower castes, in stark distinction from Gujarat. These mobilizations had repercussions for the survival strategies and legitimacy of the ruling parties. In order to maintain their legitimacy both parties had to vie with each other in devising and implementing welfare schemes and populism was a mechanism for achieving political stability and became an accepted and necessary part of the institutional distribution of benefits in the Tamil political settlement.

It was precisely because the legitimacy of the ruling parties depended on their ability to deliver populist redistributive schemes that both pursued these policies, but the latter also led to a slowdown of growth and growing unemployment in the 1980s. The necessity of combining redistribution with growth led both parties to adopt proactively pro-industry positions in the 1990s. India's liberalization reforms happened at a serendipitous moment for Tamil Nadu which could now make use of its high capabilities in engineering industries and in incipient industrial clusters like autos, textile and leather. Some of these capabilities were based on industrial location and licensing decisions of the industrial policy period, but some were based on the state's strong performance in education. The state not only has one of India's highest literacy rates but also houses some the highest numbers of tertiary education institutes in India, especially private engineering and medical universities.

The Government of India ran the Indian Institute of Technology in Chennai. This institution is at the forefront of technical research in India that is of global standards, and in these areas Tamil Nadu is ahead of Gujarat. While most of the private colleges do not provide standards of education commensurate with the needs of cutting edge technology they have nonetheless helped create a pool of human capital that finds employment in the state's fast growing IT and information technology enabled sectors (ITeS). Thus, 37 per cent of the state's engineering graduates specialize in communications, IT or computer science. The accelerated development of private educational institutions is also an accidental result of another rent management strategy which provided party supporters with land to establish educational institutions that are often looked upon as lucrative business opportunities in the state. In other instances party supporters were granted liquor 'licences' and these were usually sold on for high profits. Some of these rents were subsequently channelled into the education sector. The rise in the high technology service sector exports from Tamil Nadu is in part a consequence of these public and private investments in education. This is an example of the argument in Chapter Two that the outcomes of rent seeking are more important than the immediate costs.

One of the vulnerabilities of the political settlement in Tamil Nadu is that it is subject to fragmentation from endogenous processes of political competition. Clientelist parties typically have dynastic and personality-based leaderships. The formal institutionalization of clientelist parties is difficult because these are coalitions of sub-organizations and every sub-organization is threatened if a leader identified with a particular sub-organization is elected to lead the whole party. The clientelist party structurally requires a leader who can act as neutral arbiter in its internal rent allocation contests and a dynastic leader is usually the most acceptable to all the internal factions. But this also means that inter-generational change can be contested and lead to a fragmentation of the party when there a multiple siblings or relatives claiming the succession. In addition, changes at the all-India level have resulted in a change in the types of rents that are available to important coalition partners in states. We will see that Tamil parties have been able to access very large centrally allocated rents with ease in the context of providing support to national coalitions in Delhi. This too has had an adverse effect in reducing the importance of managing state-level industrial rents with care. By the 2010s, the state began to face capability constraints in its manufacturing sector and neither party had a rent management strategy to address this problem. The constraints were not just at the level of the supply of skilled personnel being produced by educational institutes. There was also the challenge of financing new waves of learning-by-doing in capability development to move up the quality and technology chain in sectors like auto components. In both areas rent-management strategies were falling short of addressing the constraints. This problem is particularly acute in Tamil Nadu where the bulk of manufacturing is competing in globally competitive markets. In Gujarat the manufacturing specialization is somewhat different and enjoys greater entry barriers against global competition but even there the challenge of learning and capability development for developing new competitive sectors is likely to affect the sustainability of industrial growth.

6.1 From an Ancient Civilization to Politics of Populism

6.1.1 A brief history of Tamil Nadu:

Like much of southern India Tamil history has been marked by linguistic and cultural differences from northern India. Even while Sanskrit was developing as one of the classical languages of the Indo-European languages group, the Tamil language was developing as an independent linguistic entity in the family of Dravidian languages. Evidence of a cultural region called 'Tamilakam' encompassing much of modern Kerala and Tamil Nadu comes from an ancient body of Tamil literature called Sangam. The Sangam is essentially a collection of heroic poetry with historians dating the work from the first century BCE to the sixth century CE. Non Tamil inscriptions from the era like Ashokan rock edicts also confirm the existence of this region called Tamilakam with five independent states. Archaeologically the Sangam era is said to correspond with the late Iron Age to the Early Historic period or 300 BCE to 300 CE (Abraham 2003). At various times this literature has often been invoked by Dravidian parties as an example of the difference between north and south India. While this was often used to prove populist political points the instrumentalizing role played by the Tamil language through mobilizations that began in the 19th century have ensured it centrality in Tami politics (Ramaswamy 1993). Sanskrit did indeed have a role to play in society in south India especially with regard to the adoption the Vedas there is little doubt that Tamil does indeed have a rich literary and cultural history of its own.

By the first few centuries of the Common Era three kingdoms were already organizing territory in what is now Tamil Nadu, the Cholas, Pandyas and the Chedas: and under these kings trade routes were developed between the eastern Mediterranean and south-east Asia. A later dynasty called the Pallavas helped create a sovereign kingdom for the first time in the region (Stein 1998). Later Chola kings helped the kingdom become a naval power with frequent expeditions to the island that now make up Indonesia. It is telling that at no time before the British period in India did any north Indian dynasty rule over the entire southern Indian peninsula. By the beginning of the 14th century the region came under varying degrees of Islamic rule but unlike in the northern part of the country Islam and subsequent Hindu-Muslim communalization played a limited role in the state's politics.

The first colonizing Europeans who evinced an interest in the region were the Dutch who chose Pulicat near Chennai as their base around 1609. The French and the British soon followed. By the middle of the 18th century the Dutch and Portuguese were by and large ousted from India and the south eastern coast of India where Tamil Nadu is situated reflected the rivalry the French and English shared in Europe. Three Carnatic (India's south eastern coast) Wars were fought between the two rival colonial powers and Madras city changed hands between the two during this time. A famed standoff in South Asian history between the brilliant if eccentric French governor of Pondicherry, near Chennai, Francois Dupleix and Robert Clive who could be similarly described from the British side ended with the English winning control. But English and French interference in the south marked the beginning of a policy the British were to later use successfully across India. The policy of divide and rule used by the two was essentially about supporting one Indian side over the other to help consolidate their own rule in the South. The end of the third Carnatic war however decisively ended French rule in India. By the last decades of the 18th century the East India Company was very much in power and the area was deemed as Madras Presidency.

Like Bombay, now Mumbai, in the west and Calcutta (Kolkata) in the east of India the British had developed the port of Madras to be their base in southern India. Similar to those two cities Madras, now Chennai also saw the establishment of British institutions like the judiciary and provincial administration. In fact Chennai was the first settlement the British created in India. The British made investments in upgrading agriculture, especially with regard to irrigation, industry and infrastructure with Madras port becoming the premier port in the south. It would be easy to say that these earlier institutional endowments have made it easier for Tamil Nadu to be the industrial success it is today. However while this history might have helped, attempts to leverage and build on it were attempted only in the post independence era, and not all of it in consciously intended ways. Our framework shows that growth is dependent on the political settlement that determines how politics and in particular the organisation of power interacts with economic institutions. The historical strength of institutions is no guarantee of future growth because as we have discussed in Chapter Two growth is not a linear sum of the effects of institutional variables. A very good example to demonstrate this would be the former first city of the British Raj in India, Calcutta. It was the capital of the Raj till 1912 and the British lavished enough care and attention befitting a 'second city' on Calcutta. By the early 20th century Calcutta and Bengal province of which Calcutta was also the capital were the most industrialized in the country. Yet by the 1970s West Bengal and Calcutta were both in the throes of what is now commonly described in India in as de-industrialisation. Calcutta had similar institutional features to Mumbai and Chennai (except for its riverine port which was silting up as opposed to Mumbai's and Chennai's deep sea ports) yet the ruling coalition of Left parties chose an agrarian strategy of rent creation as opposed to industrialization (M. H. Khan 2009a; P. Roy 2012). Coalitions in Maharashtra (of which Mumbai) is the capital and Tamil Nadu did not at least have antagonistic ties with capitalists. The next few sections will identify the combination of institutional variables that led to the political settlement with its specific growth-stability trade-off in Tamil Nadu.

6.1.2 The origins of the Dravidian movement and a Congress attempt to overcome it in the initial years after independence

Upper caste Brahmans were not the socially dominant force in the pre colonial era In Tamil Nadu (N. Subramanian 1999). It was with the coming of the British and their importance as a 'scribal' class that led to the rise of anti Brahmanism. The Brahmans in Tamil Nadu had knowledge of the scriptures and therefore had an advantage in being educated. Much like the Brahmans of Bengal the British picked them to be their scribes giving them access to government jobs and consequently a level of prosperity the other castes did not have. British social engineering was based on early oriental anthropology and drew its authority from the scriptures. In Tamil Nadu many of the intermediate land owning castes were not Brahmans and when the British were legalizing tradition they relegated them to the lower castes. This was because while they were not Brahmans they couldn't be fitted into the other two warrior and trading castes either as the latter two did not seem to exist in Tamil Nadu, even though most backward castes like the Mukkalathors and Vanniyars consider themselves to be a martial caste. It was due to this reengineering that temple properties also came to be appropriated by the Brahmans as were temple practices. They also dominated Congress politics till the 1940s. The Brahmans had a distinct cultural identity in that they were more Sansrikitized and at least in scriptural terms closer to North Indian Brahmans. Along with their newly minted higher (than in pre- colonial times) political and social status this already existing cultural difference only added to perceptions of their superiority (N. Subramanian 1999).

It was therefore telling that the first two political movements based on anti-Brahmanism were started by the elites among non-Brahmans. The Dravidian Association was formed in 1912 and the Justice party in 1916. The founders of these two organisations were 'anglicized landlords' who were demanding greater representation for non-Brahmans in professional and educational arenas and within the framework of colonial legality. An anti-Brahman movement that was based specifically against their superior caste position vis a vis the Shudra was to come later in the form of EV Ramaswami Naicker, better known as Periyar, in 1926. This was the Self Respect Association and the organisation became the precursor for a nativist movement based on a separate cultural and linguistic identity of non-Brahman Tamils from the rest of India. Periyar is important also because both the DMK and AIADMK owe their ideological origins to him. Several other Dravidian parties like the MDMK and PMK also owe ideological allegiance to Periyar and have often been coalition partners with the two main parties from time to time.

Periyar initially joined the Congress but was disillusioned with Gandhi's 'North Indian Brahmanism' and started the Self Respect Association. Given its avowed anti Brahmanism on the basis of a felt deep social exclusion rather than one that represented non Brahman elite sentiments of exclusion from government jobs the association became a more successful mass movement. Periyar's own attitude to both the Indian union and anti Brahmanism is the subject of many academic debates and not within the purview of the paper. But we will quickly concise a few of his main ideological points in order to understand modern Tamil politics better. Periyar was the first to articulate the 'Dravidas' or those living in the south of India were a race distinct from the north Indian 'Aryans' (though Aryan is not a race but a linguistic grouping). He opposed the Sanskritic caste system on the basis of hegemonic North Indian Hinduism and went so far as to demand a separate Dravid homeland or Dravida Nadu, as a separate entity from independent India. His views on religion were also heretical and iconoclastic though his attitude towards the Scheduled Castes of India (SC) or lower castes and Tamil Muslims and Christians remained ambivalent. The essence of his ideology was the primacy of the Shudra caste or the lowest of all castes according to Brahmanical Hinduism (N. Subramanian 1999) It was this aspect of his ideology that the later parties would adopt. His successor CN Annadurai opposed secession at the time of independence and this was one of the reason why he split from the Association (by then called Dravida Kazagham or DK), in 1949 to form the DMK. Periyar's DK was against fighting elections while DMK was a political party ready to seek an electoral mandate. At this time the Congress formed the government in the first general elections in Tamil Nadu, then still called Madras state. The Congress was riding a nationalist wave all across India after independence and this propelled it to absolute majorities in most states. However the party did not get an absolute majority in Tamil Nadu and had to depend on alliances with smaller parties to keep out the DMK and form the government.

However matters started looking up for the Congress in the assembly elections of 1957 and 1962. The Congress government under K Kamaraj introduced a number of schemes for the Backward Classes in the state. Kamaraj himself was the first non-Brahman chief minister of Tamil Nadu and this helped the Congress consolidate its base amongst the intermediate castes in the state. While Kamaraj was not the chief minister over all of the seventeen years that the Congress ruled the state nonetheless received high levels of investment from India's centrally planned economic model. The state became fairly industrialised by the 1950s and received a high proportion of investment in hydro-electric projects because of the abundance of large rain fed river systems in the state. It was under Kamaraj that the state received large public sector investments like the Bharat Heavy Electricals Ltd (BHEL), a heavy engineering company and till today one of the leaders in its sector in India. Tamil Nadu already had established industries like leather and textiles from the British times. A railway wagon making factory was established in Permabur near Chennai that still continues to function successfully. A number of sugar and paper mills were also established under his watch. Kamaraj also successfully negotiated the setting up of the prestigious Indian Institute of Technology (IIT) in Chennai. This IIT became one of the first five prestigious IITs of the country and is today known as the alma mater for some of the best engineers from India, and some would say even be comparable with the best international standards in engineering education. It is worth noting that Kamaraj was a trusted associate of Nehru and this personal equation served the state in good stead.

A quick look at these ministers in the central cabinet and how they helped influence Tamil Nadu's growth in the early post independence period is required now. For instance TT Krishnamachari was minister for commerce and industry, finance and steel for various periods between 1952 and 1965. He was also the founder of the TTK group of industries, a large conglomerate in south India which is now a Rs 1500 crore group. It is a successfully diversified group with manufacturing interests in consumer durables and pharmaceuticals among others as well as in services. The company is headquartered in Chennai and in its early years was certainly helped by the fact that Krishnamachari was himself a part of the government. C Subramaniam was first made minister for steel and mines in 1962 in the union cabinet and then became defence and finance ministers. From the second plan onwards India's five year plans were heavily dependent on investments in capital goods related industries like steel to drive growth. The portfolio of steel and mines is critical here because all Indian states were desirous of getting a steel plant at this stage. Tamil Nadu, despite being deficient in both coal and iron ore received a large investment from the central government in the steel sector—for instance the Salem Steel plant manufacturing special steels, though to be fair it is not an integrated steel plant which requires chiefly iron ore and coal. The politics of industrial location is still hotly debated in India and is not within the scope of this paper directly but 'friendly' central ministers went a long way in influencing where public sector investments went. R Venkataraman was an industry minister from Tamil Nadu who also promoted the state's interests. He later went on to become president of India. A number of licences for manufacturing trucks and heavy vehicles were provided to Tamil Nadu in this period by these ministers (Aya and Siddharthan 2007). As a senior manager in the auto components sector says, "The success of the auto component sector has its origins in this period. Ministers were actually able to pick winners".

In 1967 the Congress received a rude jolt when the DMK won an absolute majority in the assembly elections for the state parliament. There were two key reasons for this. One was the Congress' insistence on Hindi as the official language that led to anti-Hindi riots in 1965. Second was the tenure of M Bakthavatsalam who took over as chief minister from Kamaraj after the latter left Tamil Nadu politics to become the president of the Congress Party at Nehru's request. Bakthavatsalam was a Brahman by caste and did not possess either Kamaraj's political acumen in intermediate caste politics or sensitivity. The DMK under Annadurai effectively mobilised public support even in the latter case and ensured its electoral victory in the assembly elections of 1967. This was a significant event not just for Tamil Nadu but also for India because this heralded the beginning of non-Congress governments to last a full term across the country (A communist government elected in 1957 in Kerala state was dismissed by Nehru in 1959), though the wave of regional party-led governments was still some time away. In Tamil Nadu itself the Congress has never regained power since. The Congress has been marginalised to the extent that it won only five seats in an assembly of 234 in the legislative elections.

6.2 The years of the Dravidian parties, the DMK and the AIADMK:

The watering down of Periyar and the DK's initially strident ideologies (of anti-Hinduism, anti-North India and an opposition of minority religions like Islam, because of its formal ritualistic structures) by the DMK and later AIADMK made the Dravidian movement more fluid and therefore both popular and populist (N. Subramanian 1999) It helped that the central government or centre in New Delhi also made important concessions like granting a separate Tamil state on a linguistic basis and backtracked from making Hindi the only official language along with English. This helped the DMK to 'deradicalize'. It also reflected the true power base of Tamil Nadu, the intermediate castes, as opposed to the Congress support base that represented the Brahmans (Kohli 1998). The primary reason for the creation of the AIADMK was the competition for leadership of the DMK between two of its main leaders M Karunanidhi and MG Ramachandran or MGR after Annadurai's death (Sastry 1974). MGR was one of Tamil cinemas most popular heroes, sometimes hailed even as a demi god by his fans. In fact the third reason for the undivided DMK's unprecedented success was that MGR had sustained a life-threatening injury around the time of the elections and the 'sympathy' votes cast in his favour helped the DMK with its electoral victory (N. Subramanian 1999). In 1973 MGR broke away with his sizable faction based on his image as a socially crusading matinee idol (Pandian 1989). This interplay between the socio-cultural, popular culture and politics in Tamil Nadu and indeed South India has been dealt with extensively in the literature but will not be dealt with in this paper as it is beyond our current scope. However the MGR faction, called ADMK, later the AIADMK, was also able to mobilize groups that the DMK was not focusing on. This included castes like the Nadars and Mukkalathors and the party also appealed more to female voters. The AIADMK has tried to reach out to Dalits but has not been adequately successful as Dalit mobilizations are now beginning to gain independent ground (Pandian 2000).

Taking this analysis further the creation of the AIADMK from the DMK and later the even more caste-coalition specific PMK in 1989 had a two-fold consequence in the way Tamil politics played out. For one the AIADMK incorporated the political aspirations of caste groupings the DMK had neglected and thereby decreased the possibility of any violent mobilization by these groups. The incorporation then led to greater relative stability, at least for two decades despite the fragmentation of the political order. Second this also meant government patronage, whether directly to key stakeholders or through redistribution programmes led to a distribution of resources to groups which would not have otherwise been beneficiaries. Of course such a structure runs the risk of breaking down and becoming detrimental if the fragmentation gets too minute and there are not enough resources to make all breakaway factions happy. This has not yet been the case in Tamil Nadu. Also the breakaway group of the AIADMK commanded enough support to pose a serious threat to the DMK. Later groups like the PMK or MDMK have been too small pose real competition to the two main parties. Stability achieved through this form of mobilisation seems to have actually had a growth-enhancing effect on the state's economy. This could in fact run counter to the claim that nativist policies usually impede growth. A similar conclusion was reached by Swamy when he contended the state’s two party system helped prevent the outbreak of violence (Swamy 1998). The DMK was able to build sizable support among the state’s Muslim population because Annadurai was careful to forge closer relations with the community. It must be noted however that the AIADMK is not uncomfortable with employing the language a ‘soft hindutva’ when the need arises (Schwecke 2011).

Having come to power the DMK was now adept at using Tamil identity from within the confines of formal democracy and this has since become the hallmark of the Dravidian movement. The links between Tamil cultural identity and outright political mobilization has remained muted and somewhat ambiguous since. The AIADMK has also followed a similar strategy since. The core of the DMK’s policies at this stage though remained true to its roots in the Dravidian movement of anti Brahmanism. It was the first state in the country to appoint a ministry for Backward Classes Welfare though ministries for Scheduled Castes existed elsewhere. It appointed a backward Class Commission and raised the percentage of reserved seats or 'quotas' for Backward Classes in educational institutions from 25 percent to 31 percent in line with the Committee's recommendations. By bringing in new more affluent castes in to the category of Backward Class it increased the share of such classes in the population from 41 percent to 51 percent. It also provided 'quotas' for Christians and Muslims who had originally been Hindu Scheduled Castes as well as for Dakhni Urdu speaking Muslims. This ensured consistent Muslim support for the DMK (N. Subramanian 1999). The fact that richer castes were brought into the fold also made the party popular among intermediate classes and in fact laid the base for disenchantment with the DMK on the part of Dalits in the state.

The 1970s was the period that the patron-client politics of Tamil Nadu began to take shape. The DMK used redistribution and more explicit patronage to build up a loyal clientelist base. The DMK government rewarded farmers in the state's northern plains with an expansion of wells and tank irrigation networks. This made commercial agriculture viable for farmers, especially peanut farming. The area of the northern plains was where the party had made initial gains and was now being rewarded for its support. Most of the construction contracts were awarded to party supporters or wealthy farmers influential in the area who could be depended upon to bring with them the support of the villagers. As an example Subramanian mentions NC Ramaswami Gounder, a small time leader from the Vanniyar caste who was lured to the DMK fold with such contracts. In turn Gounder brought with him the support of his extended clan and supporters (N. Subramanian 1999). To go back to our framework this would count as a sound example of how a clientelist political settlement works. As a retired bureaucrat familiar with the workings of Tamil Nadu told us, 'Even if all the roads and tanks did not get built at least some did. And where none existed it is better than nothing'. While it was building its base among the intermediate classes with such instances of patronage the party was also ensuring militant industrial trade unions were immobilized and promoted its own unions, especially in factories where Communist unions were strong (N. Subramanian 1999). The DMK however maintained support for workers' unions after it demobilized the Communist run ones earning it the displeasure of some capitalists in the state. Apart from its base among the richer peasants in the state the party was gradually building a coalition of traders and industrialists in the major urban centres like Coimbatore and Madras hence it needed to stamp out militant trade unionism. On the other hand the DMK made peace with agricultural unions as at this time it was consolidating its base among prosperous caste groupings with ties of traditional kinship among smaller farmers. It was not just easier for the DMK to suppress agricultural unions but also made for better politics of survival. The DMK faced it's most serious threat in 1972 when MGR was suspended from the party's primary membership. While analysts ascribes the schism to both MGR's growing popularity and the fact that he disagreed with the DMK's corrupt practices our analytical framework seems to suggest another line of reasoning.

By the late 1960s MGR had come to realize he was the star attraction for the DMK. His 'fan clubs' used to mobilise support for the undivided DMK, his rallies always registered huge attendance and many had not heard of the DMK but knew it only as 'MGR's party'. MGR started asserting his influence within the DMK as a reflection of his importance in gaining the party votes. Karunanidhi was not willing to grant him the level of authority MGR saw as commensurate with his stature and decided to deal the DMK a body blow (Sastry 1974). He had enough supporters mobilized both within the DMK and outside and by 1972 when the split took place MGR was confident he would be a grave threat to the DMK's dominance and formed the ADMK or Anna DMK. In other words MGR was ready with another large patron-client grouping that could unsettle the political settlement created under the DMK. MGR's mobilization of his supporters into an opposing patron-client faction meant that he was then in a position to significantly change the distribution of benefits within the settlement and this in turn increased the holding power of his faction. This was demonstrated by the fact that the party won a by-election just seven months after its formation. A by-election in India is conducted after a legislative or parliamentary constituency is left empty for some reason (usually the death of the sitting legislator or annulment of an earlier electoral result) and in some cases can be used as an indicator of support for the next elections for the party that wins the by-elections. The DMK employed significant state machinery to thwart the ADMK candidate but the latter emerged victorious. Clearly here we see our framework at work. The ADMK had gained enough traction to hold out against the more powerful ruling DMK and was able to inflict losses not yet commensurate with the ADMK's formal structure. Most of the supporters and campaigners in the ADMK's mobilization programme, and not just for the elections, were students with little experience in politics before the by elections took place (N. Subramanian 1999). By the time MGR won elections in 1977 Karunanidhi had already for almost a decade from 1967 to 1976.

What MGR was effectively doing was taking positions that had a wide enough appeal and which the DMK would have difficulty in claiming. For instance MGR was consciously watering down the anti-North Indian stance of the DMK and making his politics more inclusive to the extent that his supporters even included Brahmans. This combination of political positions was inclusive enough to appeal to those who felt alienated by the DMK's nativism but at the same time appealed to voters who preferred a political opposition with Dravidian roots rather than a Congress which traditionally was weak in Tamil Nadu. Apart from this successful nuancing of political positions the AIADMK under MGR and later his protégé Jayalalithaa Jeyaram was also to become more populist in terms of redistributive politics while it was in power. Given that the DMK had already laid the ground for redistributive politics in the state the AIADMK could only go further. It did so by launching schemes that were based more on handouts and could be delivered more directly to people. For instance AIADMK sponsored schemes included free mid-day meal schemes for children in state run primary schools or providing free rice and in one instance even promising a television set to each household. The effect of such policies was more direct and immediate. The DMK's redistributive policies were based more on reservations for various castes (though the AIADMK by no means abandoned this) or schemes to alleviate unemployment. The mid-day meal scheme however was to become so successful that it was adopted by states across India as an incentive to send children to school (Dreze and Goyal 2003). The scheme's origins are another insight into how redistributive policies if properly targeted can deliver results, however expedient their origins (Harris-White 2004).

The scheme was originally implemented as much to placate one of MGR's and the AIADMK's strongest support base, women. At that time Tamil Nadu was running up a high fiscal burden given the large number of welfare schemes the government was running. The fact that DMK had implemented prohibition laws ensured a significant portion of revenue was lost by the exchequer. The AIADMK reversed prohibition laws to make up for the fiscal shortfall. Liquor licences were introduced and they soon became the largest source of revenue for the state. The liquor industry became one of the fastest growing industries in the state in the early 1980s growing at about 20 percent annually. By 1981 alone the AIADMK government had sold 15,000 licences. AIADMK activists cornered a large share of these and resold them at higher prices, ostensibly garnering funds for themselves as well as the party. In fact one such entrepreneur made enough from pay-offs by selling liquor licences to start a chain of educational institutions across the state. In the midst of this however MGR ran the risk of alienating women who saw the repeal of prohibition laws as inimical to their interests with male members of their household getting access to cheap, legal liquor (N. Subramanian 1999).

The noon meal scheme was one of the most ambitious in scope in the country and was initially launched for six million children between the ages of two and nine. Incidentally the first such scheme was launched in Tamil Nadu when the Congress' Kamaraj was the chief minster but it did not have the scope that the programme had under MGR. By 1984 it was extended to 12 million people and included homeless widows, veteran soldiers and the most poor among Scheduled Castes. The programme also employed many disadvantaged women and members of the Scheduled Castes. The scheme became very popular and remains associated with MGR to this day and had positive effects on the enrolment statistics in the state (I. S. Rajan and Jayakumar 1992). However this scheme was also used to distribute benefits to AIADMK's supporters and once again underscores how development policies cannot be made in a vacuum. It also shows how clientelistic and programmatic politics come together in developing countries. The underlying politics, especially in terms of who the beneficiaries in the patron-client structure are has to be taken into account. When we spoke to interviewees in the course of our research it became clear that the key reason for the extension of the mid-day meal scheme was that it reached out to a constituency the AIADMK was in danger of losing as well providing the party a channel to distribute lucrative contracts to run the scheme among its key supporters. Anecdotal and academic evidence suggests that procurement and distribution associated with the scheme initially provided AIADMK supporters with enough payoffs to keep them loyal (N. Subramanian 1999; Harris-White 2004). Later when the DMK ran the scheme it was similarly used to distribute patronage. In fact the scheme has been attacked by many who feel its aims of providing nutrition are being undermined by the corruption evident in its implementation. The purpose here is not to say that corruption should be allowed to be endemic. It is however an attempt at highlighting that corruption or illegal rent seeking is a structural feature of clientelist political settlements in much the same way as the AIADMK and DMK use schemes in an informal manner to build and sustain their respective coalitions in the absence of a large formal sector through which to channel resources. However as Wyatt has pointed out the fact that while Tamil Nadu politics under the Dravidian parties remains clientelistic both have combined it with 'programmatic politics' aligned with its populism (Wyatt 2013). Unlike recent arguments in some of the literature on India coming from political scientists (Wilkinson 2007; Manor 2010; Elliott 2011) the continuation of clientelism through formal programmes does not imply India is moving towards a post clientelistic phase. It only means that India's political settlement is evolving into one where some programmes at the centre and in some states like Gujarat patron-client interactions are taking place through formal programmes. Even in the case of the National Rural Employment Guarantee Act programme which could be classified as a formal redistributive programme leakages take place on the lines described by Khan (1998) as suggested by media reports from some of India's' leading publications (Mahboob 2010; Times 2012).

A notable feature in the last few decades has however been a whittling down of the difference in redistributive policies between the two parties. It is now more a question of competition between the two. For instance the DMK continued to run the mid-day meal scheme after it came to power given its popularity. While MGR was alive he was the clear differentiator between the two parties and his popular appeal was also higher. With his death in 1987 the gap between the two parties has narrowed even more. "This sort of competitive policy making is the result of the keen ideological competition between the two—who is closer to, or at least perceived to be closer to—Dravidian ideology. So if the DMK builds a tidal park the AIADMK will build an even better one. This can even work to the state's benefits at times", says a successful entrepreneur in IT who relocated to Chennai after many years outside the state. Yet competition between the two leaders is so intense that the leaders of the two parties Karunanidhi and Jayalalithaa (she is known by her first name and hence we do the same) have not hesitated to jail each other when one is out of power. This sort of politics is unprecedented even in India where political rivalry among parties frequently descends into bloody violence. There is an apocryphal story that Jayalalithaa preserved the aluminium plate on which she was served her meals in jail after her arrest in 1997 by then chief minister Karunanidhi. When she came back to power she instructed the jail authorities to serve Karunanidhi in the same plate after his arrest in 2003. Yet despite such bitterness at the personal level instances where the incumbent party has reneged on a significant investment decision made by the other while it was in power have been rare in the state. It is this unique political arrangement that has allowed the state to provide the stability necessary for industrial growth.

6.3 Relationship with the 'Centre', Coalition Politics of Today and the DMK and AIADMK

Given that we are presenting the case study of a state within the Indian federation no analysis will be complete without a discussion on the dynamics between the state and the central government in New Delhi. Tamil Nadu's politics despite being concerned with specific regional factors and dominated by regional parties was also affected by political coalitions making up the central government that the DMK and AIADMK were part of. While the dynamics of national politics did not create a sizable dent during state assembly elections national level parliamentary elections saw the two Tamil parties forge alliances with national parties, especially the Congress and the BJP. By the mid 1980s the Congress' stranglehold on national politics was significantly loosened. The first ever non Congress government was already experimented with in 1977 and though it did not last long, the Congress no longer seemed unassailable. By 1989 India was well on its way to learning to live with coalition governments. Regional parties from across India especially stronger ones like the AIADMK and the DMK were now in a position to dictate terms to national parties with regard to the choice of ministerial departments and as we will see in this section even in terms of pushing their own agenda in return for support to the national party. Depending on who gets a majority for the parliamentary elections in the state either the DMK or the AIADMK wins about 15 to 18 of the 39 parliamentary seats the state has. For a national party that has to cobble together a coalition in order to form the government these numbers regional parties provide are significant.

In 1989 the Congress allied with the AIADMK for parliamentary elections and Jayalalithaa used this alliance to bring down the DMK government in Chennai and the AIADMK won a large majority in the Tamil Nadu assembly elections. This was possible largely because both the Congress and the AIADMK ran a campaign that indicted the DMK leadership of being in collusion with the Sri Lankan Tamil secessionist organization LTTE that was responsible for the assassination of former Prime Minister Rajiv Gandhi. The accusations were never proved but it did help the AIADMK win the 1991 assembly elections. Incidentally more radical elements of the DMK were known to provide tacit support to Sri Lankan Tamils fighting to break away from Sri Lanka but it was never a key ideology of the DMK. However since the Sri Lankan government's brutal crackdown on its Tamil citizens in the north east of the country both political parties in Tamil Nadu have forced the Congress in the centre to be more assertive in its opposition towards Sri Lanka.

The DMK on the other hand tested its national fortunes by being part of a non-Congress, non-BJP coalition government that lasted from 1996 to 1998. This government did not last the full five years of its term but the DMK was already getting a taste of what national presence meant as it had ministers in the national cabinet who oversaw important portfolios (or ministries) like oil and gas and industry. This was at a time when the DMK was not in power in Tamil Nadu but by dint of the fact that it was now a member of the union cabinet it could still influence decisions about the state. This dynamic actually captures the changing nature of the Indian political structure and the balances and counterbalances that have sustained it since the breakdown of the Congress dominated one-party political settlement. From the mid 1970s the Congress was unable to keep up with the growing demands of a population that was beginning to feel some benefits of economic growth and demanded greater participation politically or economically in decision making processes. Industrial licencing had failed both as a strategy for growth and patronage. Intermediate classes were demanding more than the Congress could accommodate (M. H. Khan 2011c). It was from this political churning that India's political space became more fragmented. Interestingly space was not made by offshoots of the Congress but was a result of genuine grassroots movements based on mobilizations that were either ethno-linguistic (Telegu Desam in the southern state of Andhra Pradesh) or on mobilization of backward classes the Congress could no longer represent (like the Rashtriya Janata Dal in Bihar). This was an expansion of the federal Indian political structure rather than a fragmentation though on the face of it might seem like fragmentation given the internecine nature of political battles and ever expanding roster of political parties in India. Yet India has not seen a hung parliament in the last 15 years (three parliamentary elections) and political parties have been able to form alliances that have lasted their terms, a marked change from the turmoil of the early 1990s (though the next general elections in 2014 might well mark a return to unstable coalitions). This could be described as a centrifugal force at play where political mobilizations from the margins of the Congress dominant party system, and not from within it, enlarged the political space rather than fragmentation from within the Congress. This meant a shifting of power from the Congress to regional parties as well as the BJP. With a tightly knit Congress led dominant party system no longer possible the ‘loosening’ did not lead to a damaging breakdown but created a political order that was able to absorb the organizational power of the mobilising coalitions and prevent a collapse. How sustainable this process is depends on how fast factions break away and how effective existing factions are in distributing the benefits of economic growth.

In Tamil Nadu’s case it meant the AIADMK and DMK leveraging their relationship with the two national parties for gains both at the central and state level. For instance the AIADMK joined the BJP-led NDA government with 28 Members of Parliament in Delhi and Jayalaithaa then insisted that the BJP dismiss the DMK government in Chennai. The then Prime Minister Atal Behari Vajpayee refused and Jayalalithaa brought down the government in Delhi by one vote. The DMK was quick to offer support to the BJP soon after to ensure it retained clout in the centre to countervail Jayalalithaa. The DMK became part of the NDA government when elections were held again in but by 2003 it had withdrawn from the government. The next two general elections in 2004 and 2009 saw the DMK with the Congress’ UPA and the DMK extracted a due price for this support by asking and getting plum ministries for Karunanidhi’s associates, especially his family, namely a nephew and a daughter. Jayalalithaa meanwhile stayed away from the NDA perhaps reading correctly that the BJP’s fortunes were not on the ascendant. However an energized BJP under the likely leadership of Narendra Modi seems a formidable threat to the incumbent Congress and Jayalalithaa who is now chief minister of Tamil Nadu will most likely ally with the BJP in the coming national elections in 2014. This is what Sinha calls the ‘partisan route’ where state-level parties use their regional strengths to leverage with the national government for ministries or industrial investments (Sinha 2003). This was apparent when Dayanidhi Maran India’s telecommunications minister during the UPA’s first term, a member of Parliament belonging to the DMK successfully negotiated with mobile telephony hardware manufacturer Nokia and electronics design firm Flextronics to set up their India operations in Sriperumbudur near Chennai. Sriperumbudur has since developed into one India’s most successful manufacturing clusters with companies like Hyundai, (one of the earliest in the area), Ford, Nissan, Samsung and Dell also setting up operations there. A combination of informal compulsions emanating from Maran's ministry to locate the Nokia and Flextronics units in Sriperumbudur, both of which were in sectors in line with his ministries and the already developed manufacturing environment around Chennai helped clinch the deals for Tamil Nadu when other states were also vying for them.

The DMK controlled the telecommunication ministry in both its stints with the UPA though its second term was not as productive for the state as the first. The party was recently divested of the portfolio owing to corruption charges against the relevant minister A Raja. This ministry was more often in the news for conducting undervalued auctions for telecom spectrums to create rents for themselves and other beneficiaries than for any other reason. The core of the controversy is the fact that the licences were provided at deflated prices contrary to ruling market prices and there was no competitive bidding involved in the entire process, a result of the reverse patron-client relationships we have described in Chapter four. Some of these licences were then part-sold at multiples of the original amount. All of this, it is alleged, was arranged in collusion with Raja, a key member of the DMK and a close associate of Karunanidhi's daughter.

The Congress could only watch as the DMK with 18 seats in India's parliament but still the second largest party conducted the affairs of the telecom ministry without much discretion. An analysis of why this was so is provided a former member of the legislature. He says, "Of the two the DMK positioned itself to be more adversarial to the Congress party and once it found itself in alliance with the party in Delhi the ministers from the DMK did not quite know how long they would enjoy power and hence went overboard in their rent seeking. Another reason is that the DMK is also the party with more competing patronage structures (patron-client in our framework) and hence has more powerful functionaries to placate. Rents from central ministries were one of the best ways to fulfil these demands." Most parties recognize that corruption is a part of the system and the Congress itself is no stranger to allegations of corruption, far from it. But most political parties still prefer to be discreet in their dealings because corruption can quickly become an issue that wins or loses elections. When details of the way spectrum was allocated started becoming public it threatened to destabilise the UPA government. The Congress in a show of strength asked for Raja's resignation and instituted an investigation because of which Karunanidhi's daughter and Raja both spent time in jail. Interestingly the DMK continues to be a part of the UPA alliance and Kanimozhi's candidature to India's upper house of parliament was facilitated by the Congress. The DMK's performance has been one its worse in recent history and analysts have put the results down to a sort of fiefdom being run by a now ageing Karunanidhi's (he is 87) family and associates which leaves very little scope of patronage for outsiders. A succession battle seems to be brewing between Karunanidhi's two sons and this is bound to influence the political settlement in Tamil Nadu.

6.4 How the Politics Affected Critical Areas of Institutional Operation

The political processes we outline in sections 6.3 and 6.4 have had very specific growth outcomes in Tamil Nadu's. As we mentioned earlier in Section 3.3 of Chapter three rents can be delivered to patron-client factions and political organizers in many ways including through productive allocation of rents. In Tamil Nadu's case a combination of manufacturing capabilities built during the early years of Congress rule and the opportunities that the Dravidian parties created post liberalization for industrial investments as part of coalition governments at the centre ensured rent allocation in the state remained productive even though the corruption in the state is well documented unlike in other Indian states like Uttar Pradesh or Bihar (Wade 1985; Ambirajan 1999; Harris-White 2004; Vasudevan 2006). This led to higher levels of ancillarization, creation of cluster based industries like leather and textiles as well as a high technology oriented service sector in IT, ITeS and healthcare. Tamil Nadu also has cluster oriented industries like small engineering, leather and garments, investments which can be traced back to its populist politics. The Dravidian parties while being unabashedly populist also had to cater to a very mobilized intermediate class on whom an 'overhang' of Periyar's Rationalist movement still remains. So unlike in Bihar or UP which didn't experience similar movements of socio-economic empowerment but were overtly about political empowerment parties in TN also had to generate employment. Its leather and garments cluster is precisely about that though of course the usual caveats about labour repression have to be kept in mind. So while the two parties were competing on populism they also had to compete on delivering economic growth. As a result the state has attracted a significant share of FDI and Indian investment from businesses that have come to realize that corrupt does not necessarily mean unstable or predatory. Tamil Nadu's investment profile comprises of high technology, high capital cost sectors which are already close to the global competitiveness frontier with available human resources. These investments do not need much government assistance in the catching up process, but they do need government assistance in acquiring land, assistance for overcoming specific market failures and credible commitments not to overturn contracts in the future.

A senior executive from the auto industry also remarked that whichever party comes to power in Tamil Nadu the bureaucrats working with it ensure that at least the larger, high profile investments go through unimpeded. A senior corporate personality summed up the current state of Tamil Nadu's political parties in this manner—"They stand for themselves and against each other". In this connection a '70-30' rule is said to have existed in the state for some time. This refers to an arrangement where the payoff was split between the government and opposition in a 70-30 ratio. This is to ensure that once the current incumbent is part of the opposition the then-ruling party does the same with them. This meant both political parties had an incentive to invite industrial investments. Our corporate source also said the payoff was never more than 10-15 percent of the investment so investors were not particularly daunted by the amount either. Yet this has not stopped Tamil Nadu from becoming one of India's leading industrial states. A structure like Tamil Nadu's could always be in danger of letting rent seeking become predatorial. While this sort of rent seeking is not yet evident the long-term infrastructural investments that are more pronounced in Gujarat are less in evidence in Tamil Nadu.

The clientelist political settlement is the most common among developing countries and indeed all parts of India exhibit it. Yet frequent contestations in most states mean a decline in either industrial growth or political stability, for instance in Uttar Pradesh or for some time in Maharashtra. The reason this doesn't happen in Tamil Nadu is that at a fundamental level the constituencies the two parties are reaching out to remain fairly similar, at least so far. This ensured critical policies stayed in place even if governments changed, like reservations for the Backward Classes or the mid-day meal schemes for children in primary schools. It can be argued that it would be unwise of any government to backtrack on successful policies implemented by the previous one but this has been known to happen in India. As a senior ex-bureaucrat told us both the parties had fluid philosophies, especially when it came to fighting elections, “If one party’s policies worked earlier the newly elected party would have no hesitation is adopting and improving upon it”. It might be recalled here that this was in sharp contrast to Periyar who never wanted to contest elections and whose party, DK was ideologically quite iconoclastic. Since the Congress in the state was relatively weak and the two main parties represented a highly mobilised population based on principles of representation and equality populist schemes proved easier and in fact necessary to implement. Education was a sector both the parties prioritised—primary schooling through the mid-day meal schemes and through the private engineering and medical colleges. The first was for redistributive reasons and the second was seen as a channel for rent creation. As a result, Tamil Nadu’s performance on certain related human development indicators is higher than most south Asian standards, and certainly higher than the Indian average. It is ranked at number three behind Kerala and Maharashtra in terms of overall literacy rates. Yet the state also exhibits high inequality and some studies while recognising political clientelism as a ‘necessary evil’ have ascribed the inequality to Tamil Nadu’s competitive clientelist politics whereby poverty alleviation programmes might be implemented selectively depending on the support particular villages provide (Markussen 2010). Yet that would not seem to be the case in Tamil Nadu where the two parties adopt each other’s schemes when successful (as with the mid-day meal schemes). In the course of our research we found that some slums in Chennai keep both the parties’ flags handy and unfurl them depending on which party is in power. This way they don't lose out on largesse from either party given the nature of their cycling.

The fact that the two parties have a common ideological ancestry helps electorally because voters are able to migrate from one to the other without significantly compromising or giving up their 'belief systems' or more simply put political leanings. This is demonstrated by the fact that till assembly elections in 2011 where the DMK put in its most dismal performance, notwithstanding who won the two Dravidian parties each garnered at least 25 percent of the vote share. Between the two their vote share remains consistently over 55 percent since the 1980s (Table 6.3). What then becomes significant are the voters at the margin who decide which party gets the majority. Analysing who the marginal voters might be and why they tipped to one or the other side is not the purpose of this chapter. This statistic was used to demonstrate how similar the electoral results were for the two parties. Since these results also reflected the true distribution of power there was seldom serious violence contesting them. This similarity in the constituency that both addressed also ensured policy continuity. This was because no party needed to experiment radically to reach out to newer sections of society. It is this fortuitous combination of social and political structures that has helped maintain political stability in Tamil Nadu and in turn has been advantageous for its growth prospects.

To be sure both the DMK and AIADMK sought to reach out to constituencies other than their core grouping. The two parties do not fight elections on startlingly different platforms even though their opposition to each other is bitter. This is one reason why the clientelist settlement in Tamil Nadu is fiercely competitive. What the two parties cannot do with ideology they make up for by competing over who delivers that ideology best. In the context of the clientelist framework we have discussed in Chapter three, such a strategy is important to keep their respective support base mobilised. A similar situation exists in Bangladesh where electoral constituencies remain broadly similar and the two parties differ very little in terms of policies but the clientelist political settlement in that country has had less dramatic growth outcomes. The reasons for this are 'zero-sum' games played by the two main parties that end in irreconcilable ideological positions based on differing myths of nation creation. The live and let live 'formula' that has helped Tamil Nadu so far does not yet seem a viable option to that country's main parties. Given this investors in capital intensive projects like infrastructure projects are wary of commitments made by either party being reneged upon when the other is voted out of power. This has an adverse effect on the growth-stability trade-off (M. H. Khan 2012f) Another reason for the zero-sum posture adopted in Bangladesh is that it is national governance that the two parties are concerned with. This makes the stakes higher. In India the federal structure acts somewhat as a 'shock absorber' and given the nature of coalition politics currently parties can look to form coalitions at the national level too.

The AIADMK's decision to distribute liquor licences was however a break from the DMK's policies and led to many party members gaining through selling them onwards. Some used this capital to invest in education and make the gains look more legitimate. But both the DMK and AIADMK used private education as a means to distribute patronage and generate payoffs. Says a venture capitalist based in Chennai, "Around the 1980s building educational institutes became very lucrative in Tamil Nadu as those with political connections received land at far below market prices in return for their support. Rather than invest in real estate they built private educational and medical colleges as they were regarded as more remunerative and that too over a longer term. The consequence was that the quality of human capital available to people like us started improving substantially." Tamil Nadu (along with other southern states) actively encourages the establishment of private higher education institutes like engineering and medical colleges. Admission to such an institute can sometimes include what is inscrutably called 'capitation fees' which can be anywhere from $10,000 to $15,000. Most of this is unofficial and does not go into the accounts of the academic institute.

Table 6.3 Electoral performance of the DMK and AIADMK

Year	Party	Seats contested	Seats won	% of votes polled	% of votes in seats contested	Total seats
1977	ADK	200	130	30.36	35.36	234
	DMK	230	48	24.89	25.26	
1980	ADK	177	129	38.75	50.43	234
	DMK	112	37	22.1	45.7	
1984	ADK	155	132	37.03	54.33	234
	DMK	167	24	29.34	40.79	
1989	DMK	202	150	33.18	38.7	234
	ADK (JL)*	198	27	21.5	24.99	
1991	ADK	168	164	44.39	61.14	234
	DMK	176	2	22.46	29.89	
1996	DMK	182	173	42.07	54.04	234
	ADMK	168	4	21.47	29.54	
2001	ADMK	141	132	31.44	52.08	234
	DMK	183	31	30.92	39.02	
2006	DMK	132	96	26.46	45.99	234
	AIADMK	188	61	32.64	40.81	
2011	AIADMK	NA	150	NA	NA	234
	DMK		23			

Source: Election Commission of India (ECI) Statistical reports, various years, results for 2011, ECI website, http://eciresults.ap.nic.in/ (ECI 2011)

** The year the pattern of cycling began. Also the year when the ADK broke up after MGR's death. We have featured the Jayalalithaa faction as that came to be recognised as the official one.*

NA- not available

Anecdotal evidence suggests some of the money goes to the patrons/owners of the school and some to the political party under whose watch the school was formed. This has had a two-fold consequence. It has helped the parties bestow largesse on key supporters while ensuring they also gain financial payoffs. It has also ensured the state produces a large number of engineering graduates compared to most other states. Interestingly one of the most frequent reasons provided by many software and engineering companies for investing in Tamil Nadu is the availability of skilled manpower. And Tamil Nadu has a high share of engineering graduates in the country. As Table 6.4 shows the computer software and hardware sectors was the second largest recipient of FDI in the state from 2000 to 2011. This resource pool was made available not because the parties consciously wanted to reap the benefits of higher education for the state but was an inadvertent consequence of a rent created for quite another purpose. This ties in with our framework which analyses how strategies for rent creation that are used to create strong patron-client networks also impact growth.

Table 6.4 Top five sectors in FDI equity inflow 2000-2011

Rank	Sector	FDI inflows in USD	Share of FDI attracted in the sector (%) of all India total
1	Construction development (townships, built up infrastructure etc)	1,226.20	15.33
2	Computer software and hardware	1037.79	12.98
3	Automobile industry	1025.85	12.83
4	Drugs and pharmaceuticals	563.10	7.04
5	Services sector	505.39	6.32
Total		4358.33	54.5

Source: Table 3.2 RBI Regional Office Chennai (RBI 2011)

Apart from strong patron-client linkages within the parties Tamil Nadu is also known for its politicized but highly committed bureaucrats. Industrialists across the board rate them as one of the best along with bureaucrats from Gujarat and to a lesser extent Maharashtra. One of the frequent reasons cited for it is that Tamil Nadu has a better ‘work culture’ or ‘work ethic’. While not disputing the statement ascribing it merely to culture would be simplistic. A more political reason for this is at hand. At the time that the state was still ruled by the Congress (1950-67) there were also strong ministers at the centre from Tamil Nadu. Bureaucrats from the state interacted with key Tamil ministers in facilitating investments to the home state. It certainly helped that Madras was already one of India’s most industrialized cities thanks to British investments and Madras port was one of the largest in the country. But regular contact with senior ministers from their home state helped Tamil bureaucrats learn state craft faster. Tamil Nadu remained one of the higher recipients of industrial licences through the 1960s and 1970s. A deeper analysis of the state’s effective bureaucracy follows shortly.

Leather and textile industrial clusters were established under Congress governments but have continued to turn in strong industrial performances under the non Congress governments too. Tamil Nadu’s power looms manufacturing cotton fabrics account for 30 per cent of India’s textile exports and the net value addition in the textile industry in the state is 37.5 per cent, the highest in the sector in the country. The state accounts for 65 per cent of the total number of spinning mills in the country and the Tirupur cluster produces 60 per cent of India’s knitwear. Tirupur is also one of India’s largest textile exporting hubs accounting for 90 per cent of its knitwear exports. The net value addition in Textile industry in Tamil Nadu is about 37.5 per cent, the highest in the country. The Textile mills are concentrated in Coimbatore, Tirupur, Salem, Palladam, Karur and Erode. Tamil Nadu has around 3,50,000 power looms manufacturing cotton fabrics and accounts for about 30 per cent of India's export of textiles products (Chellasamy and Karuppiah 2005).

The Erode district in Tamil Nadu is well known for marketing of textile products of handloom, powerloom and readymade garments. The largest clusters are found around Coimbatore, Tirupur and Erode, cities in the west central region of the state as well as in Chennai. A measure of the success of the state in sustaining its textile sector can be gauged from the fact that first textile mill was set up in Coimbatore in 1888 and the city now houses over 100 mills. The organized sector employs over 200,000 workers in textile mills but the sector has a significant component of unorganized workers (Chellasamy and Karuppiah 2005). Trade unions and social activists frequently raise questions about the conditions of the labour force working in these industries and many are valid, especially environmental issues and the exploitative Sumangali scheme run by mills of the area under which Dalit and women from poorer families are employed.

The leather industry is another traditionally strong manufacturing sector in the state. Tamil Nadu is the leading leather exporting state in the country accounting for 47 per cent of the country's exports in 2007. The state employs 42 per cent of the 2.5 million workers employed in the sector in India with clusters located around Chennai, Ambur, Ranipet, Vaniyambad (NSDC 2008). A senior academic who has conducted extensive rural and semi-urban field surveys in the state says, "two things are specific about this state and quite unlike any other state, even Gujarat. This is a state with high levels of industrial capitalism but what is remarkable, in the Indian context, is how spatially spread out it is. In terms of sectors too the state's industrial composition is more balanced. It has a fair mix of successful SME sectors and high technology productive sectors that very few states possess". The continuing success of the leather and garments sector would bear this out. It needs to be added here that given the employment and export potential of both these sectors the two have attracted technical and financial aid from central and state governments as well as overseas assistance and Tamil Nadu has been no exception. Given that both these sectors attract employment from some of the state's relatively marginalized economic classes governments had tried to ensure these sectors receive enough financial attention. This does cut both ways though. While it does provide employment to backward classes it also provides mill owners with access to a pool of labour that has very little social or economic agency and hence allows some of the owners at least to get way with exploitative practices.

This strategy was unlike West Bengal where a Communist oriented coalition decided not to take advantage of the state's high levels of industrialization and instead decided on building an agrarian constituency to keep themselves in power. The rent creation strategy of the Tamil parties involved industrialization and building of infrastructure like irrigation systems, along with the redistributive policies we have mentioned earlier. Bureaucrats then found it easier to act as facilitators between investors and the state, especially in organizations like TIDCO, the state's industrial development corporation set up in 1965 that invests in joint ventures with the private sector and the State Industries Promotion Corporation of Tamil Nadu or SIPCOT set up in 1971 to facilitate term loans to industry. The state also set up the Guidance Bureau under the aegis of TIDCO in 1992 to make use of the opportunities presented by liberalization. The Bureau's biggest success has been in attracting auto sector investments into Tamil Nadu, domestic and foreign. There was another reason why bureaucrats in Tamil Nadu were effective and that was their level of political commitment to the party they chose to identify with. A retired senior bureaucrat from Maharashtra told us that given the depth of the schism between the two political parties bureaucrats perforce had to choose which party to support. Being neutral was not seen to be a practical option though there were some who chose to stay above this divide. For those who did make the choice they came to be identified as belonging to a particular party and when that party was in power they therefore had to perform effectively enough. An indicator of this system was that in the early 1970s Tamil Nadu was one of the first states to agree to what became known as 'committed bureaucracy'. This was a policy attributed to Indira Gandhi and her son Sanjay who envisaged a bureaucracy that would defer to what the elected politicians would want (since apparently that's what the electorate wanted) and not question them unless the decision could be proven illegal. As a standard for bureaucratic credibility the idea was a complete reversal of Weber's bureaucratic neutrality or even Evans' 'embedded autonomy' and this policy is now credited with the steady decline in the quality of Indian bureaucracy. In the name of making way for the people's wishes by deferring to their representatives this practice has actually led to bureaucrats abdicating better judgement to politicians and in fact went further to consolidate rent seeking. Yet Tamil Nadu adopted it fast enough because its bureaucrats were already implementing this system informally. Another explanation comes from a bureaucrat who has worked in the state, "Bureaucrats in the state are procedural and tend to work by the book. This is because they are acutely mindful of the cyclical nature of electoral results and government formation in the state. Any suspicion regarding a decision taken with the earlier government could have them facing charges with the incumbent. This ensured bureaucrats never really went beyond their ambit, a feature common across the country otherwise."

Post liberalization the competition between the states ensured state administrations had to work harder to get investments and the Tamil Nadu bureaucracy was not found wanting in this matter. Its nodal agencies that facilitate industry, TIDCO, SIPCOT and Tamil Nadu Industrial Investment Corporation or TNIIC are known as some of the more effective bureaucratic agencies in India. This demonstrates that Tamil Nadu's clientelist political settlement even included some members of the state's bureaucracy. Given that both political parties were willing to encourage industrial investments and build links with capitalists the respective allegiances of the bureaucrats ensured relatively effective implementation of policy.

6.5 The Political Settlement and Capability Development in Tamil Nadu

As we discussed in our analytical framework in Chapter Three, the holding power of capitalists in a political settlement relative to the ruling coalition also has an effect on rent-allocation strategies and therefore on growth outcome. The power of the biggest business organizations relative to political organizations was growing in Tamil Nadu as in the rest of India but here because the political organizations were themselves not likely to be in power for very long, the capture of political organizations in inverted patron-client relationships of the type emerging in incipient form in Gujarat was less in evidence. It does not make sense for a big economic organization to invest heavily in a relationship with one political organization if that political organization has a life span of five years. This meant that a strategy of controlling long-term rent flows by building close relationships with a particular political organization was not a viable strategy in Tamil Nadu in the period under review. The best that economic organizations could expect would be upfront rents to make their investment more attractive. This had beneficial selection effects. It attracted economic organizations that were already competitive or close to competitiveness. These high capability business organizations also found pre-existing formal capabilities (educated workforce) and informal capabilities (industrial clusters and tacit knowledge) in Tamil Nadu that made the package attractive. The high levels of tacit knowledge of manufacturing processes in Tamil Nadu were in turn based on significant industrial development during the period of industrial policy and protection. As we can see from Table 5.3 in Chapter Five on Gujarat, by 1980 Tamil Nadu was already the fourth most industrially advanced state in India.

The allocation of industrial licences to Tamil Nadu during the industrial policy period was very beneficial for attracting companies like Standard Motors and Ashok Leyland to Tamil Nadu, the latter eventually becoming one of India's largest manufacturers of heavy commercial vehicles. Other companies that emerged in this period included MM Forgings which began life as a dealer for Royal Enfield motorcycles in 1946 but by 1974 had moved into the automotive forgings industry. Today the company is one of the leading manufacturers of various grades of steel forgings in India. The auto and auto component sector in Tamil Nadu developed to service the auto industry that located and developed in Tamil Nadu as a result of licence allocations. The TVS group is one of the best examples of this secondary development. The company has become one of India's largest and most respected manufacturing corporations with interests in automobiles, auto components, auto dealerships and financing. It was worth USD 4 billion in 2012 and employed around 25,000 people. Companies within the TVS Group like Sundaram Clayton that manufactures air brakes, Sundaram Brake Linings, TVS Motor Company and Lucas TVS (a joint venture with Lucas UK) have won international quality standard prizes like the prestigious Deming Application Prize for excellence in manufacturing quality. Sundaram Clayton was the first Indian company to win the award. The Deming Prize is a coveted award for manufacturing companies initially awarded to recognize the best Japanese manufacturers. The Prize is now also awarded to non-Japanese companies and since then many Indian companies in the auto components sector have been recipients. A similar company also based in Tamil

Nadu is the Rane group. The Group has four award winning companies Rane Brake, Rane Engine Valve, Rane Madras and Rane TRW Steering Systems.

The two companies enjoyed similar growth trajectories. The TVS Group was founded by TV Sundaram Iyengar in 1911 and started operations as a bus fleet manager in rural Madras Presidency. From this Iyengar moved on to an auto dealership in 1945 in Chennai. By the time of independence the business was a flourishing one and in 1954 Indian Motor Parts and Accessories (IMPA) was incorporated as a distributor of automobile spare parts and accessories. In 1962 Brakes India was incorporated as a joint venture between TVS and Lucas of UK. By the 1970s TVS was a successful manufacturer of auto components supplying the auto belt gradually forming in the Chennai area. The company's initial support came in the mid-1960s from R Venkataraman who was Minister of Industries in the central government and a Tamil, who enabled TVS to get land concessions around Chennai. The group is now is a global supplier for international auto companies. The Rane Group was established in 1928 as a distributor of auto parts. By 1959 it had diversified into the manufacture of valves for internal combustion engines. In 1975 it started manufacturing manual steering gears and today has a turnover of $3.75 billion. Other successful companies include Amalgamations which began as a spare parts dealership and became one of India's most successful light engineering companies. Common to most of these companies especially the founders of the TVS Group and a tyre manufacturer called MRF were their links with successive Congress governments in the state. MRF's founder Mammen Mappillai began with a balloon making factory near Chennai but MRF is today one of India's largest automobile tyre manufacturers (Aya and Siddharthan 2007). The growth of these auto components companies in and around Chennai explains why more than 35 percent of India's auto components production comes from Tamil Nadu.

The growth of the sector can be traced to policy induced rents as a result of decisions of the Indian Tariff Commission of 1957 that discouraged automobile and spare parts imports and promoted indigenization as part of a strategy of import substitution. Firms like TVS which were importing spare parts had enough technical knowledge and some 'tacit knowledge' to venture into manufacturing some spare parts themselves. Protection was one way of delivering rents to firms that were still not competitive in particular areas to engage in capability development processes including learning-by-doing. The limitations of India's industrial policy particularly with respect to disciplining were discussed in Chapter Four. Nevertheless, even though India's planning period did not create many globally competitive industries and sectors, it did create relatively high levels of technical and organizational capabilities in some areas that later achieved competitiveness in the 1980s (M. H. Khan 2009b).

The auto component sector in Tamil Nadu clearly gained from protection as new firms were set up and new capabilities were developed (Tewari 2001; Aya and Siddharthan 2007). Companies like TVS started operations in the Padi industrial cluster close to Chennai in 1960 as a beneficiary of protection. Today the industrial cluster is one of the leading industrial hubs in Tamil Nadu housing many companies beyond the TVS group of companies. Most other auto and auto components companies in the state are also clustered around Chennai making it the biggest auto cluster in India along with the National Capital Region (NCR) near Delhi and the Pune-Pimpri-Chinchwad area in Maharashtra. By the time the economy opened up in 1991 the Chennai auto cluster was significant enough to attract the attention of international manufacturers like Ford and Hyundai and later Honda. Even after liberalization began in 1991, the Indian government maintained a 70 per cent localization rule in the 1990s in automobile production. This helped Indian auto component manufacturers to develop their capabilities as the localization rule provided implicit rents to domestic manufacturers to finance a period of learning and prepare to face competition from OEM component producers like Visteon and Delphi brought in by international car makers. For a time, foreign car makers had to source a significant amount of components from Indian component manufacturers even if they had not yet met price and quality conditions and this is the implicit rent allocation that financed their learning in the critical period of the 1980s and 1990s. The policy instrument that directed these temporary rents to auto component producers, the localization rule, was one that could be effectively enforced in this political settlement because no powerful organizations in the Indian political settlement could easily benefit by distorting the enforcement of this rule.

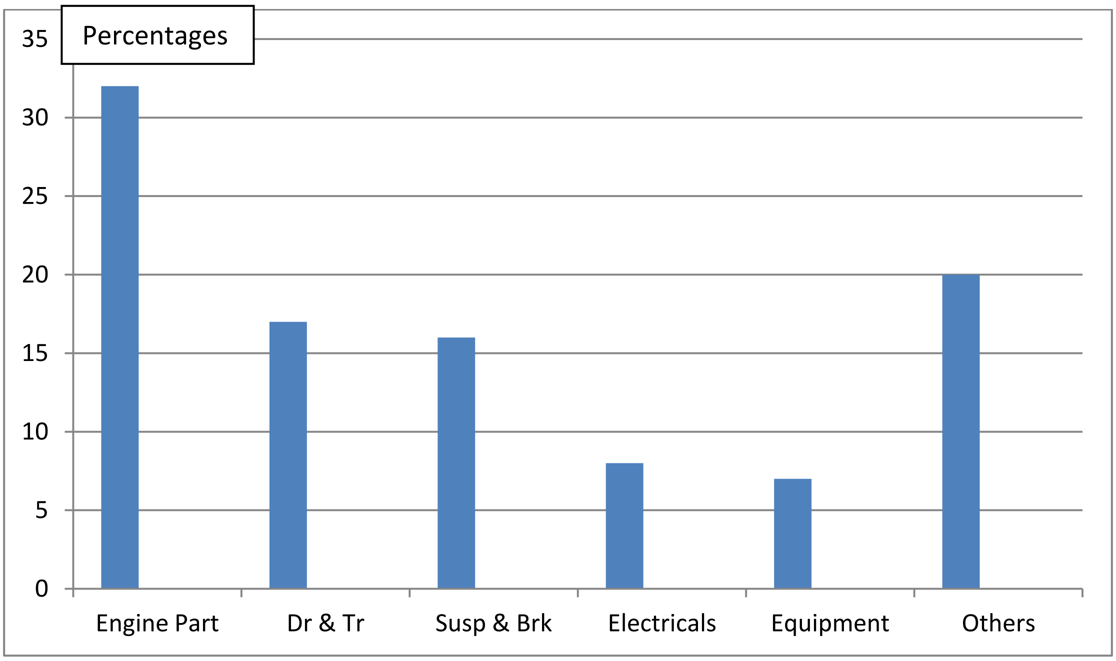

Figure 6.4 Chennai's share of the auto component sector in India

Source: Mahindra World City SEZ presentation, http://www.mahindraworldcity.com/docs/chennai/tamilnadu.pdf

Note: Figures in percentages

Dr & Tr : Drive and Transmission
Susp & Brk : Suspension and Brakes

Even though the localization requirement could no longer be used in the 2000s after India joined the WTO in 1995, by 2005 Indian auto component makers comprised 70 percent of the supplier base of manufacturers like Hyundai India. The Hyundai plant near Chennai is now Hyundai's global export base for small cars. Clearly by the 2000s Indian component producers had built enough capability to supply international auto producers. Even though Ford still sources some key components internationally it is also using the Chennai cluster as part of its global sourcing base. The years of capability building have paid off with an auto and auto components manufacturing base developing around Chennai (Figure 6.4). Net sales of the auto industry in the state have sustained steady growth in the 2000s (IBEF and ICRA 2008). Unlike other Indian states like West Bengal or Uttar Pradesh the state government in Tamil Nadu seldom faced protests against land acquisition for industry. This is largely because opposition to land acquisition has not been the focus of mass political mobilizations in a state where the growth of factory employment is widely supported as a mechanism for economic mobility.

The Tamil Nadu experience with autos demonstrates that if a sector is near the global competitiveness frontier, and if policy instruments can deliver some limited rents for capability development, the entrance of foreign players need not necessarily spell doom for local enterprise. However as Tewari points out, by the 2000s, the competitive regime in the sector meant that new entrants in the small and medium tier 2 and tier 3 levels of the industry need support to improve their skills and productivity levels (Tewari 2001). The tier 1 companies benefited from a series of policy rents (protected markets followed by localization rules) that allowed them to invest in their capabilities. Companies making up the next two tiers do not have access to these types of rents any more, nor do they have the political clout to influence policy or lobby effectively. Yet it is this segment, of potentially high productivity SMEs that need to be supported to take the auto components sector in Tamil Nadu to the next level. One option may be consolidation with tier 2 firms being bought out by their tier 1 customers. In the 2000s, some of the larger tier 1 companies also lobbied the state government to provide assistance to their smaller suppliers (Tewari 2001). These pressures have not resulted in significant policy changes. As an executive from the industry says, "India has certainly arrived at the factory gates in terms of being a successful Tier 1 producer. But beyond that the distance between Tier 1 and Tier 2 and Tier 3 is quite huge", implying more support is needed for this industry.

Unfortunately, in the 2000s and beyond, ruling parties in Tamil Nadu have discovered much easier ways of generating rents for their political redistribution without the difficult task of calibrating rent allocation to industry to develop capabilities as a way of increasing access to growth-generated revenues. The growing weakness and complex composition of coalition governments in Delhi has made it easier for well-placed regional parties to access significant formal and informal rents as the price of supporting the coalition government in Delhi. The future negotiation of effective rent allocations for capability development in Tamil Nadu will depend on the strength of economic organizations in the state and how business-government relationships evolve, the performance of manufacturing in the absence of any capability-development strategy, and the persistence of alternative sources of rents that ruling parties in Tamil Nadu have been able to access.

The evolution of the Indian political settlement in the 2010s has supported unprecedented levels of unproductive rent capture involving the allocation of resources like natural resources, land or telecom spectrum. We outlined in Chapter Four how this was related to the gradual exhaustion of productive profit-making options as sectors close to the competitiveness frontier became competitive and others were too far behind to benefit from the shrinking set of rent allocation instruments that were progressively available. At the same time the demands for political rent allocation kept growing as new social mobilizations led to the fragmentation of political organizations. Finally, powerful and cash-rich business organizations emerged that could offer quick and significant kickbacks to political organizations in exchange for allocations of land, natural resources or the spectrum, a process that is part of the phenomenon that we described as a reversal of the standard patron-client relationship between business and government.

These processes have cut out productive capitalists from the same level of political influence and political organizations are taking less interest in ensuring the profitability of these enterprises as part of their long-term rent strategies for their own political reproduction. Our respondents in business and the bureaucracy confirm that the Tamil political parties that took a pro-industrial position in the 1990s out of self interest display less urgency in tackling the constraints affecting industry and technological capability development in the 2010s. Capitalists seeking to improve their productivity, quality and competitiveness are trapped between an indifferent ruling coalition and their own inability to offer direct and large informal payoffs to political organizations. Investors in states like Tamil Nadu and Maharashtra that have a larger proportion of high technology companies relative to the rest of India find themselves at a particular disadvantage because these sectors cannot deliver quick payoffs.

On the other hand, the advantage that Tamil Nadu has over Gujarat is that a majority of its large companies especially in auto, auto components and electronics are in sectors that constantly need to strive to remain competitive. The compulsion to use rents to raise productivity and not capture them is built into the structure of their organizations. Their bargaining counter with political organizations is their ability to provide long term stability to the ruling coalition through employment generation, formal revenue generation through taxation and informal revenue generation for parties. Even if the kickbacks cannot be as large as those that can be offered by enterprises engaged in say natural resource rent capture or theft, they are sustainable over time. There is some evidence that industry in Tamil Nadu is beginning to realize it has enough holding power to nudge the government in this direction. In 2006 their lobbying resulted in the government of India launching the Indian Auto Mission Plan (IAMP) under which it seeks to build innovation architecture around programmes like the National Automotive Testing and R&D Infrastructure Project (NATRIP) which provides international standard testing and homologation (to attain standards for vehicular types) facilities for the Indian automobile industry. The IAMP Plan was to set up NATRIP centres in four regions of the country and the automobile and auto component manufacturers from Chennai were keen that the centre for south India was set up in Chennai. At that time the AIADMK government under Jayalalithaa had just come to power in the state and NATRIP was not a priority for her administration. However the industry lobbied and got her to write to the national ministry in New Delhi and the regional centre for the South was set up in Chennai, a boost to the sector's attempts at increasing competitiveness. The NATRIP centre along with other industry-academia linkages through academic centres of excellence like the Indian Institute of Technology in

Chennai are supporting the evolution of a high-tech automotive cluster around Chennai.

The longer-term prognosis for Tamil Nadu depends on whether the two-party competitive clientelism system with informal institutional arrangements ensuring relatively longer time horizons is likely to endure. The main challenge to it comes from endogenous forces driving fragmentation, related to succession issues. Both the DMK and AIADMK, but more so the DMK, are dynastic parties where succession is based on family rather than internal elections. In DMK's case the fight is between two half-brothers who are currently claiming to be the true inheritors of Karunanidhi's legacy. Their sister, who was briefly in jail on corruption charges, is also emerging as another powerful political figure. Clientelist parties in India have frequently split when succession issues remained unresolved. If the DMK moves in a similar direction the current two-party system will be upset and key features of the political settlement may change. The AIADMK faces a different challenge as Jayalalithaa does not have a family she can bequeath the leadership to nor has she identified any deputy who can take on the reins of the party at a later date. In our analysis, the smooth transfer of power between the two major parties has been important for ensuring formal and informal institutions support growth. This may change if the political parties become more fragmented and engage in more hostile contests that include disrupting previous contracts and rent allocations to business. If that were to happen, the growth-stability trade-off facing the enforcement of institutions that support even limited capability development may become more adverse, potentially affecting industrial growth in the state. In contrast to the personalised internal politics of clientelist parties, 'ideological' parties like the Left parties in India and the BJP, practice intra-party democracy to a greater extent. But as we have seen in our chapter on Gujarat, the construction of political dominance by ideological parties also has its costs.

6.6 Conclusion

Tamil Nadu has a higher share of all India industrial employment as well as a lower ICOR compared to Gujarat (comparing Table 5.1 and Table 6.1). Gujarat has a higher share of fixed capital investment and TFP in industry has grown faster in Gujarat than in Tamil Nadu (Kathuria, et al. 2010). These characteristics of industrial growth in the two states reflect the fact that Gujarat's industrial growth has been more capital intensive and concentrated in sectors like petrochemicals while Tamil Nadu's has been more broad based and dependent on capability development that achieved global competitiveness in sectors like automobiles and electronics. We have shown why these differences were not just related to differences in natural resource endowments, but more fundamentally reflected differences in the ways in which the political settlements were constructed and the formal and informal institutional support that was available for different patterns of industrialization.

In Gujarat, the ruling coalition was almost always able to align with big business interests and under Modi this ability was enhanced by the creation of an authoritarian clientelism that allowed significant discretionary rent allocations to big business in capital-intensive sectors with significant returns. In Tamil Nadu its political settlement of competitive clientelism needed more redistributive, populist policies leading to a focus on welfare policies much earlier than in Gujarat and its manufacturing base was also in sectors with lower levels of concentration like textiles, leather and small and medium engineering. The search for revenues and the availability of significant economic capabilities allowed the development of enforceable rent management strategies in the 1990s that led to further capability development and growth in sectors like automobiles and electronics.

The framework of political settlements allows us to shed light on the paradox of rapid growth of relatively high-technology sectors in a context marked by apparent political instability and high levels of corruption and clientelism. Far from developing despite these adverse conditions, we have argued that features of its competitive clientelism actually made possible some specific patterns of growth. We also identified and analysed the effectiveness of Tamil Nadu's bureaucracy, moving beyond simplistic cultural explanations. Despite the fragmentation of the DMK into the AIADMK and later into further groups like the PMK and the MDMK, the period covered by our analysis saw two major parties successively forming the ruling coalition. The fact that all these groups owed allegiance to the ideology of the Dravida Kazagham has meant that the factional conflicts were restricted to in their scope and informal 'live-and-let-live' compromises could emerge. This was also helped by the fact that the parties appealed to the same or very similar constituencies. This led to the paradox that while the parties had to compete very intensely to mobilize their base and deliver to them, it also led to stability in policies and institutions that supported the productive industrial sectors.

The policy challenge for Tamil Nadu is to devise growth strategies that take into account its competitive clientelism. This is likely to require a more pro-active role for the state's productive capitalist class. Productive economic organizations in the state have a lot to lose if the growth-stability trade-off facing developmental institutions became more adverse. This constituency has already established relationships with both parties and their dealings with political organizations are not adversarial because everyone assumes that the two parties will each cycle in and out of power. But given the weakening incentives for developmental rent management, industry may have to put pressure on the ruling parties to support capability development with rent-creating policies and institutions.

Chapter 7 . Pakistan: A Crisis of Legitimacy and Liberalization 1980-2010

SUMMARY:

Pakistan's political economy over this period was characterized by high levels of conflict compounded by low economic growth. Conventional discourse explains this in terms of Pakistan's weak governance: weak institutions, high levels of corruption, repeated challenges to its democracy and later in the period, the rise of Islamism. The political settlement that emerged in Pakistan towards the end of our period described a reproducible social balance that entailed persistently high levels of violence and poor economic development. Ironically, throughout this period Pakistan also made repeated attempts at pushing good governance reforms and liberalization. The political settlement analysis allows us to trace these problems to a growing crisis of legitimacy of the ruling coalition that has its roots in the strategies that the ruling coalition was persuaded to follow in a context of strong external influences. The alliance with the US and support for its war in Afghanistan in exchange for significant inflows of foreign rents provided the resources for a consolidation of a ruling coalition. The allocation of external rents related to security could be controlled from above and this enabled the ruling coalition to exclude many potentially powerful political organizations. But over time, this strategy made it easier for many new political organizations to challenge the legitimacy of the ruling coalition that consisted over this period of one or other of the two main parties or the army. The increasing challenge to the legitimacy of organizations that constituted the ruling coalition provoked a growing level of violence as some excluded organizations were effectively challenging the parameters of the established political settlement in Pakistan. This analysis suggests that there are structural but avoidable features in the combination of institutions and political strategies that powerful organizations have supported in Pakistan that can help to explain the evolution of greater instability and poorer development performance. This analysis identifies a different set of issues as the source of some of these

problems compared to the common explanations in terms of the weakness of 'good governance' and the challenges of rising Islamism.

The evolution of the political settlement in Pakistan in our period of interest cannot be understood without reference to the history of modern Pakistan and of partition where independence was thrust on the Pakistani state as the outcome of the exigencies of Congress-led politics in British India. The Pakistani state in 1947 was faced with the task of establishing social and political control over a territory that historically had strong social and political organizations that were not integrated into the political organization of the Muslim League. From 1958 the attempt to construct a viable ruling coalition were shelved with the onset of military rule and the prioritization of economic development. However, the strategies adopted for economic growth were themselves exclusionary and left out important constituencies. These strategies contributed to the breakup of the country in 1971. Subsequent attempts to consolidate a viable ruling coalition in a political settlement that was developmental were significantly constrained by a number of factors. The influx of external rents associated with the wars in Afghanistan and the perception of a permanent threat from India allowed a relatively narrow group of (political and military) organizations to dominate the political system. The process of gradual inclusion of intermediate class organizations into the ruling coalition was therefore slower in Pakistan compared to India with damaging consequences for political stability in the long run.

It is in the context of this specific political settlement that Pakistan embarked on liberalization and Structural Adjustment Programmes in the late 1980s and the 1990s. The features of this political settlement explain why the outcomes of liberalization were poor. Pakistan did not have the productive capabilities to benefit from greater market access, nor were there significant productive capabilities close enough to the competitiveness frontier to benefit from the compulsions of the market and the financing opportunities for capability development. In contrast in contemporary India the effects of liberalization were better because there were some industrial sectors close to the competitiveness and some of these could benefit from support mechanisms of the state which allowed them to raise their competitiveness. More importantly, the ideological and political strategies through which Pakistani ruling coalitions were constructed were beginning to unravel because of Pakistan's growing involvement in western supported strategies in Afghanistan. The easy sources of external rents allowed Pakistan's military and political elite to dominate their organizations from above and the concentration of sources of rents disadvantaged excluded organizations in the political competition. The adverse dynamics of this strategy became particularly evident after 9/11. On the one hand the concentrated rent flows controlled by the leadership of the ruling coalition strengthened the Musharraf regime but on the other hand, it became easier to mobilize against the ruling coalition whose legitimacy was increasingly questioned. The poor outcomes associated with liberalization in Pakistan can therefore be explained with reference to features of its political settlement. It resulted in the exposure of Pakistan's economic organizations to market competition when most were far from the competitiveness frontier and the ruling coalition was increasingly under challenge from excluded organizations that were now aiming at a fundamental change in the political settlement. Faced with these challenges, the ruling coalition had neither the time horizon nor the implementation capabilities to carry out developmental rent allocations.

Section 7.1 outlines the relationship of Pakistan with India, one we argue has an impact on Pakistan's own political settlement. Section 7.2 outlines the history of Islam in the Indian sub-continent in order to set the context for understanding current mobilizations based on in Islam in Pakistan. Section 7.3 provides an analysis of the Pakistani settlement under Ayub Khan, Zulfiqar Bhutto and Zia-ul-Haq. Section 7.4 outlines the advent of a vulnerable competitive clientelism in the 90s interspersed by caretaker governments which introduced liberalization reforms. Section 7.5 discusses the current crisis in the country. Section 7.6 analyses the effect of liberalization reforms on Pakistan's political settlement. Section 7.7 concludes.

Introduction

Pakistan's birth was accompanied by much sound and fury that yet signified a hopeful, if uncertain future for the 31 million people who made up its eastern and western flanks. 'Maimed and mutilated' at its birth (Jalal 1990), Pakistan was the price Jawaharlal Nehru and the Congress were prepared to pay for having a strong and stable central government in India (Government of Bangladesh 2003). The new country inherited some of the most underdeveloped parts of British India. All the major urban centres (Delhi, Bombay, Madras, and Calcutta) major industrial locations, the most important ports, much of the railway network and even the majority of the bureaucracy remained in the newly independent Indian state. Pakistan's main urban centres were Lahore, the port town of Karachi and Dhaka in East Pakistan and its most valuable inherited infrastructure from the British was the canal-irrigated area of west Punjab which had helped the fertile Punjab plains to become one of the most agriculturally productive in the sub-continent. As for East Pakistan it was even less developed. It was made up of the rural hinterland that supplied raw materials to the industrially advanced western part of Bengal, now modern day West Bengal in India. And while Dhaka was a thriving urban centre during Mughal times before modern day Calcutta had been founded, it was British Calcutta which became the second city of the Empire. To put matters in perspective the contribution of industry to Pakistan's national income was a mere one per cent and though East Pakistan grew 70 per cent of India's raw jute the province did not have a signal large jute mill (I. Ali and Malik 2009). Table 7.1 provides a brief overview of the Pakistani economy in 2013.

Table 7.1 Pakistan Economic Characteristics

Population	180 million
Gross Domestic Product 2011 current	USD 211.1 bn
GDP per capita current 2012	USD 1290
Capital Output Ratio	3.6
Investment in Fixed Capital as share of GDP	11.8 %
Percentage of population below poverty line	22 %

Source: Various, (census.gov.pk), (World Bank World Development Indicators), (Bloomberg), (Asia Development Report 2007), (State Bank of Pakistan)

Though Pakistan has had periods of stability, instability and violence have grown over the last two decades. This has contributed to the slowing down of growth in the Pakistani economy with GDP growth of 3.8 per cent and per capita GDP growth of only 2 per cent over 2008-10, the lowest in South Asia (Table 7.2). The period since 1980 divides into three phases relevant for analysing the evolution of Pakistan's political settlement. A common theme in all these phases has been a more or less intense contestation between included and excluded groups for access to the political and economic rents controlled by the ruling coalition. Pakistan's political instability reflects a failure to achieve a distribution of rents across organizations that reflected a distribution of power that was accepted by all major organizations as the real distribution of power. Several factors contributed to the failure to achieve a balance between the distribution of benefits across organizations and their relative power that could have achieved significantly lower levels of political violence. First, the concentration of significant security-related rents in the hands of a narrow ruling elite supported their perception that their relative organizational power was greater than it actually was, and reduced their willingness to compromise with other organizations. Some of these organizations represented regional elites like those in Baluchistan, the tribal areas of Khyber-Pakhtunkhwa (KP), the Federally

Administered Tribal Areas (FATA) and the Mohajirs (Muslim immigrants from India) largely based in the cities of Karachi and Hyderabad. Secondly, political organizations led by the intermediate classes had always been organizationally less developed in Pakistan compared to other parts of India. This meant that when the legitimacy of the ruling organizations began to be seriously challenged new organizations often emerged with radical agendas. Many of these organizations were willing to use violence to challenge the position of the dominant political organizations, and were not just trying to capture a bigger share or rents. The mobilizing ideology that was often used by new political mobilizations was Islam, much as the violent anti-state movement of indigenous people in neighbouring India has used a Maoist ideology.

These distributive conflicts are very similar to those in other developing countries but an understanding of the specific problems faced by Pakistan requires an understanding of the history of its creation out of British India. First, there was no geographical or cultural grouping that could be identified as Pakistan within undivided India even as late as the 1930s. Independence was thrust upon it in 1947 in large part by the Indian Congress party that was unwilling to accommodate Muslim demands for representation in a Hindu dominated India (Jalal 1985; A. Roy 1993; Anderson 2012). Secondly, the areas the Pakistani state inherited already had strong social and political organizations, while the Muslim League, the party that won Pakistan, had not been historically strong in these areas of India. The new Pakistani state dominated by the Muslim League ruling coalition thus had an immediate challenge in enforcing its authority from the outset. Thirdly, in the early years, the greater population of East Pakistan and the concentration of economic, military and bureaucratic power in West Pakistan led to a constitutional crisis over the power sharing formula between the two wings. Compounding all these problems was the threat perception from India. These challenges led to an unstable political settlement in the years immediately after 1947 and contributed to the failure of Pakistani policy makers to come up with broad-based employment generating policies. The turnaround only came with the military takeover of 1958 which imposed military rule in Pakistan and was associated with a vulnerable patrimonialism that could nevertheless achieve some progress in industrial policy and accumulation (M. H. Khan 2012a).

Table 7.2 Growth of GDP and GDP per capita under Different Regimes, Pakistan 1960-2010 (constant 2000 US$)

Period	GDP	GDP per capita
1960-71 (Ayub)	6.8	4.1
1971-77 (Bhutto)	4.2	1.2
1977-88 (Zia)	6.6	3.2
1988-99 (PPP and PML-N)	4	1.1
1999-2008 (Musharraf)	5	3.2
2008-2010 (PPP)	3.8	2

Source: World Development Indicators 2011, World Bank

A comparison of the organizational basis of the early Congress and the Muslim League is instructive. The Congress has a long organizational history, being founded in 1885 with an extensive grassroots membership that remained significant at least till the 1950s. In contrast, the League founded in 1906 was initially representative of elite Muslims in India and did not even have the intention of establishing Pakistan. It did not have an organizational structure in the parts of India that became Pakistan that was equal to the task of building Pakistan's new institutions in ways compatible with the local distributions of power (Jalal 1990). While formal political organizations were weak in these areas, there were strong informal organizations exercising authority and power using informal institutions of 'biradri' which are networks based on kinship groups, both patriarchal and patrilineal. Ethnic identities and organizations were also strong in the different provinces making up Pakistan. The military rapidly emerged as a focal point for the new state not only because of the weakness of the dominant political organization in accommodating all the interests in society, but also because of the environment of armed conflict with India that immediately affected the disputed territory of Kashmir. The dispute is still unresolved and Kashmir's accession to India remains controversial given the compelling body of evidence showing that India manipulated the accession of Kashmir without the support of the Kashmiri public (Anderson 2012).

The military takeover of 1958 resulted in high levels of economic growth under General Ayub Khan in the 1960s and Pakistan's economic growth was in general higher than that of India from the 1960s till around 1990 (Table 7.3). Ayub's military intervention changed the distribution of power and put the armed forces in a dominant position. The political settlement was a vulnerable patrimonialism in terms of the categorization in Chapter Three, with the ruling coalition enjoying enough enforcement capabilities to run a basic industrial policy but also being vulnerable to repeated challenges from excluded organizations that occasionally required the use of violence and repression against them.

Table 7.3 Comparison of India and Pakistan in terms of GDP and GDP per capita growth rates

Growth Rates %	India	Pakistan
GDP		
1960-80	3.5	5.5
1980-90	5.6	6.1
1990-00	5.8	3.7
2000-05	6.7	4.9
2005-10	7.8	3.9
Per Capita GDP		
1960-80	1.2	2.6
1980-90	3.4	3.5
1990-00	4.0	1.2
2000-05	5.2	2.4
2005-10	6.4	2.1

Source: (World Bank 2012a)

In the 1970s a democratic order emerged with Bhutto's Pakistan People's Party (the PPP) emerging as the dominant party. With elements of similarity with Modi's BJP, Bhutto maintained his political dominance using informal threats and sometimes violence against political opponents. We will describe this later as a similar type of constrained patrimonialism with authoritarian clientelist characteristics. The return of army rule under Zia in 1977 marked the reversion to another period of vulnerable patrimonialism but this time the economic policies and institutions began to change. Pakistan's military was now more concerned with establishing a new set of political organizations that would support their rule than in building productive capabilities. The rents from the Afghan war ensured inward resource flows that kept overall growth rates high without adding to competitive capabilities. Zia's political strategy was not very successful in by-passing established political organizations like the PPP, and his attempt to create new political organizations brought in elites like Nawaz Sharif in the Pakistan Muslim League - Nawaz (PML-N) who were quite similar to the elites in the PPP. Zia's death in 1988 brought in a period of weak democratic governance with the PPP and the PML-N alternating in power till Musharraf and the army again came back in 1999. Throughout the democratic period of intense competitive clientelism, liberalization strategies were implemented, often in stealth by technocratic caretaker governments that ruled in between elections.

Musharraf's military government was yet another period of vulnerable patrimonialism. As in Zia's regime, Pakistan's elites enjoyed another period of significant security-related aid inflows, this time associated with another but much less legitimate (in Pakistani eyes) US intervention in Afghanistan. Once again, the aid inflows created a perception of strength in ruling organizations that were actually facing increasing social challenges and demands for inclusion from new social mobilizations. The failure of dominant political organizations to make the compromises that may have allowed evolutionary changes in the political settlement is, in our analysis, the source of the instability that began to grip Pakistan from the mid-2000s onwards. In particular, we argue that the problem of instability was not just the result of military rule in Pakistan. Rather, both the military and a few relatively elitist political parties could access a much more centralized control over rents than in other parts of South Asia, particularly in the context of security-related aid inflows. As a result, they *jointly* failed to achieve the inclusion of significant new intermediate class mobilizations within political rent distribution arrangements.

Pakistan's army as an organization is most often held responsible for the country's instability. The army does indeed appear 'overdeveloped' with respect to the size of the economy and the state, and it does behave as if it has the authority to act to represent the popular will against corrupt political parties, but in reality it is mostly engaged in protecting the status quo (Alavi 1983a; Jalal 1990). It usually maintains and protects the interests of the current ruling coalition and its attempts to create a new ruling coalition have usually resulted in the construction of a new coalition with very similar characteristics to previous ones. In reality, the actual power of informal organizations and networks that permeate Pakistani society have meant that while formal power often appears highly concentrated in Pakistan, the enforcement capabilities of ruling coalition have been weak, and formal rules have been significantly modified in reality. As in the case of Gujarat in Chapter Four, a state cannot be characterized as developmental just because it is formally pro-business or even if it able to implement rent allocations to business organizations. More complex enforcement capabilities are required to make a state developmental in terms of achieving developmental outcomes. In terms of this criterion Gujarat is not a developmental state. Similarly, the Pakistani Army is often accused of not using its apparently high enforcement capabilities to enforce developmental outcomes and instead appears to exaggeratedly focus on external adventures. In fact, the Pakistani army arguably lacks the organizational power base in broader society to enforce the difficult institutional rules that would be necessary for developmental outcomes. Viable developmental strategies would have been to reconstruct the composition of the ruling coalition or devise institutional interventions that were developmental but also enforceable in this political settlement. Instead, the availability of easy rents for any ruling coalition that played along with external strategic interests in the area, the strength of informal organizations that the ruling coalition failed to accommodate and indeed the fact that the army perceives important strategic threats to Pakistan resulted in institutional strategies that were neither developmental nor capable of delivering stability in the longer term.

In contrast, the mainstream 'good governance' analysis of Pakistan suggests that Pakistan's instability is due to its weak democratic institutions and so the strengthening of these institutions could turn the country's fortunes around (Candland 2000; Haque 2000; Easterly 2001). Interestingly, this type of analysis cannot explain why neighbouring India which has been a democracy for most of the time and has had elections that have been largely free and fair has also experienced growing levels of political fragmentation, contestation and violence. The difference is that the Indian political settlement at the federal level has evolved to a competitive clientelism with characteristics of 'vulnerable maturity' where no one organization can imagine that it can dominate all the others (M. H. Khan 2011b; P. Roy 2012). In the context of a complex society with a proliferation of organizations, this at least allows the excluded enough of a hope of inclusion through 'normal' clientelist politics. This can entail quite a lot of 'normal' violence but keeps most aspiring organizations away from radical strategies to overthrow the state. In Pakistan, the army has for a long time been able to claim dominance and by association the parties that have ruled in close association with the army have followed strategies of dominating politics from above. But unlike Gujarat's authoritarian clientelism where Modi's ruling coalition was able to browbeat excluded organizations to be quiescent, in Pakistan the excluded have been able to increasingly challenge the legitimacy of the ruling elites, increasingly using the critique of radical Islamism, and adding to the centrifugal forces of regional and ethnic separatist movements.

In the period studied in the thesis, from 1980 to around 2010, the evolution of the Pakistani political settlement had two significant effects. The first was a loss of enforcement capacity on the part of the ruling coalition because of its ebbing legitimacy, which resulted in weaker enforcement of all formal institutions and growing levels of violence. While violence has also been growing in India, the distribution of power across organizations supported by institutional rent allocation is somewhat more stabilizing in averting radical strategies on the part of the excluded. This is not always the case, as the case of the Maoist uprisings and regional separatist movements in India testify, but the level of challenge is arguably higher in Pakistan. The second effect was low levels of economic growth associated with sustained attempts at liberalization and good governance reforms, again in a context of weak enforcement. Liberalization in Pakistan was associated with low and declining growth as is evident from Tables 7.2 and 7.3 above. This period will be analysed in greater detail in Section 7.7.

What was interesting about liberalization in Pakistan was that the most significant moves towards liberalization were made by unelected 'caretaker' governments that served between elections, made up of technocrats, with the backing of the military. They reflected the ideological preference of increasingly weak ruling elites who lacked the power to enforce any pragmatic developmental strategies. The political and policy establishment were willing to adopt the recommendations of international financial institutions and donors largely because they lacked any alternative strategy of their own. In particular, they did not consider the viability of liberalization in a country where economic organizations were in most cases not globally competitive in any sector. Even more critically for Pakistan, the limited implementation of liberalization actually further weakened already weak bureaucratic organizations through administrative restructuring and decentralization. The reforms were ostensibly driven by a desire to prevent the state from capturing public goods and hence ensuring economic growth but in reality the opposite happened. Weakening state capacities arguably led to more decentralized rent capture and declining service delivery. In contrast, in India a few sectors were close enough to the competitiveness frontier to engage in a further spurt of rent-financed learning in the 1980s which led to the emergence of at least a few globally competitive sectors (M. H. Khan 2011b).

Declining political and economic stability can open up a vicious cycle of declining legitimacy and weaker enforcement capabilities leading to even more adverse economic and political outcomes. This process has a number of elements. First, the time horizon of the ruling coalition can become shorter as it faces greater uncertainty. This can result in the creation and capture of quick rents that are more likely to be unproductive and predatorial. Secondly, this can lead to the ruling coalition facing even stronger contestation by emerging political organizations, some of whom may adopt radical strategies of overthrowing the system. Finally the ruling coalition can lose the ability to provide any support for capability development in economic sectors, and in particular in manufacturing. Pakistan's growth in the 1990s and beyond has been driven by the financial sector, real estate and associated services that do not need an effective industrial policy but which also provide few Kaldorean dynamic economies. Economic growth becomes vulnerable, providing limited employment generation and this too strengthens excluded political organizations by supporting the perception that the system is not working.

7.1 Setting the Context

The constraints to growth and stability in Pakistan can be traced back to the loss of legitimacy of the political organizations that could constitute its ruling coalition as a result of their sustained involvement in unpopular policies associated with US interventions in the region and economic liberalization. While this describes the current situation an understanding of the evolution of the political settlement requires a look at the history of the partition of India. Indeed, we argue that it is interesting to remind ourselves about the history of Islam in South Asia because this provides insights into the complex communal relationships affecting not just partition but also contemporary South Asia as well. India's internal structural dynamics which requires a politics of accommodation and concession in keeping a continental country together has an often overlooked impact on Pakistan's polity. There is an unarticulated policy of the ruling Indian elite to convince those wanting or threatening secession that breaking away from India will have huge costs. If Pakistan can have good relationships with India and perform as well as India, this is not a good signal to a multitude of other would-be Indian secessionists. As a result India's aim is to have strategic and economic dominance in the region to make this convincing and credible. This is also why any resolution of the dispute in the Kashmir Valley on any terms that signal Indian weakness is off the table even if Kashmir imposes huge costs on India. The Indian position has inevitably impacted on Pakistan's security-dominated political settlement from its birth as has been documented in Ayesha Jalal's seminal work on these issues (Jalal 1990). It is important to revisit this framework at a time when Pakistan seems to be facing its worst crisis since 1971, the year Bangladesh was created out of a united Pakistan.

Another focus of our analysis will be the ideology of nation building that led to the growing 'securitization' of Pakistan's political economy. By securitization we refer to two parallel discourses applied to Pakistan–that of providing human security and the other preventing it from becoming a 'failed state'. All other developmental agendas increasingly became subservient to these. The Indian subcontinent was partitioned on the basis of a 'two nation theory', referring to the Islamic and Hindu 'nations' but now has the distinction of housing three countries, Pakistan, India and Bangladesh. As Jalal has pointed out, Pakistan was 'painfully' carved out 'ostensibly' as a homeland for British India's Muslims (Jalal 1990). Yet as is evident from Figure 7.2 Pakistan is a far more heterogeneous country than most observers realise, and not just because of the number of languages spoken in that country. Subsequent revisionist historical accounts have pointed out that far from being a spontaneous organic process it was the result of a competition for controlling rents between the Indian National Congress (Congress) and the Muslim League in undivided India. Congress refused to admit the League's well founded contention that Indian Muslims needed some constitutional arrangement to protect their interests and the League refused to accept that the Congress could represent Muslim interests in a first-past-the-post polity where India Muslims (around a third of the population) would be a perpetual minority (Jalal 1990; A. Roy 1993; M. H. Khan 2009c, 2010a, 2011a; Anderson 2012).

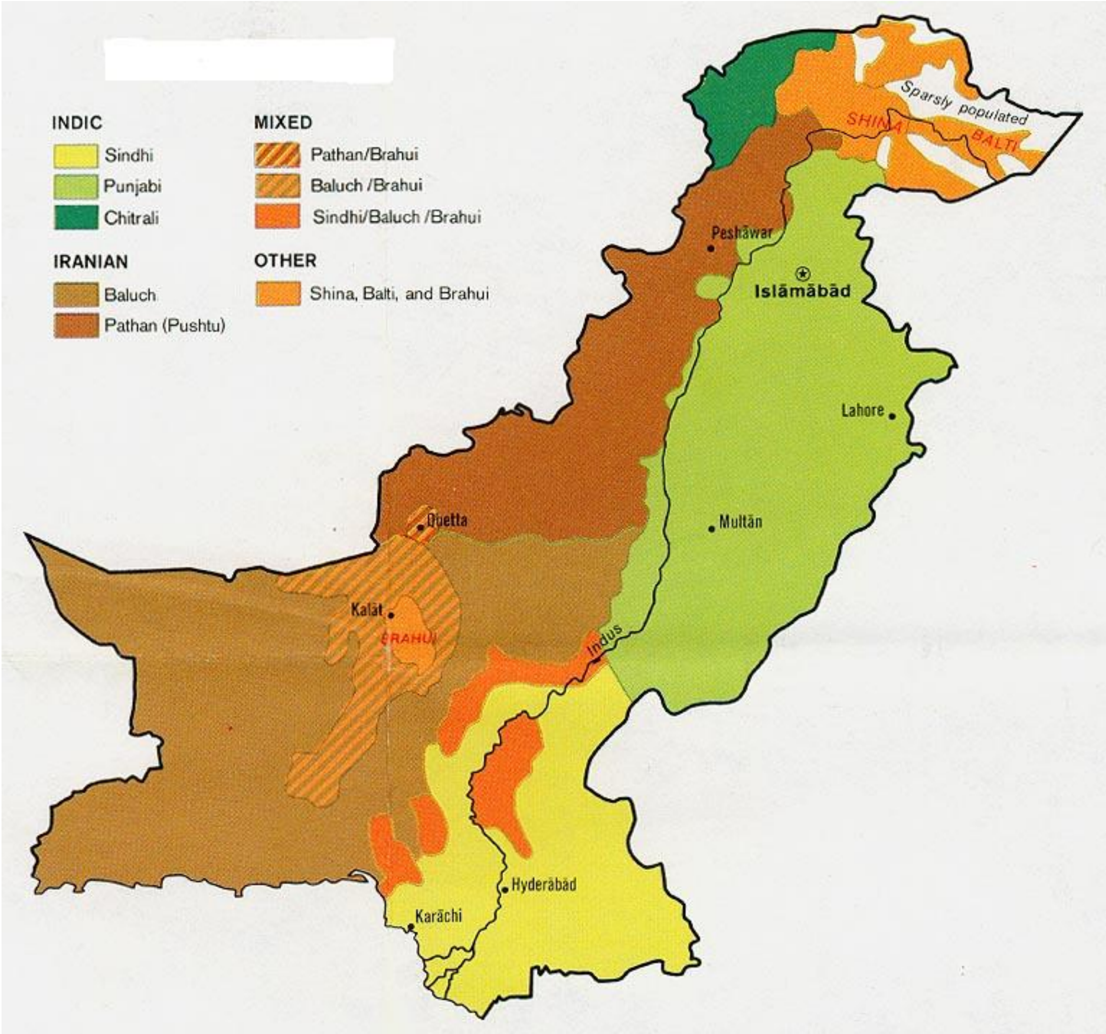

Figure 7.1 Languages of Pakistan
Source: http://ethnicityinpakistan.blogspot.co.uk/ (accessed 03/06/2012)

Note: the provincial boundaries of Pakistan in this map though not marked out correspond roughly to the Baluch (Baluchistan), Sindhi (Sindh), Punjabi (Punjab) and Pushtu (Khyberpakhtunkhwa) speaking areas. Some of the Pashtu speaking regions of the country's northwest also make up the Federally Administered Tribal Areas. Chitrali is spoken in the northernmost district of Khyberpakhtunkhwa. The Shina and Balti speaking areas are in Pakistan's Gilgit-Baltistan.

Pakistan emerged in 1947 not because the Indian Muslims had a well-articulated plan for Pakistan based on a shared idea of national identity. Rather, it emerged because all the propositions that the Muslim League came up with to achieve some level of constitutional protection for Muslims were rejected by Congress. Once it was born, however, Pakistan's leaders had to construct a national ideology that asserted that its independence movement was always about creating a separate homeland for Muslims (Jalal 1990; Talbot 2005; Kohli 2006b; Walter 2010). To be sure a small Muslim constituency in India had imagined an independent, sovereign Pakistan from the 1930s, but most Indian Muslims, including Mohammed Ali Jinnah, were not committed to an independent country till as late as 1946, when the final negotiations broke down (Jalal 1985, 1990; A. Roy 1993; M. H. Khan 2010a; Anderson 2012). One reason for this was that India's Muslims were territorially dispersed, and the regions where they were concentrated, in the east and the west, they had local majorities and did not feel threatened enough to support the Muslim League. Whether a united India would have been successful is anybody's guess but it is clear that partition was the outcome of conscious and expedient decisions taken by the Indian National Congress to maintain its dominance even if that meant losing some territory to Pakistan (Acemoglu and Robinson 2012b; Anderson 2012).

This reading of history is inconvenient for both Pakistan and India, but an objective analysis is essential for understanding the implications of partition for contemporary politics. In India the national myth is that the Congress did everything it could to keep the country together but failed in the face of the League's communal politics. In Pakistan, the equivalent Pakistani myth is that Pakistan was created to protect Muslims from Hindu dominance. The logic of prioritizing security in Pakistan is the direct result of this (mis)reading of the history that led to partition. The security imperative of Pakistan's military and political leadership continues to inform critical strategies like its pact with the US. The Pakistani perception that India may use military force to overrun it is particularly ironical given that it was the unwillingness of the majority Hindus to share power and rents with Muslims that was ultimately behind the Congress decision to push Muslims out in 1947. Interestingly, contemporary India has a significant anti-Pakistan and anti-Muslim rhetoric as part of its political discourse primarily driven by the right wing Bharatiya Janata Party (BJP) to challenge the 'secular' banner of the Congress.

Both countries have thus manipulated history at various levels to construct two nationalist narratives: one based on the idea of an Islamic nation facing an existential threat from India and the other based on a claim of secular inclusiveness. Both narratives deny significant historical facts and processes driving the partition of 1947 and the strategic calculations that led to the respective nation-states emerging. The consequence of partition was the gradual rise of 'soft Hindutva' in India (Engineer 1995; Assadi 2002; Rangarajan 2005; Banjerjee 2007; Shani 2007; R. Desai 2011). A gradual diffusion of markers of Hindu identity in culture, media and even the state is a reflection of a gradual erosion of the formal secular commitment of the Indian state. The Indian constitution still remains robustly secular but the informal norms of the Indian polity have gradually become more Hindu-centric. In a similar way, while Jinnah was hardly a religious person and was more concerned with the political goal of protecting the access to rents and opportunities for Muslims, the logic of partition gradually led to a growing Islamization of Pakistan. In particular, excluded political groups in Pakistan have increasingly mobilized by challenging the Islamic credentials of the ruling elite in Pakistan, particularly when the international alliances of the latter involve supporting the US in regional wars.

The growth of radical Islamism was accelerated in the 1980s by General Zia-ul-Haq's US-supported strategy of arming non-state Islamist actors to fight against the Soviets. By all accounts this process spawned a wide variety of non-state military organizations and by the 2000s, forces like the Tehrik-e-Taliban Pakistan or TTP began to threaten the Pakistani political establishment itself (Lieven 2011). Many observers hold Pakistan's Afghan policy under Zia responsible for the rise of Islamic mobilization. However, we argue that there were deeper fissures in the construction of the ruling coalition in Pakistan and given the country's founding mythologies, significant challenges to the legitimacy of the ruling elites were likely to emerge sooner or later in the language of a betrayal of these ideals.

A distinguishing feature of our analysis relative to most political economy analyses of Pakistan is in the assessment of the significance of the army in explaining Pakistan's developmental trajectory. The implicit pact between the Pakistani Army and business and landed elites, and the army's dominance of Pakistani politics and economics have been identified and discussed in many outstanding contributions beginning with Ayesha Jalal's seminal work on this topic (Rashid and Gardezi 1983; Jalal 1990; Cohen 1994; Jalal 1995b; Rizvi 2000; Arif 2001; Rizvi 2001; Cheema 2003; Rizvi 2003; Zaidi 2005; Siddiqa 2007; Haqqani 2010). However we contend that the Army is not an all-powerful monolith, and rules only because the dominant political and economic organizations have worked closely in tandem with it. The effect has been to monopolize a significant share of rents at relatively high levels of the social hierarchy, to the detriment of achieving a political settlement with low levels of violent contestation. If the Army as an organization were indeed powerful vis-à-vis other organizations, it may have been able to create a developmental along the lines of Taiwan or South Korea both of which were initially led by strong military-backed governments. But in fact Pakistan's army did not have the enforcement capacity to pursue a developmental agenda in the 1960s and its enforcement capacity was even weaker in the 1980s or 1990s. By the 2000s, the capability of the army to control a significant part of rent allocations from above in alliance with its political and business allies began to be challenged by significant political mobilizations that were often informal and violent. This is why we argue that the role of the Pakistani army has to be analysed in the context of a broader range of organizational mobilizations that describe the political settlement in Pakistan and its evolution.

Another element in the political violence and instability that intensified in Pakistan in the 2010s was the growing militancy of the long marginalized tribes of FATA especially in North and South Waziristan. This is often explained in terms of a strengthening of fundamentalist Islamic movements. However, the growing tensions in the region were also the outcome of a breakdown of traditional social structures in Khyber Pakhtunkhwa and the FATA brought about by economic changes and the conflict in Afghanistan. In this sense these conflicts had much in common with the Maoist movements in India's hinterland, where marginalized social groups engaged in violent attempts to overthrow ruling elites rather than attempting to enter their patron-client networks. The ideological discourse in Pakistan was obviously different given its history, but the structural features of the conflict had much in common. At the heart of this process was a significant level of exclusion of these societies from the political rent allocation processes of standard patron-client politics combined with shocks that destroyed the legitimacy of the established political organizations at the very moment when inclusion became necessary to avoid conflict.

In Pakistan, the loss of legitimacy of mainstream elites came from a foreign policy crisis. Pakistan's external rents in the 1990s were conditional on support for the US offensive in Afghanistan. While Pakistan carried out some operations in pursuit of this objective, its strategic interests in Afghanistan also meant it could not afford to fully abandon the Taliban if it wanted to ensure an eventual Pakistan-friendly government in Kabul (Lieven 2011). At the same time Pakistan's policy of ignoring US drone attacks in these areas and the Pakistani Army's own actions against in the Swat region contributed to fundamentally weaken the legitimacy of the Pakistani state in these marginal societies. A more orthodox Islamist ideology began to replace the 'Pakhtunwali', the social code of the Pathan tribes in the region (Ahmed 1980; Economist 2009; Lieven 2011). The rise of the Taliban in Pakistan is often mistakenly conflated with irredentist terrorism. We argue that strategies of violence are better understood in the context of a broader analysis of processes of mobilization and the success or failure of accommodation of new groups within an evolving political settlement.

7.2 History of Islam in the Indian Sub-Continent: Hostage to Polemics

The history of Islam in the Indian subcontinent has to be distinguished from the political mobilizations around religious, ethnic, caste and other identities as competing groups have attempted to acquire the organizational power to capture and retain rents through the political process (Jalal 1990; Rodrik 2007). The reason why a delineation of history is so important to the formation of the countries within the sub-continent is that each has constructed its identity based on the same sequence of historical events but with starkly contrasting interpretations of these events. Recent revisionist histories have demonstrated how a strand of Indian nationalism was implicitly Hindu nationalism and in certain contexts continues to be so (Sobhan 1990; Islam 1992; Chatterji 1995; Quazi 2005; Rodrik 2007; S. Khan no date).

Islam had an established though limited presence in India much before Islamic rule was established in Delhi. By the 7th century CE Calicut in southern India was India's foremost entrepot with already established trade links with Rome and the Middle East now being extended to Arab Muslim traders. By the 14th century CE the growing numbers of Arab Muslim traders were well assimilated into the society of the Hindu Zamorin kings of the region (Dale 1990; Osella 2008). However the establishment of Muslim rule on the Indian sub-continent began with the conquest of Sind under the Iraqi governor in 711 CE which resulted in the province's incorporation into the Umayyad caliphate. Mahmud of Ghazni (Ghaznavi in present day Afghanistan) invaded Punjab in the early 11th century CE but did not establish his rule. Another Afghan king Muhammad of Ghor declared himself independent from Ghazni and established a kingdom spanning the north western Indian sub-continent. His successor Qutb-ud-din-Aibak shifted the capital from Lahore to Delhi and became the first Muslim ruler of the Indian sub-continent. In India it is a measure of the contemporary polemics involved that the Sultans of Ghaznavi and Ghori are singled out as ruthless conquerors, especially Ghaznavi's campaign in Gujarat which involved the looting of a Hindu temple, Somnath. That incident like so many others of similar nature in world history is more 'a rhetoric of state building' or as Ahmad observes in both the case of Somnath and other temple desecrations it served as a 'pseudo religious wartime sport' to serve as 'proof for the self-satisfaction of the invaders that the wars they were waging were not for… the carving out of an empire, but had religious justification' (A. Ahmad 1964). Thapar has gone on to say that contemporary Hindu accounts do not ascribe much importance to the plunder of Somnath (Thapar 2005). Yet this has been mythified by the now mainstream right including the BJP as a wound on Hindu consciousness and identity wreaked by Islam in India. In Pakistan on the other hand Ghaznavi and Ghauri are short and medium range ballistic missiles capable of hitting Indian targets, so named in an obvious play on the names of the two Sultans who made successful forays into 'Hindu' India. At the time of Mahmud of Ghazni's invasion Hinduism was not the Brahmanical religion recognized as such today but a collection of diverse sects and cults which only gradually came to resemble the Brahmanical religion of today. The term Hindu according to Thapar was initially used as a geographical and ethnic marker or for the indigenous population and not as a monolithic community (Thapar 1996, 2005; Rodrik 2007; Besley and Persson 2011). This identity came into being in the 19th century CE under British rule when access to jobs and resources were dependent on the size of the community, hence a mobilization on the lines of an upper caste Brahman dominated identity became necessary (Prakash 1988; Thapar 1996; Rodrik 2007; S. Khan no date).

The period between 1206 CE to 1525 CE saw various Muslim dynasties consolidate their hold over north India in various degrees. Babar, a Chagatai Turk established Mughal rule in India from 1526 CE, making India under Mughal rule one of the largest empires in the world in the 16th and 17th centuries. The revenue system and land records formulated under Akbar the most famous Mughal king were used by the British and continue to be the basis of current revenue administration in some parts of India. For this period historians have outlined various scenarios of what the relationship between the two communities could have been. While not attempting a detailed analysis it is possible to say they straddled a spectrum from syncretic co-existence (Fearon 2010) to exhibiting political tensions (Marx 1996) to 'an insular co-existence' (A. Ahmad 1964). However despite attempts to describe this phase of Muslim expansion in India as colonization by the founders of Hindu right wing organizations writing in the early 20th century CE historical evidence shows no support for this discourse. Whatever be the approach ones takes given historiographical evidence it is not possible to conclude that the two communities were at perpetual war with each other or that the two did not influence each other in very fundamental ways. The detailed socio-political dynamics between Islam and Hinduism are beyond the scope of this paper but one would still need some references to these processes to fully grasp what happened in 1947. Eaton summarizes the dynamic effectively when he calls Islam both the dependent variable through 'accretion' or natural growth and the independent variable through the 'reform' process where Islam is posited as socially distinct (Ritzen, et al. 2000). In the deeper south there were alternating Hindu-Muslim dynasties at odds with the neat periodicity some scholars, especially earlier Orientalist ones and from current right wing organizations have tried to outline for Indian history of Ancient (Hindu)-Medieval (Islamic)-Modern (British Colonization and the independence movement) (Thapar 1996; Rodrik 2007; Besley and Persson 2011; S. Khan no date).

The growth of Islam in South Asia was achieved not through systematized and violent conversions but through a mechanism of deep rooted social transformation especially in the provinces of Punjab and Bengal and Sind. Bengal, Sind and western Punjab were areas outside the immediate primary influence of Brahmanical Hinduism at the time of the spread of Muslim rule in India. They were also far away from the centre of Mughal rule strongly suggesting there were non-state agents responsible for the spread of Islam in these places contrary to current beliefs about Islam being spread through forced conversions by the rulers. In the case of Bengal a split in the course of the river Ganga in the 17th century into what are now the Hugli that flows into West Bengal and the Padma into Bangladesh had social repercussions. The eastern and older part of the delta, now west Bengal was already Hinduized while the portion of the province now served by the Padma was largely forested and the communities there were still had animist beliefs some of which persist till today (Government of Bangladesh 2009). The Mughals who were keen to settle this area as it had turned into a fertile region due to silting by the Padma gave land grants to Muslim 'pioneers' some of who were Sufis settled eastern Bengal and gradually converted the communities there into Islam (Keefer and Knack 2007). In Sind as the various tribes of the region settled in irrigated areas around the river Indus the Pirs or holy men from various Sufi orders emerged as arbiters in fights between the tribes gradually increasing their own power and driving the adoption of Islam. In Punjab the nomadic Hindu Jat tribes would come into contact with urban residents around the Sufi shrines and once the Jats adopted settled cultivation they gradually adopted an Islamic identity focused around the shrine (Keefer and Knack 2007). Hence the areas with the largest numbers of Muslims, eastern Bengal, western Punjab, Sind, NWFP and Baluchistan were not strictly within the folds of caste-bound Brahmanical Hinduism around the times we are referring to. The idea of conversion in Islam only became popular around the 19th century CE when British scholars were trying to cast the spread of Islam in South Asia in the mould of what Christian missionaries were doing in European colonies.

The rest of the section will not delve further into Islamic rule in India once it was established because that does not contribute directly to events surrounding partition. What only needs to be mentioned about the initial period of British rule, as early as in the first few decades of the East India Company was the beginnings of the creation of a historiography of Hinduism that necessarily cast Muslims as 'foreign' in India (Chatterjee 1991). The history that we outline is certainly not the version of history of partition as it is *popularly* understood in the sub-continent and indeed elsewhere in the Western world which is of a fatal clash of opposing cultures. The reason we outline is more materialist with culture once again being instrumentalized for mobilization and the roots of the conflict between sections of the Hindu and Muslim community in South Asia lie with the advent of electoral reforms in British India and the creation of separate electorates (Government of Bangladesh 2003; M. H. Khan 2009c, 2013a). This was a period of significant constitutional reform by the British and League and Congress strategies around this time focused heavily on their responses to these attempts at reform, essentially to the various strategies of power sharing that the British were trying to implement. The decisive stage in the creation of Pakistan and India begins from 1909 with the introduction of the Morley Minto reforms or the Indian Councils Act. For the first time this Act allowed election of Indian members to the Legislative Councils at both the centre and the provinces. Following this were the Montagu Chelmsford reforms in 1919 which started the system of dyarchy in India and allowed for relatively significant autonomy to the provinces. This Act shifted the theatre of Hindu-Muslim representation to the provinces, especially Punjab and was no longer concerned with power sharing in Delhi (Jalal and Seal 1981). The Government of India Act in 1935 provided for significant autonomy to existing provinces and resulted in the creation of separate provinces, most significantly the creation of Sindh from Bombay Presidency. The proportion of franchise through direct elections also increased under this Act. Some have also credited the Act with bringing about the origins of 'patronage politics' in the sub-continent as elected ministers started jockeying for power (Alavi 1983b). Interestingly the League was still not a force to reckon when elections were held under the new Act in 1937, just a decade before partition. The Congress had majorities in seven provinces and the Muslim majority provinces of Punjab and Bengal had non-League governments, though in Bengal it was in coalition with Fazlul Haq's middle class peasant dominated Krishok Proja Party and in Punjab the Fazl-I-Husain's Unionist Party was in power. Both these parties though Muslim dominated were an alliance of class interests—upper class land owning in Punjab and middle peasant in Bengal. The irony of this contradiction makes for interesting academic pursuit but is beyond the scope of this paper. By 1946 matters changed completely in both these provinces.

In the interim British India witnessed its most tumultuous decade. While defending itself against the Axis powers in the World war the British were also trying to hammer out an Indian constitution best suited to the many diverging interests in India. To this end it organized three Round Table Conferences, set up the Communal Awards (which provided for separate electoral constituencies for minorities) and finally the Cabinet mission in 1946. The history of this period perhaps remains one of the most widely researched periods in colonial history and this paper will not attempt to reproduce it here. But between these years the League grew in popularity with the Muslims under Jinnah who was now able to legitimately claim that he spoke for Muslims given the Congress' general recalcitrance with issues of representation (Jalal and Seal 1981; Bradford Jr. 1990; Jalal 1990; Government of Kazakhstan 2003). Most level headed historical accounts of this period of history portray Jinnah as an astute leader who dangled Pakistan as a bargaining counter for securing legitimate Muslim rights (Jalal 1985; Government of Bangladesh 2003). For one certainly for a majority of his political life Jinnah disagreed, with Gandhi's strategy of mixing religion with politics. It is of course also well documented that Jinnah agreed with the one last effort the British put in to ensure an undivided India, the Cabinet Mission (Jalal 1985; Hasan 1993; A. Roy 1993; Anderson 2012). The Cabinet Mission rejected the idea of a sovereign Pakistan and divided the 11 British ruled Indian provinces into three 'sections' which could later if they wished from into three 'groups'. The centre would only oversee foreign affairs, defence, communication and finance for the three groups and substantial local autonomy was left to the sections. Provinces were allowed to secede from the Groups but not the Indian union. The three sections were the Hindu majority provinces that make up much of modern India today, the Muslim majority provinces of the north west (Punjab, Sindh, Baluchistan, NWFP) and the Muslim majority provinces of the east (Bengal and Assam though Assam had a sizable not majority Muslim population). Yet this was rejected by the Congress and Nehru who felt only a strong 'centre' ruled by the Congress was in India's interests (Bradford Jr. 1990; A. Roy 1993).

What partition does demonstrate is how important the creation of demography is once a western style representative democracy is introduced in developing countries. Historians of partition have consistently demonstrated how electoral mobilisations based on demography in Punjab, Sindh and Bengal allowed for successful cleavages to take shape (Islam 1992; Chatterji 1995; Talbot 2005; World Bank 2007). In the case of Sindh and Punjab it was mobilisation by Muslim landowners and pirs (holy men) respectively that helped the League's cause in 1947. In undivided Bengal under the British (the eastern part of the province became first East Pakistan and then won independence for itself as Bangladesh) conversely it was the upper caste Hindus who mobilised for partition (Chatterji 1995; M. H. Khan 2010a). As Khan describes it in the case of Bengal the shift towards a religion based identity or communal one was essentially a 'crisis of exclusion' where the economically and politically powerful but minority in terms of population Hindu elite were threatened by the increasing political mobilisation of a rising Muslim intermediate class. The issue at hand was who would rule Bengal's provincial assembly and wield power. Matters were very different in 1905 when Muslim-Hindu unity in Bengal was seen as exemplary. It was a successful combination of Muslims and Hindus that opposed an initial administrative partition of Bengal in 1905, a feature of imperialist Britain's famous 'divide and rule' policy. What changed from then to 1947 was the introduction of limited suffrage and separate electorates (where Muslims would vote only for Muslims) and the resulting emergence of a specific patron-client political settlement (M. H. Khan 2010a). Elections required the competing groupings of Hindu elites on one side and the intermediate class of the Muslim peasantry on the other to wield organizational power and this was done through patron-client politics. As we have mentioned in Chapter Three developing countries whether democracies, single party or with authoritarian regimes can have competing patron-client groupings. This is an almost universal feature of developing countries and their presence can be linked to their low levels of economic growth. Redistribution is then achieved through informal means that is often called patronage politics as a pejorative but is a structural feature of developing countries, and not cultural.

In the end a combination of the impatient British, expedient Congress and precipitate League ensured the rejection of further attempts to forge an Indian federation and finally resulted in partition and independence in 1947. The irony was that a third of British India's Muslim population lay outside the new 'Muslim nation'– a mockery of the two nation theory. It was impossible for the sizable Muslim population *within* the Hindu majority provinces to make the move to Pakistan even if they wanted to. This made it possible for the Congress to cast the League action almost as an act of secession (Jalal 1995a) and it is this (mis)interpretation that sticks to the sub-continent to this day.

7.3 The First Three Decades: From Industrial Policy to 'Islamization'

The first serious blow to independent Pakistan occurred in 1948 with the death of Jinnah. By 1951 its first Prime Minister Liaquat Ali was mysteriously assassinated. However through this political turmoil Pakistan pursued aggressive policies of industrialization in the first two decades of its independence. In the 1960s it actively encouraged capitalists willing to invest in industry by subsidizing their learning through bearing the start-up risk. This proved to be successful with Pakistan's manufacturing growth rate outpacing India's. While there have been arguments that Pakistan was building from a very low base its gains in the manufacturing sector cannot just be explained away by the base effect as we will see in later sections. Here Pakistan's attempts at industrial development were different from India's dirigiste economy in that it encouraged private sector participation and the state remained as the risk bearer in the initial stages, an institutional innovation not often seen in developing countries (M. H. Khan 1999). In the 1970s and 1980s Pakistan had developed two export oriented industries, a viable cotton textile industry and a highly successful surgical instruments industry. In fact right till the 1980s India's GDP growth trend was lagging behind Pakistan. However the strategies for industrial development used by the two countries did not have the desired effects.

On the political front in Pakistan the military stepped in to bolster the flagging strength of Pakistan's political parties. The League in both East and West Pakistan lost its popularity and came to be replaced by a United Front government in East Pakistan and by political parties like the Republican Party in West Pakistan. By the time Ayub Khan's coup took place in 1958 the civil-military complex was already quite strong in Pakistan. Also in place was an anti-Indian rhetoric that was based on the interpretation of having seceded from 'Hindu' India as mentioned in the Section 7.2. This meant any show of opposition to the centre was immediately marked off as anti-national and even pro-Indian (Talbot 2005).

A lot has been written about Pakistan's early years of industrial development (Gordon 1954; Papanek 1967; Sayeed 1995; Zaidi 1999; M. L. Ali, et al. 2003; Robinson 2010; National Institute of Statistics 2012) and the country was quickly able to achieve a trade surplus due to an overvalued exchange rate during the commodities boom of the Korean War in the 1950s. As Noman points out this created enough wealth for many of the country's trading class who now also had surplus to invest in industry when the boom from the Korean War petered away (M. L. Ali, et al. 2003). In the 1950s manufacturing became the leading sector in Pakistan growing at 8 per cent per year (Robinson 2010). However more important than these growth rates were three important institutions that were set up by the government in this period the Pakistan Industrial Credit and Investment Corporation (PICIC), the Pakistan Industrial Finance Corporation (PIFCO) and the Pakistan Industrial Development Corporation (PIDC). These institutions were innovations at the time as they acted as risk financiers for manufacturing though their effect on increasing inequality is now a matter of debate within Pakistan. The PIDC was the lead organization and served as a financial institution that funded learning as it made the initial investments in areas the private sector did not immediately see returns in before selling these enterprises to entrepreneurs (M. H. Khan 1999). As we have discussed in chapter two of this paper entrepreneurs in developing countries often fail to invest in critical industries due to the risk imposed by high entry costs and late profitability. With PIDC bearing this initial risk entrepreneurs could then be bought in at a stage which was relatively more within their capabilities or more importantly aligned with their appetite for risk. The declining terms of trade for agriculture also meant that the agriculture driven economy of East Pakistan suffered more due to the strategy of ISI, contributing to the perception of marginalization in that province that would reach its climax in the creation of Bangladesh (Power 1963; M. H. Khan 1999, 2012c).

The period of General Ayub Khan’s tenure (1958 to 1969) has been well documented in literature on Pakistan (Gordon 1954; Alavi 1976; M. H. Khan 1999; Robinson 2010; Walter 2010). Muhamad Ayub Khan rose to prominence when he was appointed commander-in-chief by Liaquat Khan in 1951 and he took over power in a coup in 1958. Burki suggests that the army was able to step in because a conflict between the landed indigenous elite and the migrant politicians created a situation where the army could strengthen its own position (Burki 1980). Ayub's rule is marked by two significant milestones namely the attempt to establish democracy directly bypassing political organizations in rural Pakistan through ‘Basic Democracy’ and high levels of industrial and economic growth that was achieved by first through PIDC’s policies and then by discretionary allotments to selected capitalists. These had consequences that helped explain the political settlement towards the end of Ayub’s reign, namely the explosion of secessionist dissent in East Pakistan and even in West Pakistan significant political opposition to him that saw the rise of Zulfiqar Ali Bhutto. Pakistan’s urban population grew from 17 percent in 1951 to 22.5 percent in 1961 with a three-fold increase in the number of industrial workers. It is no surprise that opposition to the Ayub regime was the strongest in growing urban centres (Jalal 1990; Sayeed 1995). For one his strategies did not even work in West Pakistan but it was even more unsuited for the east. Bengal, even as an undivided province in

British India was known for its high levels of political mobilization and sensitization (Sayeed 1995). The secession of Bangladesh from united Pakistan can be best described as the exclusion of the East Bengali elites from the Punjabi and Mohajir (Muslim migrants from India to Pakistan) controlled political.

Table 7.4 Sectoral and GDP growth rates 1971-77 (constant US$2000)

GDP	4.2
Agriculture	2.1
Industry	5
Manufacturing	3.4
Services	6.6

Source: (World Bank 2012a)

The issue in East Pakistan however was not as simple as an upsurge in latent nationalist sentiments fuelled by an almost colonial attitude of ‘Punjabi’ West Pakistan (M. H. Khan 2010a). At least in the 1950s there was a genuine attempt by both wings of the country to make the arrangement work with many Bengali politicians in leadership roles nationally and there was no groundswell of support for independence even till the mid 1960s (M. H. Khan 2010a). In the best south Asian tradition though mainstream Bangladeshi discourse excises this historical fact and concentrates only on the ‘War of Liberation. For sure the terms of trade being against agriculture and the overvalued exchange rate did affect the agriculturally better endowed East Pakistan (rice, jute) in the 1950s. Levels of investment were also higher in the western wing than in the east but as Talbot, Khan and Jaffrelot have shown towards the end of the 1960s investments were actually on the rise in East Pakistan (M. H. Khan 1999; Jaffrelot 2002; Talbot 2005). By the time popular resentment in both West and East Pakistan forced Ayub Khan to leave office in favour of General Yahya Khan in 1969 there were other catalysts would eventually lead to the formation on Bangladesh after a decisive and opportunistic Indian military intervention in 1971. This was basically the fact that Bhutto and the PPP were vehemently opposed to Mujib-ur-Rahman becoming Prime Minister of Pakistan even after he won a majority in the elections of 1970.

Zulfiqar Ali Bhutto came to power in tumultuous times but he had the support of the West Pakistani elite who despite being a minority were loathe to lose economic and political power to East Pakistan. Despite presiding over the dismemberment of the country Bhutto's early years were characterized by a high level of support for him. The first reason for this was that the army was still recovering from its loss against India and still too weak. The second reason was Bhutto's early recognition of the fact that patronage based politics was necessary to ensure his survival. To this end Bhutto diluted the strength of Pakistan's highly capable bureaucracy by firing 1300 civil servants in 1972 who had incidentally entered the civil service through the tightly regulated Civil Service of Pakistan, a holdover from the British times mirroring the similar Indian Administrative Service. This was done in order to facilitate lateral entry for important members of the PPP and supporters of the regime in return for their support. The other key feature of Bhutto's redistributive politics was the nationalization of some industries, the financial and education sectors. However he alienated a large section of small-scale industrialists and traders by nationalizing three semi- cottage industries of rice milling, cotton milling and ghee (clarified butter) production (Sayeed 1995).

Bhutto identified his policies as 'Islamic Socialism', a sort of catch-all phrase that he tried to supplement with populist, redistributive policies. But his explicit use of Islam, the first time since independence was essentially a cover for an authoritarian one-party rule. His policies could not deliver the broad based growth that Pakistan so desperately needed precisely because apart from a few populist measures most of the regime's energies were concentrated on building a combination of clientelist support that it thought would ensure support. GDP growth stalled to 4 percent and manufacturing was the worst performing sector (Table 7.4). His populist economic policies had succeeded in slowing down the Pakistani economy though some economists like Zaidi and Hamid contend that some of the growth in Zia's tenure occurred as projects sanctioned under Bhutto came on stream later and that the small scale industry sector actually did better under Bhutto (Zaidi 1999; Hermes and Lensink 2001). However the clientelist political settlement can veer damagingly towards high levels of fragmentation and contestation with patrons unable to enforce order over their various factions if economic growth is low and therefore the opportunity for payoffs is low. The operational equilibrium under Bhutto proved too tenuous with just the rural voter base on his side and once again popular protests laid the ground for Zia-ul-Haq's coup. What added to the collapse of the political settlement in this period was also the growing strength of the army that Bhutto had to depend on to quell uprisings in Baluchistan. The political settlement under Bhutto can be described as authoritarian clientelism.

Table 7.5 Sectoral and GDP growth rates 1977-88 (constant US$2000)

GDP	6.6
Agriculture	3.9
Industry	8
Manufacturing	8.8
Services	7

Source: (World Bank 2012a)

This brought Zia-ul-Haq into power with a coup in 1977 and he ruled Pakistan till his assassination in 1988. Enough has been said about Zia-ul-Haq and his rule and its import for Pakistan (Jalal 1995b; Zaidi 1999; M. L. Ali, et al. 2003; Talbot 2005; Karim, et al. 2010; Robinson 2010). Hence this section won't attempt a lengthy exposition of the details of Zia's regime but only pick out and analyse the most consequential aspects. All agree that Zia's regime turned out to be the one that firmly linked Pakistan to the Cold War anti-Soviet Union global geo-political discourse. His regime is also known for repression of civil liberties and using Islam as an ideology to foster national unity in the face of Soviet presence in Afghanistan as well as heightened political mobilization within Pakistan. Yet the Pakistani economy grew at a rate averaging over six percent in these years. Zia did not start out as an ally of the US. It was only with the Regan administration's involvement in aiding the Mujahideen forces in Afghanistan that Pakistan occupied a frontline position in the US' anti Soviet strategy.

Pakistan's growth in the Zia years was not linked to an expansion of its manufacturing sector. The economy grew due to a rise in the proportion of foreign aid, especially military aid that flowed into country because of its involvement in Afghanistan, and the increasing remittances from Pakistani citizens working in the Middle Eastern countries as the Pakistani political economy became more linked to the Middle East, especially as a result of its attempts to institutionalize Islam within the state. Between 1978 and 1986 skilled Pakistani workers sent home as much as $25 billion in remittances (M. H. Khan 2011b). A reversal of some of Bhutto's nationalization policies also followed but remittances and aid were the main reasons for Pakistan's GDP growth in this period (Table 7.5). Aid of course added to the GDP numbers and the remittances helped spawn a middle class larger than was seen in the previous decades (Zaidi 1999; Talbot 2005; Robinson 2010). The rise of this middle class led to the development of a few sophisticated industrial clusters around Faisalabad and Sialkot that sustain till today, though in the face of increasing costs and decreases in productivity, the reasons for which will be discussed later. The cotton textile sector also did well but could not move beyond low value added manufacturing. While a re-privatization was not carried especially in the insurance sectors barriers to entry for private enterprise were quickly dropped and this helped small entrepreneurs and growth picked up once again (Sayeed 1995; Zaidi 1999). However lack of appropriate policy instruments to aid this entrepreneurial base led to increasing informality in the Pakistani economy from this time. This period did see the emergence of a new type of capitalists but they were very different from those during Ayub's tenure. These capitalists had political ambitions and were more closely meshed into patron-client structures of Pakistani politics. They included families like the Lakhanis, Sharifs and Hashwanis who made their money through newly deregulated sectors like cement, oil seeds, and fertilizers (Sayeed 1995). However the growth they produced can best be described as what Khan defines as primitive accumulation or growth through off market (informal) activities like land grabs, resource capture or extortions (M. H. Khan 2002a, 2012e) without providing any positive feedbacks into the formal economy through productivity and employment led growth. The Sharifs are of course the most well known with the family now becoming one of South Asia's leading political dynasties through the Pakistan Muslim League (Nawaz) or PML (N).

Towards the end of his tenure Zia had began to distance himself from the more obscurantist demands of the Ulema but by then the country was already deeply divided on sectarian lines (Talbot 2005). Like Ayub, Zia missed an opportunity to discipline the capitalists his regime created because his focus remained foreign policy. More importantly the rise of the middle class could have provided credibility to targeted industrial policy instruments had they been introduced and implemented. The political settlement that evolved in the Zia era, a long 11 years was one where the army became the organization superior over all others. The army was also increasing its role in directing the economy and even taking part in production. Formal political organizations (electoral parties) were kept under severe repression. And informal organizations, especially of small businesses and religious organizations were created for the army to gain legitimacy at a time when political freedom was suppressed. It is impossible to answer where Pakistan might have headed had Zia not been assassinated. However the levels of repression and exclusion in the political settlement would likely have made it unsustainable.

7.4 Democracy, moves towards Liberalization and a return to Military Rule

General Zia's untimely death provided Pakistan's leaders with an opportunity to break with the past and in a sense the military establishment did so by refraining from continuing with army-led rule. Elections were held in 1988 and the PPP under Zulfiqar Ali Bhutto's daughter Benazir Bhutto won a majority enough to form a civilian government. There were high expectations from Benazir, but this was to be no transformational move that changed the political structure of Pakistan in any permanent manner but a transitional one where only the seat of formal power changed. Informally the army still retained effective power. Once again this section will only highlight the significant events that were to affect the political settlement at this time.

Table 7.6 Sectoral and GDP growth rates 1988-99 (constant US$2000)

GDP	4
Agriculture	4.3
Industry	4.5
Manufacturing	4.0
Services	4.3

Source: (World Bank 2012a)

Talbot (2005) provides a detailed exposition of this period for those interested. It was Benazir's attempts at toeing a line independent of the army and the powerful president Ghulam Ishaq Khan that cost her prime ministership in 1990. However her own autocratic style, inability to break the stranglehold of large landlords, appropriation of state resources for private use, especially deals concerning her husband Asif Ali Zardari, later to be Pakistan's president and an inability to direct economic growth provided the Army with enough rationale to dismiss her. Increasing confrontations with the powerful Islami Jamhoori Ijtehad (IJI) of which Nawaz Sharif was the main leader were debilitating but more critically the PPP's failure to come to any compromise with the Muttahida Quami Movement or MQM in Sindh meant the province, especially Karachi the economic hub of the country was rocked by violence throughout her tenure. The MQM was founded in 1974 to represent the rights of Urdu speaking migrants from British India and has remained a political organization in Sind with significant holding power that the party uses to mobilize its supporters, sometimes violently when it feels a threat to its existence.

Nawaz Sharif came to power after elections in 1990 and despite being close to the Army as well as having his power base in the influential Punjab province he found it difficult to run the government given the mistrust between the political organizations and the army. The legacies of Zia's Islamic mobilization were also bearing down heavier on him because his ruling alliance the IJI included parties like the Jamaat-e-Islami (JI) that wanted to press ahead with their agenda of Islamization. He survived in power for three years because he was a cannier politician than Benazir having been chief minister of Punjab earlier and helping his father build their industrial empire during the Zia regime (Talbot 2005). Yet Sharif's downfall was exacerbated by his anti-Saddam policies when the Pakistani sentiment was anti US and pro-Saddam. More importantly the army was also displeased with Sharif for taking Pakistan US relations to one of its lowest ebbs as a result of some Chinese arms procurements. Perhaps the greatest shortcoming was the absence of any live and let live politics between the PML (N) and the PPP on the lines of those achieved by the Dravidian parties in Tamil Nadu. If the two parties had come together to oppose the army and President Ghulam Ishaq Khan at this time at this time civilian rule might have been strengthened in the country. However the intense clientelistic competition between the two main parties made political stability a casualty in Pakistan. On the economic front Sharif's first term largely saw a policy of economic liberalization. By the October of 1990 as many as 89 state enterprises were up for sale and controls on inflow of foreign currency were removed in an effort to attract foreign investment. The Sharif government was accused of misappropriation of public funds in cooperative societies which led to ordinary depositors losing Rs 20 billion. In 1993 a caretaker government was sworn after the President Ishaq Khan dismissed the Sharif government, once again because the president and the prime minister were at loggerheads. Moeen Qureshi, a former vice president of the World Bank was brought in to head the caretaker government. This feature of caretaker governments in Pakistan being headed by political outsiders will be discussed later in the section.

Benazir was re-elected in the elections of 1993 but like with the two elected governments before decisive power remained with the army and president. But the most singular problem in her second term before she was dismissed again in 1996 was the civil war like situation in Karachi as pitched battles were fought between the MQM(A) or the Altaf Hussain faction of the MQM and the army with the PPP government being unable to stem the violence. However incessant counter insurgency tactics ensured the violence at least died down. However, Talbot argues that this also ensured Pakistani society still remained deeply divided. It is not as if the violence in Karachi was the only issue that plagued the second PPP government. The needs to implement IMF imposed austerity and the realities of keeping the military on her side ended up with the party alienating organized labour, a key PPP support base. Labour was hit by privatizations under austerity and on the other hand her own party functionaries uncomfortable with ex-military officials being appointed as governors of provinces (Talbot 2005). The PPP victory also had an adverse impact on sectarian conflicts rather than quelling them. As our framework suggests powerful organizations that do not accept the legitimacy of an election result will contest it to achieve a distribution of benefits and authority that reflect what they believe is the true distribution of power. In this case organizations like the Tehrik-e-Nifaz-e-Shariat-e-Mohammadi (TNSM, a breakaway group from the Jamaat-e-Islami) were fighting the Pakistani army for the implementation of the Sharia in the Malakand region of Khyberpakhtunkhwa, a fallout of the strategy of aiding the Afghan Taliban (Talbot 2005). Contrary to popular knowledge Pakistan was already fighting its own citizens who wanted a society based on exclusively Islamic tenets as long ago as 1992. By the mid 1990s the Pakistani state was trying to balance two similar forces but opposing strategies (Toufique 1996). On the back of these developments ambitious efforts were made to bring down the budget deficit to 4.5 percent of the GDP in line with IMF requirements. Her budget of 1996 proved to be highly unpopular as an already beleaguered middle and lower class were saddled with higher costs of living. Benazir agreed to further tax increases to receive the third tranche of a standby which the IMF was refusing to release. This proved politically unsellable and violent anti budget demonstrations followed spearheaded by the transport sector, doctors, booksellers and newspapers vendors going on strike

(LaPorte 1997). Political recriminations between Benazir and president Leghari acted as the catalyst in the dismissal of her government.

Nawaz Sharif and the PML (N) were voted back in the elections of 1996 with the JI refusing to take part. The JI boycotted the elections at this time because it felt the voter lists and constituencies need to be redrawn and did not reflect changes in population. In reality the JI was unable to match the patron-client politics, especially the biradri based politics of the two main clientelist parties (PPP and PML) and hence would have been unable to compete electorally with them. This is still one of the reasons why the JI hasn't become a formidable electoral force in Pakistan. (However after elections held this year the JI has entered into a coalition to run the provincial government in Khyberpakhtunkhwa with Pakistan's emerging opposition party Pakistan Tehrik-e-Insaaf though it itself has a share of only nine seats). By this time Pakistan's debt levels meant every Pakistani carried a liability of $500 (Talbot 2005). Given the increasing politicization of the bureaucracy and Sharif's attempts at deliberately weakening the judiciary the Army was called in to perform routine administrative tasks. This only made the Army stronger and better able to check Sharif's growing bent toward authoritarianism (Talbot 2005).

But the real import of Sharif's animosity towards the Army was its consequences for the economy. The Pakistani economy saw a dip in the GDP growth rate from the levels of the Zia years, from 6.6 to 4 per cent (Table 7.6). The PML(N) at one point seemed to be political organization most suited to develop capabilities among Pakistan's indigenous businessmen (Lieven 2011) . It was created by the Army, specifically Zia, and the Sharifs and similar families were successful businessmen with the correct kinship networks. This would have helped the Army overcome difficulties arising out of picking 'winners' and hence solve the problem of lack of legitimacy that so often confronts states pushing an industrial agenda that favours some over others. As we have mentioned before one of the reasons for the failure of Ayub Khan's attempts at implementing industrial policy was an inability to choose capitalists who could also claim legitimacy from Pakistan's other social classes. By the time Sharif came to power the Pakistani middle class had also evolved enough to demand the benefits of further industrialization. The party was also in alliance with the JI and the latter's popularity among those sections of the country who are both conservative and lower middle class and newly emerging middle class would have provided the PML (N) with the added legitimacy it lacks now, especially with Islamic organizations mobilizing much more intensely in contemporary Pakistan and not always for economic redistribution.

Another advantage was that the PML (N)'s stronghold is in Punjab, Pakistan's industrial heart which includes industrial centres like Faisalabad (in the Saraiki speaking region) and Sialkot (near Lahore). The Saraiki speaking regions can sometimes be at odds with the Punjabi speaking regions but Sharif was still able to carry his party through in the Saraiki regions. However Sharif took the Army head on and at this time General Pervez Musharraf ensured Sharif's wings were effectively clipped. This prevented any repetition of a military-political-capitalist alliance reminiscent of Ayub's times. Along with the efforts of the Ayub era and Zia's missed opportunity the Sharif administration's second tenure can also be seen as a phase that showed the highest potential for implementing an industrial policy, but the opportunity soon dissipated in part due to Sharif's own political recalcitrance. As Lieven points this is one of the key reasons why Pakistan will not see a replication of even the modest growth in Egypt and Iran which was achieved through the Muslim Brotherhood's support base of a relatively prosperous commercial class or in Iran's case through the Bazaaris. The Bazaaris are Iran's heterogeneous commercial class who were neglected by the Shah but were mobilized effectively by leaders of the Revolution especially through their networks in mosques located in urban trading centres. Some Bazaari leaders were subsequently given positions of power in the government. A Turkish 'model' seems almost an impossibility given that the ruling AKP has its support base directly among the Anatolian capitalists who were neglected by the Army regimes in Istanbul. This gives the AKP credibility among a sizable section of capitalists in the country. More importantly the per capita incomes of all these countries are higher than Pakistan's, especially Turkey, and the classes mobilized could utilize their relative economic prosperity to move towards a more successful transition to a broad-based capitalism. It would be difficult for the JI to drive such a transformation in Pakistan because there is little investible surplus among its aspirational but lower middle class support base who could mobilize to drive growth. The JI has strong views about social justice based on its Islamic world view but would have little to deliver on formal economic policy (Lieven 2011). Yet it is interesting that the widespread lawyer's movement in Pakistan that proved to be General Musharraf's undoing found strong support with the JI. Hence attempts at policy making would do well to involve the JI even though its presence in the National Assembly of Pakistan is very low.

The interregnum between the PPP government and the PML (N) government in 1993 saw a caretaker government in power headed by a former vice president of the World Bank (there was another headed by Balakh Khan Mazari but achieved little in terms of the economy). While this might not seem out of place now, what with African leaders frequently having World Bank careers behind them, in 1993, and certainly for South Asia, this was a first. Other senior ministers in the Moeen Qureshi government were also more businessmen than politicians: the finance minister was a leading industrialist while the information minister was the head of IBM in Pakistan. For a country whose organized sector was pitifully small and which was still caught up in a transition from a proto-capitalist to a broad-based productive capitalism this was a technocratic government that in no way represented the true social, political or economic structure of the country. However both Benazir and Sharif acquiesced to this choice largely because it meant unpopular reforms could be carried through without the popular politicians taking the blame. The Army also backed Qureshi as a means to introduce austerity based reforms. Pakistan had already received its first structural adjustment loan in 1982 under Zia but the military government had cancelled it perhaps anticipating the protests that later such programmes would lead to. Military expenditure was one of the key reasons why Pakistan's foreign debt liabilities reached close to $19 billion in 1990-91. By 2008 this had gone up to unsustainable levels of $44 billion (Mahmood Tahir 2009). In 1996 the second caretaker government of Meraj Khalid stepped in between Benazir's and Sharif's second term. This included Shahid Javed Burki, a World Bank vice president as the country's chief economic advisor. Once again in line with IMF requirements Burki tried to introduce reforms like taxing agriculture, privatization, rationalizing petroleum prices etc.

Table 7.7 Sectoral and GDP growth rates 1999-2008 (constant US$2000)

GDP	5
Agriculture	3.2
Industry	6.8
Manufacturing	8.6
Services	5.7

Source: (World Bank 2012a)

The political settlement of the democratic period reflected a competitive clientelist distribution of power across political organizations. The ruling coalition, whether PML-N or PPP was weak, and lacked long time horizons and implementation capabilities. Technocrats supported by the army and with the tacit approval of the political and business leadership pushed through early liberalization reforms. There was little evidence of significant resistance from big business which suggests that the hidden subsidies and benefits were informally continued. However, subsidies to social sectors began to be cut, reflecting the weak incorporation of intermediate class interests in the ruling political organizations. While this was happening, the capture of significant resources by economic and political organizations higher up the political hierarchy intensified. The evidence and charges of political corruption increased as a result of heightened primitive accumulation involving elites in both parties. The partial implementation of liberalization reflects the distribution of power in the political settlement with adverse effects for long-term growth and political stability. Much of the structural adjustment programmes were pushed through the institutional mechanism of the caretaker government. The caretaker governments were not answerable to Pakistan’s National Assembly, nor were they composed of political parties who operated on the basis of any patron-client system and they had the tacit support of the army. This freed the technocratic caretaker governments of any clientelistic compulsions and the army's support gave them a free hand to announce the reforms. A later section in the chapter deals with the adverse consequences of such reform by stealth.

The government of General Pervez Musharraf that followed was dominated by security issues and security-related rents. Musharraf is likely to be remembered for two key issues–the brief and rash Kargil War with India and the decision to take on the Taliban in earnest (though Pakistan had started initial crackdowns on Islamist organizations as early as 1992) at the behest of the Americans after 9/11 including sending the Army into vulnerable areas like the Lal Masjid (Red Mosque) in Lahore. The regime's imperatives of charting out a strategy that would allow it to balance between the need to be an American ally and using the Taliban to create strategic anti-India depth placed Musharraf between a rock and hard place. Like Ayub and Zia, when faced with growing civil and political unrest he fell back on local municipal elections in 2000 to bypass the clientelist political parties and co-opt new political organizers at lower levels (Talbot 2005; Lieven 2011). In 2002 Musharraf created a party mostly of defectors from the PML (N) called the PML (Qaid e Azam) or PML (Q). As Lieven says Musharraf was genuinely committed as a liberal progressive but once again ran into the realities of South Asia's complex social structures and patron-client politics. On the economic front his high profile finance minister and later prime minister Shaukat Aziz, a former Citibank senior executive steered the economy at a time when growth hovered between 6.6 percent and 9 percent (Lieven 2011). His policies once again veered close to Qureshi's and Burki's, essentially privatization and deregulation. For a while his policies seemed to have worked and enhanced yet military aid was once again responsible for higher growth rates (Table 7.7). It was 3.9 per cent when Musharraf took over in 1998 (Lieven 2011). In certain consumer driven sectors like mobile telephony and internet usage these policies worked well. The number of mobile phone subscribers rose from 300,000 in 1997 to 35 million in 2007. Internet users went from 200,000 to 2.4 million in the same period. Even exports did well increasing from $7.5 billion in 1998-99 to $17 billion in 2006-07 (Shaukat Aziz in an interview in Emerging Jordan) (Oxford 2007). However as Lieven recounts businessmen in key industrial centres like Faisalabad felt the growth targets of Aziz (phones, fridges, net connections) were misplaced when what the country needed a comprehensive investment architecture for industrial growth. That was simply not provided (Lieven 2011).

The political settlement under Musharraf approximated to a more vulnerable variant of vulnerable patrimonialism. Compared to Zia Musharraf had to exercise greater repression to exclude powerful organizations. This ironically led to the weakening of the army and its ability to discipline excluded organizations. Moreover, unlike Zia, the Afghan adventure that now gave the military access to external rents was this time deeply unpopular in many sections of Pakistan's population. But these strategic and rent capture imperatives once again overshadowed a developmental agenda. Finally, compared to Zia, Musharraf's strategy was even less aligned to deliver to lower levels of society and the political organizers and organizations at these levels. The exclusion of a majority of the intermediate class in areas like the FATA and Khyber Pakhtunkhwa eventually led to their successful mobilization by informal religious organizations and pushed the country to the brink of civil war. This ensured the gains from the early years Musharraf's tenure could not be consolidated.

7.5 Contemporary Pakistan–Deepening of a Crisis of Legitimacy

Table 7.8 Sectoral and GDP growth rates 2008-10 (constant US$2000)

GDP	3.8
Agriculture	2.2
Industry	4
Manufacturing	.9
Services	2.2

Source: (World Bank 2012a)

For the first time since independence an elected government completed its five-year term in Pakistan 2013. Elections were held in the same with a relatively high turnout that returned Nawaz Sharif to power. Importantly the current Army chief of staff Ashfaq Parvez Kayani has maintained a studied distance from political developments and has passed an order directing senior Army officials to withdraw from civil departments, though Pakistani analysts have also suggested the Army is very active in the political arena, only not visibly. What this means for an organization long used to political power and patronage will be difficult to predict but that this is an organization in transition is not in doubt. The PPP is surviving only because those planning any possible revolt know that in the tradition of South Asian dynastic politics unseating Zardari, now seen as a member of the Bhutto dynasty, will destabilize the party as such parties only coalesce around a dynasty. Both the military and political establishment's complicity in allowing drone attacks that kill Pakistani civilians on Pakistani as 'collateral damage' soil is ensuring they lose credibility in the eyes of ordinary Pakistanis. In all of this the economy has taken a back seat. As Lieven recounts businessmen do want the government to provide credible direction but do not want what the government is now offering in the way of more liberalization (Lieven 2011), and in some cases even the 'Most Favoured Nation' status to India is being opposed given that India remains the stronger economy.

From the point of view of our framework the strength of informal political organizations with high holding power has made the enforcement of formal institutions difficult even by the Army. The Army's operations in the North-West of the country in the early 2000s actually weakened its hold over organizations it could once direct. According to the International Growth Centre violence in FATA, Balochistan and Khyber Pakhtunkhwa increased significantly since 2005. Sind and Punjab had historically been witness to high levels of political violence but the other three provinces remained relative peaceful. It was with Pakistan's involvement in the so-called war on terror that violence escalated especially in Khyber Pakhtunkhwa. After 2005 the province became the second most violence prone province. On the heels of the Army's operation in Swat and Malakand militant attacks in response to the Army's operations increased by 46 times (Shapiro, et al. 2012). This best demonstrates the reasons for escalating violence with the Army operations pitting the state against organizations that were once allies of the ruling coalition. Once again the state thought it could manage the choices of including and excluding organizations at will. But events proved otherwise with the distribution of power being such that organisations like the TPP had the potential to destabilize the country significantly.

Contrary to beliefs that the Army was the most powerful organization dominating political, bureaucratic and economic sub-systems, our analysis suggests otherwise. While there is little doubt that the Army in Pakistan pervaded these three sub-systems, it was by no means uncontested. If anything contestations by both formal and informal political organizations increased in the decade starting in 2000. The rents that the Army distributed to its clients came under increasing contestation by other informal, irregular groups we have identified earlier. Given that the Army experienced a crisis of legitimacy due to its support, though qualified, of US policy and the drone attacks, its power relative to other organizations has become even more contested than in the past. A spate of attacks on defence personnel in 2013 around the country pointed to the fact that the Army no longer had the requisite enforcement capability to direct the irregular forces it once employed for strategic purposes.

Organizational power was embedded within informal religious and quasi religious organizations and their sustained exclusion from the US aid-led distribution of benefits overseen by the Army is pushing Pakistan towards more significant challenges to the existing political settlement. However a distribution of benefits bringing these organizations more in line more in line with their real holding power will require fundamental, non-incremental changes to the Pakistani political settlement. The current political settlement where the Army and bureaucratic and business elites share the distribution of benefits is unlikely to be changed voluntarily by the latter organizations. What we observe therefore is increasing contestations by informal Islamic organizations that are no longer demanding pay-offs but are seeking a change in the constitution of the political settlement. The new Sharif government in 2013 expressed a desire for rapprochement but continued drone attacks undermined the credibility of this effort. A lack of developmental institutions is hampering growth though there are signs of higher private sector involvement with a consensus towards more pro-market reforms, especially in the financial sector. As a result of this most productive organizations still possess only moderate capability and with little formal support developing further capabilities is difficult. As Table 7.8 shows manufacturing growth was eventually the hardest hit.

7.6 The Political Settlement and Liberalization: Wrong Policy or Poor Implementation?

Liberalization dominated the institutional and policy reform agenda of Pakistan from the 1980s to the 2010s. It was driven by IMF supported Structural Adjustment Programmes (SAPs) that aimed for a combination of austerity and liberalization, particularly trade liberalization and privatization. While the growth of GDP and per capita incomes both declined in the 1990s they were some improvements in the 2000s. However inequality increased in both periods though poverty data was on a declining trend between 2001-05 (Husain 2010). Total Factor Productivity growth was at its lowest from 1990-91 to 2000-01 (Harber 2009). Pakistani economists attribute much of the adverse outcomes to Structural Adjustment Programmes (SAPs) that Pakistan implemented in this period (Anwar 1996; T. A. Khan 2000; Bhutta 2001; Becker-Ritterspach 2007; Nosheen, et al. 2010; Khan Ali Ejaz Rana 2011; P. Roy 2011). There are two types of questions about liberalization in Pakistan during this period. The first was whether it was the appropriate policy response to the political and economic problems that Pakistan was facing. The second was to understand how the programme was likely to be implemented given the weak formal enforcement capabilities of the state. Even if the programme had been theoretically appropriate it may not have achieved good results in this context. More interestingly, the manner of its partial and modified implementation may have had specific adverse effects.

Pakistan received six tranches of loans under SAPs since the 1980s. A large body of literature has evaluated their impact (Redelet S 1998; Naiman and Watkins 1999; Baro R. J 2005). The Pakistani criticism of the SAPs suggests that the slowdown and growth in economic inequality is at least in part a result of these programmes. Table 7.9 compares economic growth before and after reforms. The GDP growth rates and rate of growth of exports were both higher in the pre reform period. Pakistan received approximately $31 billion in IMF loans and other external assistance between 1985 and 2000. The most damaging phases of structural reform seem to have occurred under the Nawaz Sharif governments. In 1989-90 the government put 108 of Pakistan's 175 public service enterprises on sale in industries ranging from engineering, oil and gas, telecommunication and fertilizers. At that time their pre-tax profit amounted to $ 605 million and their total assets were valued at $ 36.7 billion. A 'fast tracking' of the process resulted in 66 of these being sold but the proceeds yielded only $3.9 billion, far lower than their asset values (T. A. Khan 2000). The private sector only continued to do well in a few sectors like cotton textiles and for the most part the growth of the private sector came in the service sector.

Table 7.9 Key economic indicators before and during the reform period

Pakistan	Mean BR (1980s)	Median BR	Standard Deviation BEFORE	Mean AR (1990s-2007)	Median AR	Standard Deviation AR
Real GDP growth rates	6.7	6.5	1.7	4.8	4.8	2.3
Investment rate (% of GNI)	18.7	18.8	0.4	18	17.3	1.4
Current Account deficit (% GDP)	-2.9	-3.3	1.2	-1.3	-2.7	3.7
Real export growth rates	9.8	12	13.2	7.8	7.6	11.3

Note: BR is before reform, AR is after reform.

Source: (Nosheen, et al. 2010: Table 3)

Nawaz Sharif also liberalized Pakistan's stock markets in 1991. As a result the market capitalization of the Karachi Stock Exchange increased five times between 1990 and 1994. Net portfolio inflows into the Pakistani economy amounted to $3.3 billion between 1991 and 1995 (I. Ali and Malik 2009). In 1990 the share of total banking assets owned by the public financial institutions was 92.2 per cent. By 2009 this share had dropped to 18.70 per cent (Waheed 2010). However despite the increase in private sector participation and increased financial flows Pakistani banks performed less than satisfactorily in terms of extension of credit to the private sector. In 2006 Bangladesh had a higher private sector credit to GDP ratio than Pakistan despite being the country with lowest per capita incomes in the sub-continent (SBP 2006) Credit has also not been flowing to sectors like SMEs despite efforts of the government (GoP 2011). Pakistan's GDP growth rates were slightly higher under Musharraf, but then declined again (Table 7.2).

Tables 7.5 to 7.7 show that manufacturing had spurts of growth after the process of liberalization but by the end of the 2010s the industrial and manufacturing sector in Pakistan faced significant challenges. Unlike India and Bangladesh, Pakistan did not develop any new globally competitive sectors in the 1980s or 1990s. According to some studies economy-level TFP improved in the 1990s but this is largely explained by the growth of some high value services like finance, after the liberalization of 1991 and better capacity utilization of in the 1990s as domestic demand was sustained by security-related external rent inflows (Kemal 2007; Husain 2010). Some studies show that growth in the manufacturing sector remained input-driven rather than productivity-driven over this period (Chaudhry 2009). A working paper of the State Bank of Pakistan concludes that trade openness had a negative correlation with TFP growth while government consumption and FDI were positively correlated (S. U. Khan 2006). Most empirical studies of this period agree that growth was driven by the service sector and manufacturing growth suffered from low productivity and competitiveness. A cross country report by UNIDO on competitive industrial performance (CIP) shows that Pakistan's competitiveness since liberalization has shown a downward trend. The same report also identifies an aggregate competitiveness problem in India but its performance was relatively better than that of Pakistan. Pakistan's manufacturing value added per capita was close to India's in 1990 but by 2000 it had fallen to 70 per cent of India's and 18 per cent of China's (Table 7.11). Significantly the value of manufactured exports per capita was 165 per cent higher than that of India in 1990 and even exceeded China by 7 per cent. But by

2000 this figure had dropped considerably to become only 58 per cent higher than India (Ansari 2005). Pakistan's higher manufacturing exports per capita reflect the initially greater export orientation of Pakistan's manufacturing sector. The interesting feature is the time trend in export performance relative to India.

Some level of volatility is expected in manufacturing performance in developing countries, but the trends in productivity and competitiveness in Pakistan's case suggest that liberalization has had an adverse effect on competitive capabilities. This is consistent with our qualitative finding that there were no capability development strategies in the 1980s and 1990s even of the type that Pakistan attempted in the 1960s and the results are validated in productivity and competitiveness indicators for the manufacturing sector (Tables 7.10 and 7.11).

Table 7.10 TFP growth in Pakistan

Year	60-04	60-69	70-79	80-89	90-99	00-04
Real GDP Growth	5.4	6.31	4.9	6.3	4.4	4.5
Capital	1.9	2.1	1.8	1.9	1.9	1.6
Labour	1.8	1.6	2.0	1.8	1.7	2
TFP	1.7	2.6	1.1	2.6	0.8	0.8

Source: (Husain 2010: Table 5)

The growth of the financial sector did not translate into more innovative credit instruments that could assist capability development in Pakistani manufacturing. Interestingly the ten largest corporate groups in India, including Reliance, Essar and Adani, have an average net debt to EBITDA (earnings before interest, tax, depreciation and amortization) ratio of 5.6 and are probably excessively overleveraged as a ratio above 5 is considered unsustainable (Crabtree 2013). In contrast, Pakistan's corporate sector displays the opposite problem. The equity to debt ratio of 8:2 suggests they rely far too much on internal resources for investment and have limited access to acceptable terms of credit from the banking sector. According to Husain if this ratio could be reduced to 7:3 the country's investment to GDP ratio would move up to 21.2 per cent from 20 per cent (Husain 2007). Arguably, financial liberalization has not served the manufacturing sector even though this was one of the reasons cited for liberalization in the 1990s. In India's case the figure quoted above is probably evidence of liberalization increasingly serving narrow, and increasingly unproductive interests as highlighted in Chapter Four.

Table 7.11 Pakistan's declining competitiveness

	1990				2000			
	MVA per capita USD	MHT in MVA (%)	MX per capita USD	MHT in mfg exports (%)	MVA per capita USD	MHT in MVA (%)	MX per capita USD	MHT in mfg exports (%)
Pakistan	56	31.9	45	8.1	63	35.1	60	8.9
China	113	57.6	42	34.4	350	57.3	183	44.6
India	60	55.3	17	17.9	90	58.4	38	19.7

(Competition as measured by the Competitiveness Industrial Performance Index)
MVA- Manufacturing Value Added
MHT- Medium and High Technology
MX- Manufactured Exports
Source: UNIDO quoted in (Ansari 2005: Table 2)

Our comparison of Pakistan with India suggests that while there are differences there is also much in common in the challenges faced by the two countries. Their per capita incomes are fairly close and in terms of indicators like poverty and inequality they are also very similar. Both adopted liberalization reforms in the early 1990s that led to the rapid growth of the service sector. However as outlined in Chapter Four India adopted liberalization reforms when at least a few of its important manufacturing sectors like automobiles and pharmaceuticals had achieved global competitiveness. Despite this, the Indian economy still suffers from market failures in finance that impede manufacturing companies from achieving greater competiveness and new manufacturing sectors emerging. In the case of Pakistan, liberalization happened at a time when it did not have any major sectors of manufacturing that were reasonably close to the global competitiveness frontier.

Yet Pakistan's manufacturing included sectors like textiles, simple electronics and surgical instruments that could have benefited from capability development strategies. There is no evidence in Pakistan of the type of capability development strategy in the Indian automobile sector outlined in Chapter Four and Khan (2009b). This is despite Pakistan having an auto components and assembly sector which may have benefited from similar incentives for technical and organizational capability development. The textile industry is Pakistan's most critical industry in terms of its contribution to the economy. Pakistan is the fourth largest producer of cotton with a nine per cent share of the world market. Its textile industry accounted for 54 per cent of exports, 38 per cent of industrial employment and 8.5 per cent of GDP in 2011. But the textile sector also faces 'significant productivity and quality gaps' (Iqbal, et al. 2010). It still operates at the low end of the value chain rather than high value added products. The chief constraint in the sector despite relatively low wages is the lack of technical and organizational capabilities to compete in global markets. Pakistan is also trying to be a significant player in the ready-made garments sector but has some way to go before it can catch up with Bangladesh. Given that the average total cost per operator hour in the case of Bangladesh is $0.31 and Pakistan's is almost double that at $0.56, it faces a significant challenge in raising productivity and quality enough to compensate for its initial cost disadvantage (PRGMEA 2010). These are unlikely to happen without adequate policies.

The Sialkot industrial cluster producing high quality surgical instruments for western export markets is one of Pakistan's successful manufacturing sectors. The sector exports close to 90 percent of its production and was established in the 1960s under Ayub Khan's industrial policies. It was an early beneficiary of export incentives. It is already at a higher end of technical competence than the cotton textile industry and exports to high income markets. In 2008-09 Pakistan exported surgical instruments worth \$250 million mostly to the US with the sector employing about 150,000 workers. Like much of the developing world's success stories government policy was important in pushing the sector up the value chain. In 1994 significant quality requirements were imposed by the American Food and Drug Authority (FDA) on imported surgical instruments. Given the importance of the sector, manufacturers reached an understanding with the government to provide the necessary training to employees that would enable the sector to compete on the terms required by the FDA (Nadvi 1999). This collaboration required limited public funds or monitoring because the sector already had high capability and a strong incentive to improve its quality to keep its market. It was one of the few examples of successful capability improvement with government assistance in the 1990s when the political settlement was competitive clientelist. The effort proved a success and Pakistan was able to regain its lost share in the export market.

The Pakistani government has since delinked itself from direct involvement in the sector, but the successful outcome suggests that these linkages should be maintained for pragmatic capability development initiatives. The PML-N government of Sharif that was involved in this initiative was not anti-industry but it was also not pro-actively promoting industry. The extensive privatization programmes of the 1990s provided the PML-N with enough opportunities for rent allocation without difficult strategies of promoting industrialization through capability development. A report of the Rawalpindi Chamber of Commerce identifies why government assistance is necessary for addressing productivity and competitiveness problems (Aaliya 2010). Training and re-skilling are consistently identified as bottlenecks and we would add the problems of organizational capability development, which requires learning-by-doing strategies. All these competitiveness enhancing strategies require financing and an appropriate design of the governance of the financing strategy so that financing is not captured as an unproductive rent. The report says that despite the presence of many banks and leasing companies, access to finance is only easy for large companies who have good personal relations with the banks. Small vendors have limited access and face higher financing costs, making investments in raising competitiveness risky and costly. Small and medium manufacturing and agro based industries remain 'credit-starved' (Husain 2007).

A sector that has the potential to transform the fortunes of Pakistan's manufacturing industry is the auto and auto components sector. Till the 1970s the automobile sector in Pakistan relied on simple assembly of imported kits and early attempts at localization did not succeed. The Pakistan Automobile Corporation (PACO) was set up under the Bhutto administration to manufacture cars locally and consisted of two segments: Pak-Suzuki in collaboration with Suzuki of Japan and Millat Tractors (the latter was nationalized having been established in 1964 to market Massey Ferguson Tractors in Pakistan). While the economic policies of the Bhutto era are often criticized for setting back the pace of Pakistan's industrial growth some sectors actually benefited from these dirigiste policies. The automotive sector was certainly one of them. Pak-Suzuki was the largest auto company in the country and Millat Tractors emerged as one of the country's leading manufacturing companies looking to export to markets like Afghanistan and some African countries by the early 2000s.

A comparison with India's auto sector is useful here. It is significant that Maruti Suzuki made its entry into India's protected market almost a decade after PACO was established and played the role of a catalyst in developing India's auto sector. One difference stands out clearly. Unlike India where the auto sector was protected till liberalization in the 1990s the Pakistani auto market was dominated by imports till 1971. The long period of protection had allowed India to achieve significant learning by doing even if it produced very low quality cars and heavy commercial vehicles. Nevertheless, India had achieved the capabilities to make these vehicles entirely within India. When Suzuki came to India it was promised significant implicit rents in the protected market (as well as other explicit subsidies like the allocation of prime land) as long as it achieved significant local content in five years based on developing the technological and organizational capabilities of tier one and two component producers. The ex-post rents offered to Suzuki and the possibility of actually achieving the indigenization given the high initial capabilities encouraged Suzuki to accept this deal. It was able to roll out cars with the required levels of indigenization by the 1990s. The consequent development of Suzuki's vendor base led to the growth of India's auto component sector that today has two successful indigenous auto manufacturers, Mahindra & Mahindra and Tata Motors. India's auto component manufacturing sector is also one of Asia's most competitive. It would not be inaccurate to say the long period of protection had positive dynamic consequences for India despite significant short-term inefficiencies (M. H. Khan 2009b, 2013c, 2013b).

Pakistan did not have a strong initial capability base in automobile manufacturing in 1971 and could not set ambitious targets for Suzuki in the 1970s that India could in the 1980s. Given that the manufacture of tractor parts was technically and organizationally less complex compared to car components it was this sector that saw the most growth (Ghani and Khan 2004). However since the 1990s a process similar to the one observed in India's auto sector was unfolding in the Pakistani auto sector in scope if not in scale. The opening up of the market to foreign manufacturers meant they were able to make use of the base developed by Pak Suzuki, and Honda and Toyota also set up assembling and manufacturing operations. As a result some auto component producers like Ragstar Engineering achieved high levels of export competitiveness. The Pakistani government established programmes like the National Trade Corridor Improvement Program (NTCIP) and the Auto Industry Development Program (AIDP). However, policymakers failed to come up with instruments for financing capability development that ensured compulsions for high-effort learning. This failure can be understood given the difficulties of enforcing formal instruments in the political settlement in Pakistan that was gradually moving in the direction of weaker enforcement and time horizons.

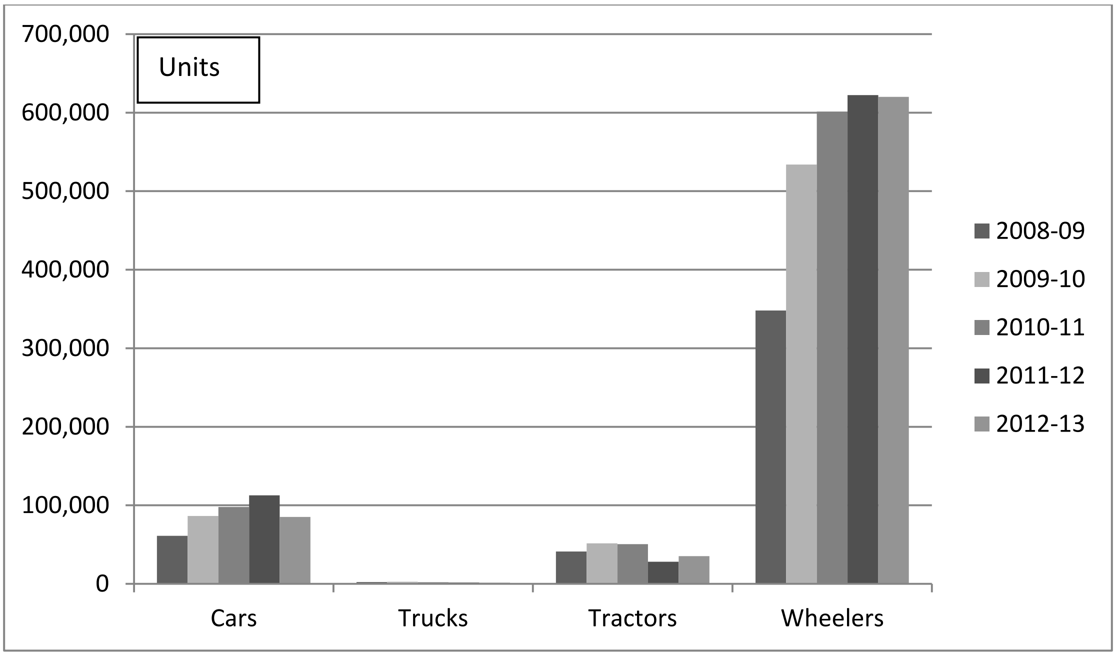

Figure 7.2 Automobile sales figures from 2008-09 to 2012-13
Source: (PAMA 2013)

Note- Wheelers are 2/3 wheelers (scooters, motorcycles, 'tempos')

Automobile production has not broken through to achieve global competitiveness. Production was low in the 2010s with production in 2012-13 being at its lowest level since 2009-10 (Figure 7.2). Tractor production figures are somewhat better, picking up in 2012-13 after a period of low growth, but two and three wheeler sales have been the most robust reflecting the relative competitiveness of Pakistani vehicles at the lower end (PAMA 2013). The policy and academic literature on the automobile sector uniformly mentions the important role of government and why it needs to do more despite initiatives like the NTCIP and AIDP. A crucial problem here is the relationship between economic organizations in the sector and the ruling coalition. The Indian auto and auto components producers in Tamil Nadu had historical links with different parties who could constitute the ruling coalition. The ability of the ruling coalition to direct rents to their clients in the business sector in a context of competition between firms and between political parties made rents available for capability development with competitive compulsions for raising productivity. The configuration of economic and political organizations in Pakistan was less favourable for rent allocations that could create compulsions for capability development. There were too few players in the automobile sector, their capabilities were not close to global competitiveness and political organizations in the 1980s and 1990s had weak implementation capabilities and short time horizons. Credible support for high effort capability development therefore did not emerge.

A few qualifications on the measures of competitiveness in existing studies are needed here. Studies on competitiveness carried out by the World Bank, the Asian Development Bank (ADB) and the Competitiveness Support Fund (CSF) have been influential in policy circles but they have also and rightly come in for some criticism for the particular indicators they use. They rely on indicators like education or infant mortality that are useful in their own right but have little necessary bearing on levels of competitiveness. Some of the data also suffers from selection bias and is unrepresentative. For instance the Executive Opinion Survey in the CSF report was conducted among Pakistani executives who work in firms with more than 100 employees, when most of Pakistani business is concentrated in the small scale sector (McCartney 2011). The UNIDO report is less biased towards inappropriate 'good governance indicators' of the sort used in the ADB, WB and CSF reports and relies more on measures of per capita MVA or manufactured exports, but these measure competitiveness by looking at its outcomes. In the UNIDO report there are also problems with assigning equal weight to all indicators and not adequately differentiating between assembly and manufacturing (Ansari 2005). Yet it is arguably the index that comes closest to measuring true competitiveness (see our discussion in Chapter Four) unlike measures based on good governance indicators of competitiveness like security of property rights and democracy.

Finally, privatization has been a much bigger programme in Pakistan than in India but it has not achieved significant results. Privatization will only lead to greater static and dynamic efficiency if firms are capable of competing in a more open economy *and* if privatization reduces the unconditional support given to firms by different types of explicit and hidden subsidies. Hidden subsidies to large business organizations in

Pakistan come from a variety of mechanisms including bank loans on soft terms, and these remain politically easy to access for large private sector firms (Khwaja and Mian). Indeed, privatization was a mechanism for directing further rents the politically connected business organizations. Between 1990 and 2004 the sectors that accounted for the largest share in privatization proceeds were banking, energy and telecommunications, sectors (Syed, et al. 2012) that are not linked directly to manufacturing growth and capability development. Thus, the implementation of privatization and liberalization in the context of the configuration of power in Pakistan did not create significant pressures for capability development and more importantly, reduced the policy space for interventions that could assist capability development except in a small number of cases.

A Government of Pakistan Labour Force Survey in 2003-04 concluded that the majority of new jobs were created in the country's unorganized, informal economy the share of which in non-agricultural employment was 70 percent (M. H. Khan 2012d). Two recent studies on the impact of the SAPs have found they have had an adverse effect on indicators like employment, poverty, income distribution and export performance (Nosheen, et al. 2010; Lieven 2011). As Table 7.8 and 7.9 suggest per capita GDP growth rates remained low throughout the period of SAP reforms and export growth suffered. Liberalization reforms in Pakistan had poor effects because the country was neither politically nor economically ready to be an open economy. It did not have a broad base of economic organizations close to the competitiveness frontier and its political organizations were becoming weaker and facing greater contestation, which reduced their enforcement capabilities and eventually resulted in high levels of political instability and violence. Liberalization enabled a very small section of the population to reap benefits through the growth of the service sector and through informal rent allocations that continued through the banking system, through privatizations and overt forms of 'primitive accumulation'. Most economic and social indicators suggest the majority of Pakistan's population remained outside this 'globalized' economy. This is where significant structural similarities remain with India whose liberalization strategies are proving to be inadequate for driving further growth (M. H. Khan 2011b). The structural exclusion of Pakistan's excluded social groups is however greater than in India and the declining legitimacy of the traditional political organizations creates challenges for maintaining stability.

7.7 Conclusion

The application of the political settlement approach to Pakistan provides a number of insights. The mainstream discourse on Pakistan highlights the absence of right institutions especially democratic ones, the presence of corruption and the growth of Islamism as the sources of Pakistan's problems. Our analysis suggests a different set of problems. First, the founding myths of Pakistan and the security prioritization it allowed created a more centralized rent distribution system that failed to increasingly integrate emerging mobilizations within the intermediate classes. At the same time, the political settlement that had allowed substantial capability development interventions in the 1960s became progressively less conducive for interventions that could address these market failures in the 1980s and 1990s. Exacerbating the problem was the strengthening of liberalizing ideologies in this period that led to the deliberate abandonment of capability development strategies in this period. By the 2000s Pakistan was in the double bind of lacking capability building strategies for its economic organizations while its political organizations faced growing challenges from new more informally organized political organizations that want to overthrow the system and not just claim a share of rents.

Capability development strategies were most successful in Pakistan immediately after the onset of military rule in 1958 under Ayub Khan. The ruling coalition did not have the capacity to discipline subsidy recipients as in East Asia, but significant capability development happened, financed by public subsidies. The problem was that that vulnerable patrimonialism excluded too many powerful organizations and resulted in political conflict and the violent rupture of 1971.

This was followed from 1972 to 1977 by Bhutto's attempt to create a dominant party in a version of constrained patrimonialism with authoritarian characteristics. He used the populist slogan of Islamic socialism to sustain an authoritarian party. There were a few successes in setting up capability development projects, as in automobiles, and some public sector investments, but his period was marked by an attack on Pakistan's big capitalist that generally served to destroy productive and organizational capabilities. A second phase of military rule under general Zia-ul-Haq was a significant turning point towards Pakistan's current impasse. The availability of centralized security-related rents associated with support for the Americans in Afghanistan and a failed attempt to destroy the old political organizations without successfully incorporating organizations representing the lower intermediate classes set the characteristics of the unstable political settlement that continues to affect Pakistan. Economic liberalization began in the 1980s as the military ruling coalition relied more on external rents and took less interest in capability development.

Zia's death brought in an era of deepening liberalization and structural adjustments under weak political governments in an intensely competitive clientelist political settlement. Economic organizations were too weak to dominate the political system and negotiate support for capability development, but individual business groups were powerful enough and well-enough connected to political organizations to sustain their rents through informal mechanisms like bank loans, and primitive accumulation based on getting government contracts and land allocations. Sectors like textiles and the successful surgical instruments sector soldiered on but did not enjoy the support for capability development that could have pushed them into more diversified and higher valued products. At the same time, the alienation of excluded groups increased as the traditional political parties engaged in more and more egregious corruption and unproductive rent capture.

Islam in Pakistan gradually progressed from being the identity of Muslim elites in British India mobilizing to protect their access to rents in a democratic independent India where they would be a perpetual minority to the mobilizing ideology of excluded groups within Pakistan. To isolate the ruling groups who are also Muslims but who subscribe to more 'liberal' forms of Islam, it is not surprising that excluded groups would distinguish themselves by defining Islam in a form that is guaranteed to isolate the ruling elites. The sometimes misguided attempt by military and traditional political elites to use Islam to consolidate their own support is only part of the explanation for the growing mobilization of the excluded using increasingly radical Islamic ideologies. The logic of the political contest over rents suggests that radical Islamism would probably have emerged anyway as long as the political organizations controlled by higher level elites failed to rapidly incorporate organizations led by and catering to the political ambitions of lower intermediate class groups.

This is the context in which local religious leaders, or mullahs, who were once at the bottom of the social hierarchy in regions like FATA and Khyber Pakhtunkhwa relative to the landowning maliks and the educated ulemas, gradually became leaders of political mobilizations (Dorronsoro 2002; Lieven 2011). These leaders have overturned the social hierarchy in many places and displaced the maliks and amirs to fill the vacuum the Pakistani state had never really filled (Lieven 2011). We have argued that the emergence of violent political conflicts and strategies of radically targeting the social order rather than demanding incorporation is similar to the experience of Maoist movements in India. The failure to gradually incorporate marginalized groups in rent distribution systems can result in the emergence of radical rejectionist movements. Class divisions superimposed on the failure of inclusion of potentially powerful groups within the political settlement can explain these outcomes, with culture and ideology playing a secondary role in explaining the mobilization ideologies. The role of class conflicts and failed clientelist strategies of inclusion and exclusion in explaining the rise of movements like that of the Taliban and other rejectionist social movements in Pakistan and India is an area of research that needs to be developed further in the future.

Islamic culture is often wrongly used to explain Taliban radicalism. A distinction has to be made between Islam as a set of cultural norms and its role as a mobilizing ideology for different types of social movements. In fact Islam has been used as a mobilizing ideology by many different types of groups and classes in South Asia with very different strategies that can be understood and explained in the context of specific contests over assets and rents. The new mobilizations using Islam in Pakistan are novel because a history of exclusion of certain classes and groups has resulted in

Islam being used for nothing less than a complete restructuring of the political settlement. Our analysis of political settlements adds further depth to approaches that have argued that Islam as culture does not explain much about the specific characteristics of different political and economic mobilizations.

The political settlement in Pakistan in the 2010s seems to be sustainable only in the form of a medium-term impasse. The ruling coalition still has access to enough rents to sustain their hold over power but the excluded organizations are also displaying high holding power through their mobilizations that are often violent. The low enforcement capabilities of political and bureaucratic organizations also mean that strategies of creating new productive capabilities are likely to face significant constraints. Economic organizations are too weak in terms of political power and economic capabilities to define a productive policy agenda. But many are well-enough connected to benefit from quick rent opportunities that can be shared with their political allies. These emerging features of unproductive business-government relationships are common to both India and Pakistan. The political settlement in Pakistan can and should change but this is a political process and not a technical or economic one that is amenable to policy in any simple way. Clearly, the incorporation of significant layers of new groups and organizations into the political settlement not just marginally, but as important players, is necessary if political stability is to be achieved. How this can be done when established elites still believe that the principle battle they are fighting is against Islamist extremism that on is a political challenge that will have to be faced by Pakistani political entrepreneurs. The political settlement analysis suggests that this type of organizational restructuring can only evolve internally and cannot be achieved through the interventions of external agencies. The conventional security and governance agenda assumes that with appropriate support to the Pakistani elite, groups like the Taliban can be wiped out. By locating the emergence of these challenges to Pakistan's established elites in the context of failed strategies of exclusion we contend that strategies of continuing this exclusion through the use of more force are likely to fail in the long-run and indeed result in even more violent and radical responses from below.

Chapter 8. Conclusion

This dissertation applies the analytical framework of political settlements to understand institutional and policy evolution and associated outcomes in Gujarat, Tamil Nadu and Pakistan. The research contributes to the development of a consistent political economy approach for understanding the historical experiences of development and ultimately the development of better frameworks for discussing policy options and alternatives in different contexts.

The ruling coalition in each of our case studies, Gujarat, Tamil Nadu and Pakistan was constructed differently and reflected historical differences in the organization of social, political and economic organizations in these localities. The differences in the organization of power at the level of society and in the ruling coalition had significant implications for responses to economic and political challenges. The evolution of institutions and policies followed different trajectories and the enforcement of particular institutions and policies was quite different depending on the interests of and contestation by powerful organizations. The political settlements framework argues that understanding these contextual differences is critical for understanding differences in the evolution and performance of particular institutions.

This analytical claim is illustrated in this dissertation by looking at the policies and institutions that supported industrialization and industrial capability development. The focus on industry was simply to make the scope of the research manageable even though other related institutions and issues emerged to elaborate the dynamics of each case. Apart from that, we believe that industrial development and in particular the development of a broad-based employment generating manufacturing sector is essential for sustaining development in labour surplus economies.

The aim was to study the process of transformation in these cases so as to identify the factors that can explain the relative success of some cases and the potential sources of vulnerabilities. Focusing on India at the state level is important because

India is too often looked at as a single growth model whereas in reality each state has different political arrangements, institutional capabilities and a ruling coalition that has evolved differently as a result of specific social and historical processes. Regional imbalances in India are glaring and demand deeper explanations. The political settlements framework that identifies the distribution of organizational power provides important insights into the emergence and operation of a number of growth-enhancing institutional arrangements in these states.

The high rates of growth in Gujarat are commonly attributed to the superior leadership of Narendra Modi, to 'good governance' in the state or to the evolution of a 'developmental state' in Gujarat. Our framework suggests that much can be explained by the specific distribution of power that supported its ruling coalition and that was further reinforced by political strategies of selective violence. The 'authoritarian clientelism' that was constructed in Gujarat was critical for understanding the specific enforcement capabilities that drove growth in a particular set of industrial sectors. This analysis suggests that leadership quality was a second order factor, and that the model is not likely to be replicable across India. Tamil Nadu's growth is usually not held up as a model in India despite achieving growth outcomes similar to Gujarat and having a manufacturing sector that is more broad-based and competitive. One reason for this is that its fractious competitive clientelism based on populist politics is harder to describe as good governance or a developmental state. The political settlements approach helps to show how the distribution of power in the state allowed a series of growth-enhancing institutional measures that attracted high capability economic organizations. Rather than the dominant party of Gujarat and its authoritarian clientelism, the politics of Tamil Nadu is closer to the politics of most developing countries making the state particularly important in discussions of policy design in these contexts.

Pakistan is often dismissed as a country close to state failure. The solutions are often thought to involve even more intense attempts at institutionalizing good governance and strengthening its security capabilities. Deeper questions are not asked about the reasons behind its failure to resolve internal conflicts so that a relatively stable political settlement with lower levels of violence can emerge. The analysis here suggests that much of this has to with historically exclusionary political strategies of successive ruling coalitions including the army. The dual strategy of elites since the 1980s was to keep powerful informal organizations out of the rent-creation and allocation processes of mainstream politics while using them for strategic purposes against external enemies. The result of this has been to increase contestation and violence, particularly after the legitimacy of the ruling elites began to collapse as a result of their association with a failing US political strategy in Afghanistan.

By the 2000s, the distribution of benefits allowed by formal and informal institutions in Pakistan was much more out of step with the distribution of power across its formal and informal organizations compared to the situation in Gujarat or Tamil Nadu. This explains the greater violence and political instability in Pakistan. From the perspective of this analysis, the danger to Pakistan comes less from the intransigence of its informal Islamist organizations and more from the strategies of its ruling elites who refuse to accommodate demands for the inclusion of new groups from the lower intermediate classes in rent allocation and management systems.

Each of our cases demonstrates different strategies of organizing patron-client politics that in turn results in contrasting interfaces between politics, institutions and economic outcomes. The structuring of political organizations through patron-client relationship is deeply consequential for how social transformations are negotiated in developing countries, using a combination of formal and informal institutions. One of the common themes emerging from our case studies is that the informality of patron-client structures makes even successful arrangements relatively vulnerable and 'developmental' political settlements face continuous endogenous transformations that can make them less developmental over time. The regressive evolution of the political settlement is most obvious in the case of Pakistan, but worrying aspects in the evolution of patron-client structures are evident in Tamil Nadu and at the all-India level. The strong dominant party in Gujarat was based on the implementation of some pretty undesirable political strategies involving considerable violence. Even so, this configuration of power is not only unlikely to remain unchanged over time, but more importantly, it does not provide a replicable model for other parts of India. The latter is an important policy observation given the often unquestioning support for the 'Gujarat model' in some policy circles.

A significant observation that emerges from our research is that the political settlements of both Pakistan and India are facing substantial endogenous changes. We have highlighted elements of these changes but our framework is not a predictive one as far as the evolution of the political settlement itself is concerned. The direction of change depends on which organizations are mobilizing and how they do so. Further research could focus on what drives these mobilizations in South Asia and elsewhere. At a more specific level more work is required on how the nature of coalition politics in India is changing and the implications of these changes for the systems of rent management at the state level. We have considered these questions briefly in Chapter Six but this could be a future area of research on the Indian economy.

We conclude by reiterating that the aim of this research is essentially to demonstrate an application of a method for understanding institutional performance and we did not aim to provide a full analysis of comparative growth in these localities. We have not looked at other factors that explain growth differences like natural endowments or linkages with the global economy. We have also not looked at agriculture and services in any great detail, or the linkages between these sectors and industry. Nevertheless, we hope to have established that the framework of political settlements can shed important light on institutional performance by focusing on a narrow range of issues.

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Appendix

List of People Interviewed

A Member of Parliament who wishes to remain anonymous

A senior police officer in Chennai who wishes to remain anonymous

A senior national level journalist from the English print media who wishes to remain anonymous

A leading Indian industrialist with interests in Gujarat who wishes to remain anonymous

A senior bureaucrat in the Ministry of Finance, Government of Tamil Nadu who wishes to remain anonymous

A senior bureaucrat, Finance Dept, Government of Tamil Nadu who wishes to remain anonymous

Ajay Umat- Resident Editor, Times of India, Ahmadabad

AKD Jadhav- Former Secretary, Ministry of Mines, GoI

Ashish Vachhani- IAS, Deputy Director, Lal Bahadur Shastri National Academy of Administration

Basant Rawat- Correspondent, The Telegraph, Ahmadabad

Bhaskar Chatterjee- Former Secretary, Department of Public Enterprises, Ministry of Heavy Industries and Public Enterprises

CJ Murali- Director, Inexco Case Metals Solutions

CP Raman- Former President, TVS Motors Ltd

Dr Ali Cheema- Associate Professor of Economics, Lahore University of Management Studies

Dr Asad Sayeed- Director and senior researcher at the Collective of Social Science Research

Dr Ashok Desai- Former Chief Economic Adviser to the Prime Minister of India

Dr Pronab Sen- Chairman of National Statistical Commission, Former member, Planning Commission of India

GD Gautama- Chief Information Officer, Government of West Bengal

M Velmurugan- Executive Vice Chairman, Guidance Bureau, Industries Dept, Govt of Tamil Nadu

Madhavan Nambiar- Former Secretary, Ministry of Civil Aviation, GoI, Mohan Eddy- Director, India Satcom,

Musa Raza- Former Principle Secretary Government of Gujarat and Former Chief Secretary Jammu and Kashmir

Naresh Gupta- Former Chief Electoral Officer, Tamil Nadu

Prof GSG Prasad- Asst Prof, Madras Institute of Development Studies (MIDS)

Prof R Nagaraj- Formerly at MIDS

Prof Venkatesh Athreya- MIDS

R Poornalingam- Chairman, Nagapattinam Energy, Former Secretary, Ministry of Textiles, GoI

R Ramakrishnan- Director, TVS Motor Company, Former Rajya Sabha member and sheriff of Madras,

R Ramaraj- Senior Advisor, Sequoia Capital

R Ramasubramanian- General Manager, Manufacturing, Fasteners Division, Sundaram Fasteners

R Seshasayee- Executive Vice Chairman, Ashok Leyland

Ramnath S Mani- Chairman and CEO , Emergys Software Pvt LtdEntrepreneur

Sashi Kumar- Chairman, Media Development Foundation

Stavan Desai- Resident Editor, Divya Bhaskar, Baroda

VN Bharadwaj- MBBS, former General Manager, Indian Airlines

Zoha Waseem- London and Karachi based Security Analyst

Sample Questionnaire

The questions below were indicative ones only to test the hypotheses for each of the case studies. However the actual discussions that followed were always open-ended.

Questions for the Tamil Nadu Case Study

1. At a political level did the common ideological ancestry of both the DMK and AIADMK (through the DK) have any bearing in providing stability to the state despite their intense rivalry?

2. Is it possible to ascribe any structural reason to the periodic cycling in and out of the two parties from government ever since the death of MGR?

3. What were the initial links between industrial houses (especially in the auto component/engineering sectors) with politicians like Kamaraj, TTK, Anna Durai, C Subramaniam and later Karunanidhi, MGR and Jayalalithaa?

4. What were the constituencies that the DMK and AIADMK looked at to distribute patronage--specifically industrial/commercial or agricultural, or combinations of both? How did industry calibrate its relationship with the two parties?

5. Specifically what kind of links were established between Chennai's auto and auto components industry and the DMK/AIADMK leadership? Companies in this sector had grown and developed competencies before 1992 (liberalisation) and this couldn't have happened without some help from the state/government.

6. What effect has the evolution and institutionalisation of coalition politics at the centre had on the political strategies of the two parties?

7. Assuming a level of corruption exists in Tamil Nadu (as it does in every state) why is it not predatorial with harmful growth outcomes?

8. A significant portion of Tamil Nadu's Plan expenditures is on redistributive, sometimes populist expenditure schemes. How has this affected politics in the state and how does the state generate resources to sustain them (apart from sales tax revenues and the Central government portion of Plan allocations)?

9. What is specific about the political structure in Tamil Nadu that has allowed its bureaucracy to be one of the most effective in India? Did the Tamil Nadu Industrial Corporation play any significant role in industrialisation, especially post-1991?

Questions for the Gujarat Case Study

1. In the context of Gujarat the thesis analyses what are the aspects of the administration under Narendra Modi that led to its high growth, albeit accounting for the fact that Gujarat has always been one of India's highest growth states with a very efficient bureaucracy and abundant mineral resources namely oil and gas. What did Modi do to add to this that sustained Gujarat's growth?

2. Specifically I am trying to establish a link, if possible, between the riots and the image Modi has cultivated of being a leader in command and who can 'control'. Did it signal a sort of effectiveness Indian businessmen were looking for and were always ready to support but couldn't because of political correctness immediately after the 2002 riots? But once Modi had established his business friendly credentials found it easier to support him? For instance Christophe Jaffrelot suggests it is the new urban middle class that supports Modi the most, (along with the business elite of course).

3. In the above context why did Modi have to use the idea of Gujarati Asmita to forge an identity for the state? What was the political strategy behind it?

4. Secondly what is the specific nature of the business government relationship in Gujarat that leads to high industrial investments? For instance what led to the sudden rise of the Adani Group (and I mean in the last decade or so post Modi's chief ministership)?

5. In terms of how state-led incentives and interventions are structured what sort of industries are most likely to succeed in Gujarat, for instance those with high gestation periods like infrastructure (engine power and ports), high technology manufacturing (auto, electronic components) or those in the ancillary sectors?

6. At a time when liberalization has meant states are out-competing each other with incentives for both domestic and foreign investment how has Narendra Modi developed the enforcement capability that makes it easy for industry to locate in Gujarat? For instance despite Buddhadeb Bhattacharjee's high credibility the government under him lacked the enforcement capability to ensure Nano's viability in the state even after enjoying over a two-thirds majority in the state Assembly. Gujarat has also seen a share of anti-industry agitation but the Modi government seems much better equipped to handle those. What feature in the Modi administration allows this to happen?

Questions for the Pakistan Causes Study

1. To your mind what has been the primary cause for the decline in Pakistan's economic performance?

2. How deep is the link between kinship and political office in Pakistan? I ask because most analyses of Pakistan's polity seem to emphasise that ties of kinship are important both to gain votes and office, and these ties are invoked by those with either huge landholdings or large businesses. If these were as important the societal

structure of Pakistan has very influential bearings on its political economy. Also do you see any changes in this structure?

3. To what would ascribe the continuing influence of the military in Pakistan's political economy?

4. Who would you consider the dominant groups that can influence Pakistan's politics currently, in order of influence, for instance, the Army, lawyers, political parties mobilised around Islam, the more 'established' parties like PPP, or PML (N), now the TH, large landlords, big capitalists?

5. How acute do you think the current crisis of governance is in Pakistan, especially the face-off between the PPP government and the judiciary and then the situation in Waziristan?

6. There is a concept in economics called rent, which I am sure you are aware of! How do you think each important political constituency in Pakistan generates this rent? It could be through some form of state capture of subsidies, grants etc, it could just be political rents that is access to power. Unpacking these links would make it easier to understand Pakistan's economic map.