

Economic Liberalization, Identity Politics and Investment Policies in India

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1. Introduction

From the point of view of an extensive literature on redistribution, a focus on growth-oriented policies in poor democracies, including measures targeted to attract private capital, is very unlikely. Starting with the seminal models of Romer (1975) and Meltzer and Richard (1981), scholars have posited that individuals with lower incomes are likely to favor greater redistribution. At a more macro level, a related set of studies link democracies to redistributive outcomes (e.g., Acemoglu and Robinson 2005; Boix 2003). Some scholars also suggest that democracies are better for the welfare of the poor as they provide more social spending and public goods than non-democracies (e.g., Brown and Hunter 1999; Lake and Baum 2001).¹

If the poor prefer greater redistribution and democracies have a proclivity to redistribute, we should expect to see poor democracies focusing predominantly on redistributive policies. Given resource constraints in developing countries, policymakers are unlikely to focus on strategies targeted specifically at growth, much less policies directed towards a privileged section such as business, under such circumstances. Yet, India's growth transformation since 1991 poses a clear challenge to this hypothesis. Catalyzed by a shift in its policy framework, notably a move from a state-dominated system to one where private capital began to play a primary role, India has been one of the fastest growing economies in the world over the last two and a half decades. Indeed, some scholars have characterized the change in India's development framework as a "pro-business" shift (Kohli 2012; Rodrik and Subramanian 2004). Interestingly, this transformation has occurred in a democracy where the poor not only form a sizeable portion of the electorate but are more likely to participate in the electoral process than richer sections (Yadav 1999, 2002).

India's overall growth performance over the last two decades, however, has been very uneven. Impressive national averages rates mask considerable regional disparity; subnational performance in growth and related outcomes such as investment has varied considerably (e.g., Ahluwalia 2000; Besley et al. 2007; Kohli 2006, 2012; Subramanian 2008). Further, scholars suggest that these differences in growth and related outcomes can be linked both to initial conditions as well as the policy environments created by individual states. In this paper, I leverage this background of subnational policy variation to gain insight on the following broad

¹ Ross (2006) challenges the claim that democracies have a better record on the welfare of the poor. Levels of redistribution also vary within democracies (e.g., Iversen and Soskice 2006).

yet highly consequential question: what are the political and social conditions conducive to business-friendly policies in the midst of poor electorates? Specifically, I examine varied policy responses of states to the competition for private industrial investment, which ensued after economic liberalization in 1991. Among several major ramifications, liberalization led to the onset of competition for private industrial investment between states. Even though they experienced a common shock in the form of the 1991 market reforms, Indian states have reacted very differently to the competition for investment. Some states have been far more proactive and business-friendly in the competition for investment; both the speed and scope of policies designed to attract investment has varied across states. Despite being subject to similar legal, electoral and fiscal rules, and despite being accountable to largely poor electorates, why has this been the case? This is the specific puzzle I address in this paper.

Through the comparison of varied policy responses in the competition for investment, I make two main claims. First, I argue that, at a proximate level, certain configurations of electoral coalitions, the social base of voters backing governments, are more favorable to growth-oriented policies than others. Who votes for governments matters strongly for policy outcomes. I argue that certain configurations of electoral coalitions with a narrow class basis are more favorable to growth-oriented policies than others. More specifically, *narrow-right coalitions*, characterized by the joint presence of core groups with similar economically-advanced profiles and substantial representation of business interests, are most conducive to a growth-friendly policy agenda. These coalitions represent a congruence of political and economic power and this overlap tends to be most favorable for the formulation and implementation of a growth-oriented policy framework.

Such narrow, growth-friendly class coalitions, however, cannot readily win electoral power in largely poor polities. How then do they emerge in the first place? The second main claim of the paper is that the emergence of narrow growth-friendly coalitions can be traced to the primacy of non-economic factors in electoral politics. In particular, symbolic concerns such as identity and ethnicity have cut across economic interests in electoral politics; both party strategies of mobilization and voter attachments at the state level have been driven by social factors rather than purely economic interests. This, in turn, has impeded the formation of large lower class coalitions in some states, which we might have otherwise expected given the income

distribution. Instead, I find that the focus on identity politics, notably caste politics, has meant that underlying social cleavages critically affect the composition of electoral coalitions in Indian states. Based on a four-fold classification of social demography across Indian states, I suggest that certain types of social cleavages are more likely to give rise to specific types of electoral coalitions. In particular, pro-business coalitions are most likely to emerge in dominant caste states.

This paper is part of a larger project that examines the political conditions conducive to growth-oriented policies in India. In this paper, I draw on empirical evidence from two cases in the broader project – Gujarat and Punjab – to support the argument above. Gujarat and Punjab are among two of India's richer states and exhibited a fair degree of similarity along a variety of socioeconomic indicators when economic reforms were undertaken in 1991. Despite relatively comparable initial conditions, the states have responded very differently to the competition for investment that ensued as a result of economic liberalization. At a proximate level, I trace this policy variation to differing electoral coalitions that have backed governments in both states. I then suggest that the underlying social demography in these two states can explain the types of electoral coalitions that have emerged.

Before proceeding further, it is worth highlighting one caveat related to the broader explanation. My argument assumes a trade-off between business-friendly and redistributive measures. This trade-off is likely to arise in developing countries for a variety of theoretical and empirical reasons. Unlike their counterparts in advanced industrial countries, policymakers face significant resource constraints while attempting to balance multiple policy imperatives. Moreover, measures to attract capital have to be undertaken in the short-term while potential benefits, if present, accrue only in the medium or long-run. The benefits arising from growth are often not evenly distributed. Ultimately, the question of a trade-off is an empirical one. In India, there is considerable evidence to suggest that growth has not been inclusive. Growth has been capital-intensive and service-sector led (e.g., Kochhar et al. 2006b; Subramanian 2008). It has resulted in very weak employment generation in the formal sector in a country that remains largely rural and agricultural (e.g., Anant et al. 2006; Nagaraj 2004). For these reasons, the argument made in this paper assumes a trade-off between redistributive and capital-oriented policies in India.

The rest of this paper is organized as follows. Section 2 briefly describes the specific empirical puzzle while section 3 outlines the rationale for case selection. The main argument is expanded in section 4. A comparison of Gujarat and Punjab follows in section 5 while section 6 briefly outlines alternate arguments. The concluding section extrapolates on the argument and attempts to predict which states might be more likely to pursue a growth-oriented agenda in the medium-term.

2. Economic liberalization, subnational competition for investment and divergent policy responses

India's 1991 reforms led to a marked transformation of India's political economy. Among several key changes, reforms reduced state control on the private sector, raised the importance of private corporate investment as a driver of growth and engendered a major reconfiguration in the role of the central and state governments in the policy process. Prior to 1991, New Delhi enjoyed dominant control of economic policy but the onset of reforms brought state governments to the forefront of policy-making. Under India's federal system, states have jurisdictional authority over several aspects of economic policy.² With the virtual abolition of the industrial licensing system – the infamous license-permit raj – in 1991, New Delhi's role in influencing the geographic distribution of investment was effectively eliminated. One of the most salient aspects of liberalization is that states are now engaged in open competition to attract domestic and foreign private investment.

Despite the common shock of market reforms, Indian states have responded to the competition for investment very differently in policy terms. Both the speed and scope of policies formulated and implemented have differed across states. Using eight dimensions of policies – infrastructure, regulatory environment, concessions and subsidies, land acquisition for industrial use, labor laws, special economic zones, organizational framework, and branding and promotion – typically identified in investment climate surveys as influencing investor decisions, table 1

² By the provisions of the Indian constitution, state governments have jurisdiction in the area of industries, except those declared by parliament to be necessary for defense purposes or expedient to public interest. States also have significant responsibility in most policy areas relevant to micro-level investment decisions such as land, electricity, roads (excluding national highways), labor laws, certain taxes, special economic zones and law and order. Until 1991, the presence of the licensing system allowed the center to control the location of investment.

summarizes the contrasting policy responses of Gujarat and Punjab, the two cases in this paper, between 1991 and 2010.

[Table 1 here]

Gujarat has, arguably, been the most proactive state in India in attempting to attract investment. It has formulated measures that are more business-friendly than its counterparts and has also adopted some policies at an earlier period. The state has offered generous concessions and subsidies to investors, consistently enhanced its infrastructure base and created a large number of special economic zones. A strong bureaucratic framework for industrialization, which existed even prior to 1991, has been frequently supplemented with new laws and organizations. Gujarat has had fewer problems in transferring land to industry than its counterparts. This is particularly notable; land acquisition has perhaps been the most politically contentious issue surrounding industrialization in India since 1991. Finally, Gujarat has promoted itself vigorously through investor summits and other branding exercises.

In contrast, Punjab has been slow to react to the needs of the post-liberalization environment. A vicious cycle of competitive populism since the mid-1990s has weakened the state's finances. As a result, its ability to create new infrastructure and offer subsidies to business has been significantly eroded. Measures such as free electricity to powerful agricultural interests have resulted in shortfalls and acted as major constraints to new projects. It has also been slower than Gujarat to enact regulatory changes. Land acquisition efforts have been limited.

3. Argument

Why have these advanced states reacted in such different ways? I offer a two-stage explanation (figure 2). At a proximate level, policies and measures undertaken by the state in relation to investment promotion is dependent on the nature of electoral coalitions, which refers to the social base of voters backing governments. Typically, policymakers in units competing for mobile capital face two sets of incentives – pressures to undertake business-friendly policies and demands arising from the electorate that are often more redistributive. In developing countries, the two sets of pressures are often at odds with each other. Unlike their advanced industrial counterparts, policymakers in the developing world face significant resource constraints while attempting to balance multiple imperatives. Moreover, incentives to attract investors have to be

undertaken in the short-term while benefits in terms of growth and employment often accrue in the medium or long-run.

Faced with these differing pressures, what goals governments prioritize and how they balance multiple aims in the context of limited resources is dependent on the class profile of core voters who comprise electoral coalitions. As a result, certain configurations of electoral coalitions are more conducive to pro-business policies than others. Based on two dimensions – similarity of socioeconomic profile of core voters and the incorporation of business interests – coalitions are conceptualized as four types, *narrow-right*, *narrow-left*, *wide-right* and *wide-left*. This classification of coalitions can be represented as a 2 x 2 (figure 3). Core voters can range from poor to rich and the first dimension tries to capture the extent to which these sections are similar in terms of their socioeconomic standing; whether class bases are confined or diverse. By core voters, I refer to those with a strong preference for a particular party and on whom the party depends significantly for its support. The second dimension focuses on the level of business representation in coalitions, which can range from minimal to substantial.

[Figures 2 and 3 here]

States that have been more proactive and investor-friendly are backed by narrow-right electoral coalitions. Core voters in such coalitions have a similar wealthy profile and business groups are substantially represented. The *joint* presence of these factors has two consequences. First, the class profile of the core groups in narrow-right coalitions allows policymakers to prioritize pro-business goals. There tends to be a closer coincidence in narrow-right coalitions between the interests of core groups and the imperatives of the state to attract investment than the three other configurations. The wealthy and entrepreneurial nature of core groups also means that redistributive pressures exerted by narrow-right coalitions on policymakers are more muted than those arising from other types of coalitions. Second, the confined class profile of core groups leads to fewer contradictory incentives for policymakers backed by narrow-right coalitions. As a result, policymakers can prioritize investor-friendly policies in a consistent and coherent fashion.

In contrast to narrow-right coalitions, narrow-left ones generate primarily redistributive impulses and policies are likely to be far less business-friendly. The two types of wide coalitions represent intermediate cases and include economically-dissimilar core groups with varied

interests. Policymakers backed by wide coalitions are likely to be pulled in multiple directions and unlikely to prioritize growth-related policies to the extent that those backed by narrow-right coalitions can.

If narrow-right coalitions with their confined class basis and substantial business representation are most conducive to pro-business policies, how do they emerge in the midst of poor electorates in the first place? I argue that such coalitions can arise in poor democracies when the primary basis of political mobilization is non-economic. In several developing countries, symbolic politics – often based on identity, ethnicity or nationalism – frequently acts as the primary basis of electoral contestation. A non-economic logic of political competition can lead to two consequences. Parties mobilize voters on the basis of social attachments and voter attachments are based on social factors rather than economic interests. Social attachments, thus, cut across economic interests in electoral politics. As such, this distinct set of dynamics prevents large lower class coalitions from emerging, which we might have otherwise expected in developing democracies. I show below how this general argument works in the context of Indian states.

3.1. Applying the argument to Indian states

For a country at its stage of development, the composition of India's GDP as well as its growth patterns since 1991 have been idiosyncratic (e.g., Subramanian 2008). Services accounted for 67.4 per cent of the country's GDP in 2013-14 while 13.9 per cent originated from agriculture and allied services.³ Economic growth in the post-1991 period has been driven by capital-intensive industries and the service sector (e.g., Kochhar et al. 2006a; Subramanian 2008). Employment generation in the organized sector has also been extremely poor (e.g., Anant et al. 2006; Nagaraj 2006). According to one widely-cited government-commissioned report, the unorganized sector also accounts for 92 per cent of the total workforce and over 65 per cent of this group are engaged in agriculture (Sengupta 2007). As such, given the underlying structure of the economy, the capital-intensive, service-sector driven patterns over the last two decades have limited the extent to which the process has been inclusive.

³ Calculated from RBI (2014) Table 3: Components of Gross Domestic Product (At Factor Cost) and Table 2: Macroeconomic Aggregates (At constant prices); In 2010, the end of the time period of this study, the figures were similar. Services accounted for almost 65 per cent of the GDP in 2010 while the share of agriculture and allied services was 14.6 per cent.

However, within this larger context, some subnational governments have managed to prioritize investor-friendly policies in a consistent and coherent fashion. As the case studies show, Gujarat has consistently adopted a pro-business agenda while Punjab has been consistently apathetic to the competition for investment. I associate these policy differences to the nature of electoral coalitions backing governments in these states. Narrow-right coalitions in Gujarat can be linked to the state's superior performance in the competition for investment while wide-right coalitions explain Punjab's sluggish response. The interests of core groups in narrow-right coalitions mean that they support business-friendly measures. Moreover, the confined nature of core groups in narrow-right coalitions means that policymakers are not pulled in multiple directions and can pursue a coherent capital-friendly policy framework.

What explains the emergence of different coalitions in the first place? My explanation suggests that electoral coalitions have social origins. I focus on the role of identity politics, mainly along the dimension of caste and to a lesser extent on religious nationalism and sub-nationalism in Indian states. The effect of identity on both party strategies and voter attachments has prevented large lower class coalitions from forming in some cases, which we might have otherwise expected given the income distribution of the broader electorate.

Instead, I find that the focus on identity in politics has meant that underlying social demography influences the construction of electoral coalitions significantly. I argue that the variation in social demography across Indian states has influenced the nature of political competition and conditioned the emergence of different types of electoral coalitions. Placing emphasis on differences in subnational social environments, I focus on two dimensions – numerical size of social groups and nature of economic resource control embedded in social cleavages – and argue that these aspects have structured the formation of electoral coalitions.

The first dimension – group size – influences party strategies in that it determines whether parties can rely on a few groups to construct electoral majorities or have to depend on a more diverse base. Conversely, where groups are small, parties have incentives to employ a more catch-all strategy. The ability of parties to rely on a few specific groups is strongly reinforced by the fact that voter attachments occur on the basis of social identity. The salience of large groups in India's FPTP system has been further magnified by the degree of political fragmentation over the last two decades. High degrees of fragmentation, and subsequent low vote thresholds for

victory, offers incentives for parties to focus on certain vote banks. In the midst of high degrees of fragmentation, parties that can capture the support of large social sections can potentially enjoy sizeable electoral benefits while relying on a relatively confined set of groups.

While group size influences the likelihood of parties relying on confined or diverse electoral bases, I suggest that the inclusion of business interests in electoral coalitions is linked to a second dimension – the nature of resource control historically embedded in certain social cleavages. In several developing countries, business interests often tend to be concentrated within specific social and ethnic groups (e.g., Fafchamps 2000; Iyer et al. 2013). In India, certain groups have historically enjoyed access to resources, either capital or land, by virtue of their position in the social hierarchy. Access to resources, in turn, has resulted in those groups forming the main business sections in particular states.

The association between ethnicity and capital is particularly evident in the fact that the social origins of entrepreneurship in India can be divided into two major strands. Entrepreneurs in the first and older strand have typically emerged from traditional merchant and trading communities within the social system. This includes groups such as Baniyas, Marwaris, Parsis, Chettiars, Gounders, Khatri, Aroras, Sindhis, Khojas and a variety of other regional variants (Damodaran 2008; Tripathi and Jumani 2007). A second, more recent, strand of entrepreneurs in India has arisen from certain landowning castes that have moved from commercial agriculture to industry (e.g., Baru 2000; Damodaran 2008; Sinha 2005). This shift has been particularly true of “dominant castes” such as the Patidars in Gujarat and the Kammas and Reddys in Andhra Pradesh. The groups that form the bulk of capitalists in the country have, thus, historically enjoyed control over economic resources, whether capital in the case of the trading communities or land in the case of the dominant castes. This access to resources arose as a result of the location of these groups within social hierarchy, creating a significant link between caste and capital.

3.2. Variation in social demography in India

Based on the two dimensions of group size and resource control, I suggest that we can characterize subnational social demography in India into four patterns. The first type includes states with “dominant caste” patterns; a well-known concept in Indian sociology developed by

Srinivas (1959). In these states, certain social groups, typically non-Brahmin, share two features – they are numerically preponderant relative to other castes and enjoy considerable economic power arising out of landownership. States such as Gujarat, Andhra Pradesh, Karnataka and Maharashtra tend to follow this pattern. In Gujarat and Andhra Pradesh, the traditional access to land of dominant castes enabled the transfer of surpluses from commercial agriculture into industry. As a result, these groups came to form a major part of the entrepreneurial base in those states. Importantly, these social groups also have some numerical leverage.

The second pattern, which is found mostly in the populous Hindi-heartland states of the north, is one where the social system historically conformed to the traditional four varna structure. These states have representation of castes (jatis) from all four varnas; lower castes form the vast majority of the population but upper castes dominated all aspects of social and political life until the 1990s. Importantly, certain large castes exist such as the Yadavs in Bihar (nearly 12 per cent of Bihar's population) and the Jats in UP. But these large groups did not control economic resources and were socially marginalized. The entrepreneurial base in these states is thin and the few producer groups that exist are small in size.

The third variation, which I refer to as the southern pattern, exists in states such as Tamil Nadu and Kerala. The structure under the southern pattern has some similarities to the structure found in the Hindi-heartland in that upper castes were historically powerful, both politically and socially. However, most social groups in the southern pattern tend to be small and none is numerically preponderant. The apex of the structure tends to be much narrower with upper castes forming a much smaller proportion of the population than their counterparts in the Hindi-heartland (Jaffrelot 2003). Moreover, the southern pattern includes a more notable entrepreneurial base than the Hindi-heartland configuration. A variety of landowning groups, smaller merchant groups and some upper castes came to form an entrepreneurial base but these capitalist groups tend to be small and fragmented.

Finally, there is a fourth group of states such as Punjab and West Bengal where other cleavage dimensions such as religion have interacted actively with caste (Kohli 1989). The cross-cutting nature of cleavages in these states has resulted in politically-relevant social groups being small. Entrepreneurial groups exist and are small. The interactive, cross-cutting nature of

cleavages and resulting small size of groups implies that parties cannot rely disproportionately on a single social group to create electoral majorities.

3.3. Divergent social demography and distinct electoral coalitions

These variations in social demography have led to different modes of political competition, notably divergent part strategies of political mobilization and coalition construction. Narrow coalitions tend to occur where numerically sizeable sections are present. This has been the case in dominant caste states such as Gujarat and Andhra Pradesh or Hindi-heartland states such as Bihar.⁴ Party strategies have been supported from below by the fact that voter attachments amongst large groups in such cases have been strongly driven by social identity. Importantly, as I argue below, narrow-right coalitions have occurred in those cases where numerical size has coincided with economic resource control. This has typically occurred in dominant caste states such as Gujarat and Andhra Pradesh. Wide coalitions, in contrast, have been constructed in states where numerous small groups exist but no group is large enough to dominate electorally. Therefore, parties have had to rely on a relatively diverse base of voters to construct majorities. Wide coalitions have typically occurred under the southern and cross-cutting patterns in states such as Tamil Nadu, Kerala, West Bengal and Punjab.

If group size has driven how narrow or wide coalitions have been, the extent of business representation has been determined by the ethnicity-capital link in India. Certain social groups are disproportionately represented in business and this has occurred due to the fact that they historically enjoyed access to economic resources by virtue of their social position. Though the ethnicity-capital association exists under all four cleavage patterns described earlier, the numerical strength of business groups varies under different cleavage structures and results in dissimilar levels of political leverage for capital across Indian states. If groups that control economic resources are also numerically sizeable, this allows parties in poor democracies to construct electoral majorities around these sections. It is only under dominant caste structures that the two factors of size and resource control coincide. As a result, the political leverage of

⁴ Narrow coalitions are not necessarily comprised of a single caste. In most cases, no single caste can provide sufficient electoral support and multi-caste coalitions are a necessity (Chhibber 1999). However, multi-caste coalitions in India do not always include a large number of groups.

business groups has been more significant under dominant caste patterns and narrow-right coalitions have been more likely to emerge under these structures.

A robust base of capital also exists under the southern Indian and cross-cutting cleavage patterns. However, producer groups in these cleavage patterns are small. The lack of numerical strength of social groups has meant that parties have resorted to catch-all strategies and targeted diverse bases of support to construct winning electoral coalitions. As a result, wide-right coalitions have arisen in these states. Finally, the Hindi-heartland, over the last two decades, has seen configurations that are on the opposite end of the spectrum from narrow-right coalitions. Large caste groups exist in these states but these groups are also the most economically-marginalized sections of society. As a result, narrow-left coalitions have been more likely to arise in these states and the potential to create business-friendly coalitions has been limited.

The ability of narrow-right coalitions to win elections has been assisted by the nature of India's competitive FPTP system and high degrees of party fragmentation, particularly over the last two decades. The vote share required to form governments at the state level in India in the last two decades has typically fluctuated between 35 and 40 per cent. In states where electoral fragmentation is high, the threshold for victory has been particularly low.⁵ In some cases, social groups are also geographically concentrated, leading to high electoral payoffs for parties that mobilize these groups.⁶ In sum, elections in Indian states have been routinely won with much less than 50 per cent of the vote share, allowing parties to rely on specific vote banks rather than creating diverse bases of support. In the case of dominant caste states, these vote banks have comprised of large caste groups that are entrepreneurial in nature leading to narrow-right coalitions.

The focus on pre-existing social demography in the broader explanation, does not, however, imply that political agency is irrelevant. While party strategies are conditioned by underlying social demography, the process of coalition-building is not static. Political agency matters and politicians have attempted to aggregate or disaggregate cleavage dimensions with

⁵ For example, the average vote share of the largest party in elections in Bihar between 1990 and 2005 was 28.62 per cent.

⁶ One clear example of the electoral impact of spatial concentration is the case of the Kammas in Andhra Pradesh (discussed in chapter 5). Though the Kammas are approximately 5 per cent, their geographic concentration in coastal Andhra has allowed the TDP to win elections by depending on their support in substantial measure.

varying success. Since political competition is also strategic, choices of parties at different points in time are also conditioned by what their competitors do. In addition, past choices influence current mobilization. To highlight the fact that coalition building is evolving, I chronologically trace the process of coalition construction in the post-independence period in each of the case studies. I also emphasize shifts in the nature of electoral coalitions over time.

Before presenting evidence on the two case studies, Gujarat and Punjab, the rationale for case selection is first outlined below.

4. Case selection

I relied on the method suggested by Lieberman (2005) to pick the cases of Gujarat and Punjab. Though other studies have observed that policies varied across Indian states since 1991, the nature of policy differences is not well-documented. Given the lack of systematic data on policy variation, I selected the cases based on investment outcomes.

A preliminary quantitative analysis was first used to examine the explanatory leverage of existing theories in accounting for the variation in investment outcomes observed across Indian states. Specifically, existing studies from neoclassical economics and economic geography predict that certain socioeconomic factors are likely to drive investment location (e.g., Barro 1991; Lucas 1990; Krugman 1998). To determine the adequacy of socioeconomic variables in explaining investment outcomes, a simple cross-section OLS regression was run. Cumulative investment across Indian states between 1991 and 2007 was regressed on proxies of four socioeconomic variables frequently identified as affecting investment location (level of economic development, market size, human capital and infrastructure). Using results from this regression, figure 1 plots actual investment values against values predicted by socioeconomic variables identified in existing theories.

[Figure 1 here]

As figure 1 suggests, existing theories offer only a partial explanation for outcomes observed. Employing an “off- the-line” strategy, two cases – Gujarat and Punjab – that are not well predicted by socioeconomic factors were chosen (indicated by ‘GUJ’ and ‘PUN’ in figure 1). Importantly, socioeconomic variables would have predicted very similar levels of investment

in Gujarat and Punjab but actual outcomes vary considerably, making the comparison a potentially interesting one.

5. Contrasting coalitions and outcomes: Gujarat and Punjab

When liberalization began in 1991, Gujarat and Punjab appear broadly similar. The two states were among the richest in the country; a similar proportion of the population was rural (nearly 63 per cent in Gujarat and 66 per cent in Punjab); both had middling literacy rates (61.3 per cent in Gujarat and 58.5 per cent in Punjab) and the levels of urban and rural inequality in both states were almost identical.⁷ While industry enjoyed a more prominent place in 1991, accounting for 36.7 per cent of the gross state domestic product (GSDP), it had a notable presence in Punjab, constituting almost 25 per cent of the GSDP.⁸

Given these parallels, the two states might have plausibly been expected to react similarly in the competition for investment. Yet, Gujarat has been extremely proactive in attracting investment while Punjab has exhibited a weak commitment. In the account that follows, I first trace these differing policy responses to the nature of electoral coalitions. Having suggested that the social basis of electoral support matters for policies, I then link the emergence of coalitions to distinct social demography in these states.

5.1. Gujarat: narrow-right coalitions and pro-business policies

Created in 1960, Gujarat has been one of India's most industrialized and prosperous regions over the last five decades. The region has a long history of maritime trade and was a key industrial hub under the British (Damodaran 2008; Tripathi and Jumani 2007). Under the license-permit raj, Gujarat's "bureaucratic developmentalism" ensured high investment flows to the state despite the constraining effects of central rules (Sinha 2005). Gujarat's growth acceleration in the post-liberalization period has been even more rapid; between 1991-92 and 2009-10, GSDP grew at 8.1 per cent compared with a national average of 6.5 per cent.⁹ High growth has been backed primarily by the state's aggressive response to the competition for industrial investment – though

⁷ Population data from the Census of India, 1991; Literacy data from the Government of India's Economic Survey 1992-93; GINI coefficients from the Planning Commission of India (planningcommission.nic.in)

⁸ Data from CSO, Government of India (mospi.nic.in).

⁹ RBI (2011).

it accounts for about 5 per cent of India's population, Gujarat received 12.4 per cent of total number of investment proposals between 1991 and 2010.¹⁰

On the surface, Gujarat's proactive response to the competition for investment is not entirely surprising given its economic history. While favorable initial conditions have mattered, a sole focus on continuity leaves two key factors unaddressed. Why has Gujarat maintained its economic dominance when some other states such as Punjab have managed to squander their pre-1991 advantages? Second, why did Gujarat adapt more effectively and rapidly to the new framework than similarly placed high and middle-income states? These questions merit additional explanation.

I suggest that Gujarat's success in the competition for investment is part of a larger political economy framework. Four aspects are the heart of this framework – a strong pro-business policy commitment, disproportionate emphasis on growth over other development dimensions, majoritarian and illiberal politics and a degree of exclusion of certain social groups from economic gains. In turn, Gujarat's social demography and political history, described in the next two sections, are a vital part in explaining this specific political economy.

5.1.1. Gujarat's social structure: dominant caste patterns and a history of entrepreneurship

Gujarat's social structure is characterized by what M.N. Srinivas defined in his seminal study as "dominant caste" patterns, where certain groups are numerically preponderant and also wield economic and political power (Srinivas 1959). This very coincidence of size and economic power acts as an enabling factor for the emergence of narrow-right coalitions. The Patidars are Gujarat's dominant caste, accounting for over 12 per cent of the state's population (e.g., Shah 1989).¹¹ The Patidars have enjoyed considerable economic clout arising from their ownership of land (e.g., Kohli 1990; Kothari and Maru 1970; Sinha 2005). The access to land crucially allowed the Patidars to turn to commercial agriculture under the British. Subsequently, since the

¹⁰ Data from SIA Statistics (January 2011), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry (dipp.nic.in).

¹¹ The 1931 census in India was the last one to collect information on individual castes other than scheduled castes and scheduled tribes. Despite the short-coming of not having current details on individual castes, most studies on Indian politics, including the ones cited in this paragraph, use the 1931 data and extrapolate from it.

early 20th century and in greater scale after 1960, the Patidars began to transfer surpluses from commercial agriculture and overseas migration into industry. Along with the Banias, the Patidars have since constituted the key entrepreneurial sections in the state (Shinoda 2000).

The Brahmins (approximately 4 per cent of the population) and Banias (almost 3 per cent) form the two major upper caste groups and are also among Gujarat's wealthiest sections. Historically a trading and merchant caste, the Banias enjoyed access to financial capital and business networks and constituted the earliest wave of indigenous industrial entrepreneurs in Gujarat and other parts of India in the colonial period. They continue to form a major section of Gujarat's entrepreneurial base. Brahmins in Gujarat are mainly found in white-collar professions.

The main lines of political conflict in Gujarat have been between the Patidars, Brahmins and Banias, on one hand, and the Kshatriyas, on the other. The Kshatriyas, constitute a little more than 29 per cent of Gujarat's population (Kohli 1990; Kothari and Maru 1970). They are a relatively loose social grouping that exhibits considerable internal economic diversity. The most economically and socially-marginalized groups in Gujarat include Dalits (Scheduled Castes) and Adivasis (Scheduled Tribes), who form 7.1 per cent and 14.8 per cent of the population respectively, and Muslims who are approximately 9.1 per cent of the population.¹²

5.1.2. Politics and development in Gujarat

In addition to social demography, a longer lens is needed to understand the particular political and economic framework that has characterized the state in post-liberalization period. The brief background of Gujarat's politics that follows suggests two continuing threads. First, bipolar competition has generally characterized the electoral sphere. Second, except for the decade of the 1980s, Patidars, Brahmins and Banias have dominated Gujarat politics. However, the political modes through which they have exerted power have changed over time.

Until 1975, Gujarat was a one party state ruled by the Congress. The wealthier castes, the Patidars, Brahmins and Banias, tightly controlled Gujarati politics in the 1960s. Low levels of mobilization of marginalized groups and intra-elite harmony characterized state politics (Kohli 1990). Though politically uneventful when compared with subsequent decades, Gujarat put in place the institutional framework for subsequent industrialization at this time (Sinha 2005).

¹²Data from Census of India 2001 (censusindia.gov.in).

The character of Gujarat's politics would be indelibly altered in 1969 when the Congress split at the national level into two wings, the Congress (R) led by Indira Gandhi and the Congress (O) led by Morarji Desai. This resulted in a major realignment in the social base of the party in Gujarat and paved the way for considerable political instability. Till the 1960s, the sizeable Kshatriyas remained outside the Congress' power structure in Gujarat and this led to considerable alienation. Throughout the country, Indira Gandhi's strategy was to mobilize weaker socioeconomic sections. In Gujarat, her party, which became the official wing of the Congress, targeted the marginalized Kshatriyas, Dalits and Adivasis through populism and a variety of redistributive promises.

The strategy paid handsome electoral dividends for the Congress but the political ascendancy of marginalized groups elicited a sharp response from the established Brahmin-Bania-Patidar alliance. This response took the form of the mass Navnirman ("social regeneration") movement, which a protest against rising food costs but morphed into violent opposition against Congress rule. Congress' subsequent defeat in the 1975 Gujarat elections acted in part as a trigger for Indira Gandhi's proclamation of a national emergency, which ended two years later. Crucially, it was in this period that marked polarization in the social bases of the main parties became established. While the Congress depended on more marginalized groups, the opposition Janata aligned with the Patidar-Brahmin-Bania coalition.

The Congress' successfully consolidated support of the Kshatriyas, Dalits, Adivasis and Muslims, through an electoral strategy known as KHAM, an acronym for these four groups, and dominated electoral politics in the 1980s. Paradoxically, electoral dominance would be accompanied by political instability and violence. Disenchantment of the Patidar-Brahmin-Bania alliance took the form of two sets of riots against reservations (affirmative action provisions) in 1981 and 1985. The disenchantment of the elite castes would benefit the Hindu-nationalist BJP, which targeted the support of Patidars, Banias and Brahmins. What began as anti-reservation protests transformed by the BJP and its affiliates into riots against the state's Muslims and lower castes using appeals to a broader Hindu identity (e.g., Shah 2007). Both sets of anti-reservation riots allowed the dominant Patidar-Brahmin-Bania alliance through the BJP regain their political hold on the state and this dominance continues till today (e.g., Shah 1987, 1996, 2007; Sud 2007).

The BJP has dominated electoral politics in Gujarat since the 1990s. It was part of a coalition government that controlled the state between 1990 and 1994 and has since headed governments almost continuously from 1995.¹³ Despite its electoral success, the BJP was wracked with considerable leadership instability; Gujarat had seven chief ministers between 1990 and 2001. Since 2001, the state has been led by the controversial Narendra Modi. Celebrated in business circles for leading an efficient, investor-friendly and relatively clean administration, he is equally vilified outside these circles for his government's role in the 2002 Godhra pogrom, where over 3000 people, mainly Muslims, were killed.

Under Modi, the state's pace of growth has accelerated and the political formula accompanying the development framework has varied compared with the past. Four aspects of Gujarat's political economy under Modi stand out. First, a strong pro-business inclination is at the heart of Gujarat's economic framework. Impressive growth rates have been driven by a capital-friendly state apparatus that has been extremely successful in attracting investment and the state enjoys considerable credibility with big business. Second, Gujarat has prioritized growth over other development metrics. Despite its impressive growth rates, Gujarat's development model is considerably skewed. The state underperforms in terms of social and human development indicators relative to its income as well as in comparison with other states.

A third trend is that the majoritarian political formula utilized by Modi has strongly combined the themes of Hindu nationalism and Gujarati 'asmita' (pride). In keeping with the larger ideological platform of the BJP, a strident anti-Muslim platform has continued to be a key piece of Modi's political strategy. The BJP has also increasingly emphasized Gujarati subnationalism in several campaigns (Shah 2002). Over time, the state's governance and growth record has been repeatedly used as a foil to deflect criticisms of the state's involvement in the Godhra riots (Mehta 2011). A fourth aspect of the broader political economy framework, and closely linked to the trends of majoritarian politics, is that some social groups in Gujarat, particularly Muslims, have not benefitted as much from the state's development as others (e.g., Hirway 1995, 2000).

5.1.3. Tracing the mechanism: from narrow-right coalitions to investor-friendly policies

¹³ The sole exception was a brief period between 1996 and 1998 when a group of defectors led by Shankarsinh Vaghela broke away from the BJP and headed the government.

Gujarat's distinct political economy can be traced to the nature of electoral coalitions in the post-liberalization period. Who votes for the BJP in Gujarat has mattered for the nature of economic policies. Narrow-right coalitions have continuously backed Gujarat governments over the last two decades. Since the 1980s, the polarization in the social bases of the BJP and Congress was markedly evident with the elite Patidar, Bania and Brahmin castes supporting the former and Kshatriyas, Dalits, Adivasis and Muslims rallying behind the latter. The BJP relies disproportionately on the support of the Patidars, Banias and Brahmins and its strategy has been complemented by the fact that these groups have voted resoundingly for the party.

The polarization of social bases and high degree of correlation in the vote choice of social groups in Gujarat is clearly evident from electoral survey data in tables 2, 3 and 4. Despite economic differentiation within social groups, vote choice of individuals within the same social group is highly correlated. As table 2 shows, over 81 per cent of Patidars and 67 per cent of the upper castes voted for the BJP in 2002. In contrast, Muslims, Dalits and Adivasis strongly support the Congress. Since the mid-1990s, the BJP attempted to widen its base to include sections of the other backward castes (OBCs), Dalits and Adivasis, through a combination of Hindu unity appeals, Gujarati subnationalism and welfare programs (e.g., Patel 1999; Shah 2007; Sud 2007). But these attempts have seen mixed and temporary results.

[Tables 2, 3 and 4 here]

I classify the BJP's coalitions since the 1990s, comprising of core Patidars-Banias-Brahmin support, as narrow-right. These three core groups are among the wealthiest in the state and share a similar class profile. The representation of economically-marginalized groups is limited. Patidars, Banias and Brahmins also form the bulk of the capitalists in Gujarat, satisfying the criterion of substantial business representation in narrow-right coalitions.

Gujarat's pro-business agenda is firmly in line with the interests of the Patidars, Brahmins and Banias. Essentially, there is a coincidence between the interests of these groups and investor-friendly policies. The priority accorded to investment and growth has been strongly supported by the fact that redistributive pressures from this electoral coalition are relatively muted. As a result, successive Gujarat governments have not been forced to adopt contradictory policies that might otherwise have diluted its business-friendly agenda. Gujarat has been relatively distinct among

Indian states in that the government has tended not to reward electoral support through large populist schemes. The state's finances have remained buoyant, allowing for improvements in the business environment and concessions to investors.

5.1.4. Explaining the emergence of narrow-right coalitions in Gujarat

If the overlap of interests of narrow-right coalitions and the state has driven Gujarat's business-friendly agenda, how did such coalitions arise? I suggest that the answer lies in the prevalence of identity politics, which has affected both party strategies of mobilization and voter decisions. The focus on identity has meant that the underlying social demography influenced the type of electoral coalitions that parties have chosen to construct. Critically, the coincidence of economic resource control and numerical strength inherent in dominant caste patterns in Gujarat has allowed for a subsequent overlap of economic and political power. The BJP derives its core support from Patidars, Banias and Brahmins. In particular, support from the dominant Patidar caste, who constitute almost 12 per cent of the state's population and constitute a major portion of entrepreneurs, is a critical factor. Through its primary reliance on these core groups, the BJP has managed to dominate the electoral space over the last two decades. As such, the ability to achieve comfortable electoral victories while relying on these core groups limits the necessity to construct broad bases of support. This is not to suggest that the BJP does not receive any support from other groups. While it does receive some support from a section of the OBCs as well as Adivasis and Dalits, these groups overwhelmingly support the rival Congress.

Dominant caste patterns also enable a second characteristic associated with narrow-right coalitions – substantial levels of business representation. When numerically-sizeable groups targeted by parties are also entrepreneurial, this leads to substantial business presence in electoral coalitions. It is this exact conjunction of size and entrepreneurial identity that has facilitated narrow-right coalitions in Gujarat.

While social demography has allowed the BJP's need to construct narrow bases of electoral support, a longer historical lens is necessary to understand the specific timing behind the emergence of narrow-right coalitions in the 1990s. As explained earlier, Gujarat witnessed one-party dominance of the Congress in the 1960s and control of party politics lay in the hands of the Patidar, Brahmin and Bania elite. A split in the Congress in 1969 led to a realignment of social

bases of parties in the state. From the mid-1970s, the Congress shifted its base to the Kshatriyas, Dalits, Adivasis and Muslims. The Patidar-Bania-Brahmin alliance responded violently to their exclusion from party and government. Subsequently, the BJP targeted the support of these disaffected groups through the 1980s. The general patterns of polarization had their roots in the early 1970s and remain clearly evident even today.

These party strategies in Gujarat have been complemented by the fact that there is considerable similarity in the voting decisions of individuals within certain groups. Individuals typically vote en masse for the BJP. Such social affinity is not exclusive to the BJP; Dalits, Adivasis and Muslims show equally strong support for the Congress. Survey data in tables 2 to 4 confirm the strong correlation between social identity and vote choice in Gujarat.

Table 5 includes results of a basic multinomial logit analysis of the determinants of vote choice in the 2002 Gujarat assembly elections. A regression of vote choice as the dependent variable and social group, locality, gender and class (education level is used as proxy for class) was run. Vote choice for the Congress is the reference category. Social group is a categorical variable consisting of 7 categories – Muslims, Adivasis, Dalits, OBCs, Patidars, upper castes and a residual category of others. Broadly, the variable was constructed in such a way that higher values correspond to a higher position on the traditional social hierarchy. Table 5 shows that controlling for gender, locality and class, social group is strongly significant in predicting vote choice for the BJP when compared with the Congress. The log odds of voting for the BJP compared with the Congress are much greater for groups that are higher on the traditional social hierarchy.

[Table 5 here]

5.2 Punjab: wide-coalitions and competitive populism

Punjab has been one of the country's richest states since independence. It has been India's grain bowl; 66 per cent of the state is rural and agriculture contributes a quarter of the GSDP. The share of industry and services in the state are significant, accounting for nearly 32 and 44 per

cent of the GSDP respectively.¹⁴ Punjab does not have as long an entrepreneurial lineage as Gujarat but it nevertheless emerged as a strong industrial performer in the 1960s and 1970s.

Though more prosperous than most other parts of India, Punjab has had a long history of political crises and violence. In the 1970s and 1980s, troubles surfaced in the form of a violent Sikh separatist movement. The period of militancy came to an end in the early 1990s and the state has remained peaceful since. Despite being in the throes of militancy for most of the 1980s, the state's industrial growth was well above the national average but the return of peace in Punjab has ironically coincided with slow industrial and agricultural growth. Punjab's inability to compete effectively in the competition for investment has been a central feature of its economic slowdown. In turn, this can be traced to the nature of electoral coalitions. I begin with a brief overview of the social structure in the state, which has contributed to the make-up of these coalitions.

5.2.1 A brief overview of the social structure

Punjab is India's only Sikh majority state. Sikhs account for nearly 60 per cent of the state's population while Hindus constitute almost 37 per cent of the population.¹⁵ Unlike other Indian states where one dimension of identity has typically dominated, Punjab's social structure has been actively subject to multifold influences. Among these multiple influences, religion, caste and class have all interacted vigorously to create a complex social structure (e.g., Wallace 1989). The active interaction of multiple identity dimensions have resulted in a structure that is characterized by social groups of a small size. I refer to this cleavage pattern as "cross-cutting."

Both Sikhs and Hindus are divided internally by caste and sects. Castes and sects have been particularly crucial in preventing the Sikhs "from acting in politics as a single entity on a sustained basis and have made for competing groups within Sikhism" (Nayar 1968: 437). Among the Sikh castes, the Jat Sikhs have been a key political player. Few social groups enjoy numerical leverage in Punjab but the Jat Sikhs carry more weight than other sections. A predominantly landowning agricultural caste, the Jats comprised 35 per cent of the state's pre-partition Sikh population (Wallace 1989). A sharp divide exists between the landowning Jat Sikhs and lower

¹⁴ GSDP data from Central Statistical Organization, Government of India (mospi.nic.in).

¹⁵ 2001 Census of India.

caste Sikhs, particularly Dalit Sikhs (e.g., Kumar 2006; Wallace 1989). Dalits are present among both Hindus and Sikhs. Punjab is also home to several economically-powerful merchant and trading castes such as Khatri and Aroras, who are present among both Hindus and Sikhs, and the Banias, a Hindu caste. These entrepreneurial groups, however, enjoy little numerical weight. Among upper caste Hindus, Brahmins have a small presence in Punjab (3.7 per cent) while Rajputs are more sizeable (8.3 per cent).

Like other parts of India, certain social groups are tied to particular economic activities. The historical pattern in Punjab has been that Sikhs, especially Jat Sikhs, have been agricultural while Hindu groups such as the Khatri, Aroras, Agarwals and Banias have dominated trade, commerce, money lending and the service sector. These groups have sizeable presence in industry. Over time, other Sikh groups such as Tarkhans and Lohars have also moved into industry (Damodaran 2008). In general, no entrepreneurial group in Punjab enjoys notable numerical leverage.

5.2.2 Punjab's political economy: competitive populism and a sluggish response

Punjab's inability to compete effectively for investment after 1991 can be traced to the nature of politics. A vicious cycle of competitive populism has characterized politics in the post-liberalization period. Populism, in turn, has decisively limited Punjab's ability to compete effectively for investment. The rest of this section explains the political roots of this populism.

Three commonalities can be identified in Punjab politics over time. First, the Congress and the Shiromani Akali Dal (SAD), a party formed to represent Sikh interests, have been the two main poles of competition. Other parties, most notably the BJP, have been alliance partners at various times with both the Congress and SAD but have lacked the ability to win elections independently. Second, different cleavage dimensions – religion, class, caste and, to a lesser extent, language and region – have all mattered in Punjab's politics (e.g., Kumar 2006, 2009; Wallace 1989). Third, active interaction of cleavage dimensions has meant that parties have had to target a broad range of social groups to construct electoral majorities.

In the 1950s and early 1960s, communal conciliation and accommodation essentially characterized politics under the Congress chief minister, Pratap Singh Kairon. Kairon reformulated the Congress' electoral base to create a coalition that was broadly representative of

religious, class, caste, rural-urban and regional dimensions of Punjab's polity. By including a variety of elector profiles within its fold, the Congress's strategy in Punjab was to appropriate the political middle ground (Wallace 1989). The party has continued to adopt the same strategy since.

The 1950s saw the SAD beginning to voice greater demands for Sikh autonomy. Realizing that the central government was not amendable to demands for autonomy made on the basis of religion, the SAD in the 1960s resorted to secular appeals. It focused on language and called instead for a separate Punjabi-speaking state. Though initially rejected, the central government relented and the borders of Punjab were redrawn in 1966. The post-1966 political situation would, however, pose a major political dilemma for the SAD; one that the party has continued to grapple with ever since (e.g., Wallace 1989).

As the main party of Sikh nationalism, its demands until 1966 had been primarily confined to Sikh-specific issues. With the changed borders, the Sikhs became a majority in Punjab. This changed demography might have appeared seemingly advantageous for the SAD. However, the SAD does not attract support from all Sikh castes and sects and it entered a political situation where a Sikh-specific platform was insufficient to construct electoral majorities. The SAD temporarily solved this dilemma after the Assembly elections in the late 1960s by entering into an alliance with an unlikely bedfellow, the Hindu-nationalist Jan Sangh. Ideological differences aside, the SAD-Jan Sangh alliance was electorally effective in combining the predominantly rural Jat Sikh vote base of the SAD with the urban Hindu base of the Jan Sangh (Kumar 2006). This alliance would also be the precursor for a similar collaboration between the SAD and BJP since the 1990s.

The period from the mid-1970s saw the emergence of a major Sikh secessionist movement. While the details of the secessionist movement are not relevant to the analysis, it is important to note is that Punjab was afflicted by high levels of violence in the 1980s. Through considerable force and some carrots in the late 1980s and 1990s, the Indian government managed to regain its hold on the state. By the early 1990s, the secessionist movement virtually ended.

With a return to peace, a clear bipolar configuration emerged with the SAD and Congress as the main parties. In addition, the Hindu-nationalist BJP has proven to be a third party with

considerable leverage. The SAD has allied with the BJP since 1997. Anti-incumbency has been a prevalent factor in Punjab; the Congress won state assembly elections in 1992 and 2002 while the SAD-BJP combine came to power in 1997, 2007 and 2012.

With the end of separatism, parties once again have been forced to balance a variety of different pressures. This is evident in the approaches of the two main parties to political mobilization and coalition-building. Outflanked on one side by the predominantly Sikh SAD and, on the other, by the Hindu-nationalist BJP, the Congress since the mid-1950s has sought to build a diverse social base that cuts across religion, caste, class and region. The SAD's strategy has been distinct. The SAD's ability to win electoral majorities on its own is circumscribed. As a primarily Sikh party and, even more specifically, one dominated by the agricultural Jat Sikhs, electoral alliances are a necessity for the SAD (Kumar 2006). Moreover, the Congress tends to attract more votes among certain Sikh sections. Since the mid-1990s, the SAD has worked to enlarge its vote base through a formal coalition with the BJP. The complementary bases of the two parties – the rural, Jat-Sikh base of the SAD and the urban, Hindu base of the BJP – has seen considerable electoral success.

5.2.3 Tracing the mechanism – wide-right coalitions and competitive populism

Both the Congress and the SAD-BJP coalition have relied on a diverse base of support. I classify the electoral coalitions of both the Congress and SAD-BJP as wide-right. Both sets of electoral coalitions include a range of voter profiles that span the entire socio-economic spectrum. Both coalitions include rich and poor, rural and urban, agricultural and business, Hindu and Sikh voters. As such, this base of voters is not confined in class terms. Second, both sets of coalitions include business interests and incorporate key entrepreneurial sections. Social groups that form the entrepreneurial base are not numerically sizeable as in Gujarat.

These wide-right coalitions have crucially affected Punjab's responses in the competition for investment. In particular, the class interests of diverse core voters have often been conflicting and have pulled various Punjab governments in different directions. Both Congress and SAD-BJP governments have responded to conflicting demands by pursuing a strategy of populism (e.g., Kumar 2006; Kumar 2003). Punjab has a political tradition, dating to the Green Revolution

in the 1960s, of placating groups through subsidies of various kinds such as free electricity and fertilizer concessions. Such populism has taken an intense form since the 1990s.

The question of who receives free electricity is an example of an issue that has been contested vigorously and provides insight into the type of politics prevailing in the state. “The politics of populism introduced new competition among various sections of the population. It was alleged that Mr. Badal’s [*the chief minister of the SAD-BJP government*] populism is pro-Jat peasantry and it discriminates against other sections of society. For instance, the Bahujan Samaj Morcha, an ally of the Akali Dal (Badal), asserted that the Punjab Chief Minister’s decision to give free electricity to farmers created a wide gap between the farming community, those living in urban areas and Dalits...In response to these assertions, the state government decided to give free domestic power up to 30 units each per month to those Scheduled Caste [*Dalit*] consumers who had a sanctioned load of not more than 300 watts. The effort of the state government to appease the Scheduled Castes and Backward Castes did not succeed. The Badal government was accused of betraying the weaker sections by fixing the 300 watt limit, whereas no limit was fixed in case of farmers” (Kumar 2003: 386).

Such complex balancing through populism has detracted from investment promotion in several ways. Populist schemes have affected the ability to create industrial infrastructure. Punjab has the highest per capita consumption of electricity in India and free electricity to groups has strained the state’s weak generation capacity. Since agriculture is politically powerful, the solution of various governments to the electricity problem has been to enforce regular mandatory cuts for industry. Land is another major constraint; unlike other states, the Punjab government has chosen not to get involved in land acquisition for industry for the fear of losing agricultural support.

The financial strain placed by populism has also meant that the state is also unable to deliver on concessions promised in industrial policy statements. As a result, it enjoys low credibility among business. Low credibility with capital is compounded by the fact that agricultural income in India is not taxed. This has meant that the industrial and trading section, which are mostly urban, face most of the burden in Punjab but see little benefit as revenue ends up as subsidies to rural groups. Further, Punjab has often used local taxes such as octroi and

entry taxes on inputs, which are paid by industry, to raise revenue when these taxes were virtually abolished in most other states due to their adverse effect on industrial growth.

5.2.4 Explaining the emergence of wide-right coalitions

If populist politics, engendered by wide-right coalitions, explains Punjab's policy response, how did such coalitions originate in the first place? I suggest that Punjab's cross-cutting cleavage structure has critically influenced party strategies of coalition-building. The nature of voter attachments has reinforced these tactics. Religion, caste and class have all had cross-cutting effects and have created a complex social structure characterized by small group size. In turn, small group size has structured strategies available to parties. In particular, parties cannot depend on a few social groups disproportionately to win. Wide coalitions have therefore been an electoral necessity in Punjab.

The two main parties have arrived at wide-right coalitions through different routes. The Congress since the 1950s has been a catch-all party in Punjab and appealed to a cross-religious, cross-regional, cross-caste and cross-class base. Inasmuch as parties in Punjab can rely disproportionately on one social group, the SAD depends on the Jat Sikhs. Knowing that Jat Sikhs are not large enough to ensure an electoral majority and recognizing its limitations as a historically Sikh party, the SAD has instead relied on electoral alliances with the BJP since 1997. The complementary nature of the SAD and BJP's core support – the rural Sikh base of the former and the urban Hindu base of the latter – has resulted in victories for the SAD-BJP coalition in 1997, 2007 and 2012.

Unlike Gujarat, where there was a strong correlation in the vote choice of individual members within social groups, the effect of identity on vote choice in Punjab is weaker. Voter support within social groups is split more evenly between the Congress and SAD-BJP. Closer analysis of survey data points to this. A multinomial logit regression of vote choice as the dependent variable and social group, locality, gender, age and class (education level is used as proxy for class) as explanatory variables was run. The variable social group consists of 10 categories – Adivasi, Dalit Sikh, Dalit Hindu, OBC Sikh, OBC Hindu, Jat Sikh, Jat Hindu, Upper caste Sikh, Upper caste Hindu and Others. The regression results in table 6 suggest that social identity is not a significant predictor of vote choice for the SAD-BJP coalition compared to the

Congress. The lack of a durable link between voter attachments and social identity reinforces the need for parties to construct wide coalitions.

[Table 6 here]

6. Additional and alternative explanations

The explanation stands in contrast with existing arguments. To evaluate its strength, I juxtapose my argument against other prominent political economy explanations below.

6.1. Leadership

Media accounts often highlight the role of chief ministers such as Narendra Modi in Gujarat, Chandrababu Naidu in AP and Nitish Kumar in Bihar for economic improvements in their states. Some scholarly accounts too suggest that reform-friendly chief ministers are a driving force in India's post-liberalization economy (Rudolph and Rudolph 2001). To be certain, political leadership matters. But treating leadership as an exogenous factor neglects the question of where and how preferences on individual leaders originate. In contrast, I argue that electoral coalitions shape leadership preferences and constraints. Policy agendas of leaders need to be viewed as a product of broader coalition interests and not as individual predilections.

Empirically, strength and tenure of political leaders in India has neither been necessary nor sufficient in creating favorable investment climates. Leaders such as Mayawati in Uttar Pradesh or Lalu Yadav in Bihar enjoyed long stints in power but lacked developmental focus. In contrast, as Sinha (2004) points out, Gujarat performed exceedingly well in the 1990s despite having considerable leadership instability; the state saw seven different chief ministers in the first decade after liberalization.

6.2. Colonial inheritance

A growing interdisciplinary literature has highlighted the role of colonialism in affecting economic outcomes (e.g., Acemoglu et al. 2001). In India, studies have focused on two sets of colonial institutions in explaining current economic outcomes – nature of land tenure systems and direct vs. indirect British rule. Banerjee and Iyer (2005) find that areas previously under the zamindari (landlord) system exhibit lower levels of agricultural investments, productivity and

inferior health and education outcomes when compared with non-zamindari regions. Banerjee et al. (2005) and Iyer (2010) find that areas previously under direct British rule had lower access to public goods in the post-independence period than areas under princely states. The cases of Gujarat and Punjab do not point to a strong association between investment policy and colonial institutions. Zamindari land tenure, which is highlighted as having detrimental effects, had virtually no presence in either state. Both Gujarat and Punjab contain within them a mix of areas under both direct and indirect British rule. Yet outcomes vary significantly.

6.3. Partisan preferences and ideology

Evidence from advanced-industrial countries suggests that parties on the left and right have distinct preferences that affect economic strategies (e.g., Alvarez et al. 1991; Boix 1997, 1998; Garrett and Lange 1985). There is little empirical evidence that party ideology has driven policy differences between Gujarat and Punjab. Indeed, in some periods after 1991, the BJP has headed governments in Gujarat while simultaneously being part of the ruling coalition in Punjab. But policies in these states have varied.

Generally, party ideology has had low salience in explaining economic policy orientations in India for several reasons. Ideological positions of Indian parties tend to be fluid and often shift dramatically. In several instances, such as the case of labor reforms, the same party has taken contradictory stands on a particular issue when in government and opposition, or in different states. Second, it is difficult to make a clear left-right distinction between parties at the regional level in the economic realm. Moreover, policies have sometimes deviated significantly from espoused ideological positions. Perhaps the most interesting case of ideological ambiguity was the attempted reinvention of West Bengal as a business-friendly state by the governing Communist Party of India –Marxist (CPI-M) in the 1990s and 2000s. Third, in connecting partisan preferences to economic policy, the existing literature assumes an organizational link between labor and left parties. The union-party association in India is very different; all major parties have affiliated unions and this is not restricted to left parties alone (Anant et al. 2006).

6.4. Party system fragmentation

Dimensions of political competition have been linked to both policy adoption as well as economic performance in several countries (e.g., Chhibber and Nooruddin 2004; Murillo and

Martinez-Gallardo 2007). In India, Chhibber and Nooruddin (2004) find that states with two-party competition provide more public goods than multi-party states. Party system fragmentation does not have sufficient leverage to explain Gujarat and Punjab's varied responses. The nature of fragmentation is relatively similar in both states – two-party system in Gujarat and bipolar competition in Punjab.

6.5. Ethnic fractionalization

Several studies suggest a negative link between ethno-linguistic fractionalization and various economic outcomes (e.g., Alesina et al. 1999; Easterly and Levine 1997). Typically, this line of thinking assumes higher diversity leads to polarization and, in turn, to corruption, rent-seeking and weak economic policy outcomes (e.g., Easterly and Levine 1997). Ethnicity plays a consequential role in this paper but through very different mechanisms. The argument here looks at patterns of social cleavages and its effects on party strategies. It also links ethnicity to economic endowments. As such, this paper emphasizes a link between ethnic demography and class in India. In turn, the class makeup of electoral coalitions ultimately affects policies.

7. Conclusion

This paper leverages the spatial unevenness of India's performance to analyze political conditions favorable to pro-business policies in the midst of poor electorates. It focused on a specific empirical puzzle – varied subnational policy responses in the competition for investment, which ensued after the onset of economic liberalization in 1991. Despite being subject to similar institutional conditions and a common shock, some Indian states have been far more investor-friendly in policy terms than their counterparts. Initial socioeconomic conditions do not account for these policy differences. Nor do explanations privileging colonial institutions, political competition, party ideology, leadership or ethnic fractionalization.

What explains this variation? This paper advances a two-stage argument. At a proximate level, I argued that certain types of electoral coalitions with a confined class basis are most favorable for the prioritization of a pro-business agenda. Specifically, narrow-right coalitions, characterized by the joint presence of core voters with similar economically-advanced profiles and substantial representation of business interests, are most conducive to investor-friendly policies. Narrow-right coalitions are, however, unrepresentative of the broader electorate in class

terms in poor electorates. How then do they arise? I argue that such coalitions can arise in the midst of a poor electorate if the basis of politics is non-economic. In the case of Indian states, I focus on the role of identity politics. In particular, I show how variation in social demography has affected the formation of electoral coalitions and, in turn, economic policies. Specifically, I link pro-business policies in Gujarat to dominant caste patterns in that states.

By pointing to the links between social identity and economic policies, this paper draws attention to a factor that has largely been ignored in the political economy literature. More broadly, this paper has a clear implication for the political economy of growth in India. Following scholars such as Kohli (2012), this paper suggests that India's high growth phase and the policies surrounding it are closely associated with narrow class bases of political power. It finds that the conditions most conducive to the prioritization of business-friendly policies in the midst of largely poor electorates are at odds with broader notions of inclusive democratic representation. Moreover, Kohli has suggested that India's high growth phase has heightened the two track nature of Indian democracy where the poor are confined to the electoral sphere while a technocratic elite controls policymaking. This paper suggests that identity politics is one mode that has been central to the separation of the electoral and policymaking realm of Indian democracy.

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Table 1: Varied policy responses in Gujarat and Punjab

	Gujarat	Punjab
Institutional framework for infrastructure building	GID Act in 1999. GIDB, GMB and GIDC very active. Special initiatives such as port-led industrialization. GMB's port policy in 1995.	PID Act and PIDB in 2002.
Infrastructure (electricity)	Captive power policy has facilitated surplus electricity generation. Gujarat Electricity (Reorganization and Regulation) Act in 2003. Average annual state expenditure on energy (as % of total expenditure) between 1991-92 and 2009-10 was 10.4%. Generally eschewed electricity subsidies, unlike other states.	Very slow to undertake process of electricity restructuring reforms. Cabinet approval of unbundling in 2010. Major electricity shortfall. Average annual state expenditure on energy (as % of total expenditure) between 1991-92 and 2009-10 was 8.5%. Free electricity to various groups has had an adverse effect on state finances.
Infrastructure (Roads)	Average annual state expenditure on roads and bridges (as % of total expenditure) between 1991-92 and 2009-10 was 3.9%.	Average annual state expenditure on roads and bridges (as % of total expenditure) between 1991-92 and 2009-10 was 1.9%.
Incentives and subsidies	Strong reliance on tax concessions prior to 2003. Over time, focus has shifted to other aspects of investment promotion but continues to offer subsidies comparable to competitors including land, capital investment subsidies, commercial tax concessions, stamp duty and technology reimbursements. Sizeable	Poor fiscal situation has meant state not able to provide substantial subsidies, including those promised in policy statements, leading to low credibility with investors.

	subsidies continue to large investors.	
Regulatory environment	Single Window Act in 2000. Functions as initial point of contact. Includes time limits and provisions for deemed clearances. Investor facilitation services offered since 1978 by Indexbt. Self-certification in lieu of inspections and consolidated returns under several laws.	Punjab Industrial Facilitation Act in 2005. Self-certification allowed in many areas.
Labor laws/environment	Labor law flexibility in SEZs and IT sector, particularly with respect to hiring and firing related to section V of the Industrial Disputes Act. Low mandays lost.	Low mandays lost. Labor law flexibility in SEZs and IT but scope not as wide as Gujarat.
Land acquisition	State has been proactive in creating land banks and then transferring to industry. Active in providing subsidized land for large projects. Amended laws to allow easier conversion from agricultural to industrial use and to acquire land around highways.	Land is major constraint for manufacturing. State reluctant to acquire land.
Special Economic Zones (SEZs)	SEZ policy in 2004. 53 SEZs approved and 30 have been notified (as of 3/30/2012).	8 approvals and 2 notifications for SEZs (as of 3/30/2012).
Institutional framework for industrialization	State corporations have adapted effectively to post-liberalization environment. Indexbt, GIDC, GIDB, GIIC, GFC, GMB all active.	Bureaucracy slow to adapt post-liberalization environment. Corporations performed poorly. PSIDC defunct.
Branding, promotion and information activities	Major effort in promoting state as investment destination and information dissemination through Vibrant Gujarat investor summits. Indexbt plays an active role in these areas.	Few efforts at promotion and information dissemination.

Figure 1: Case selection

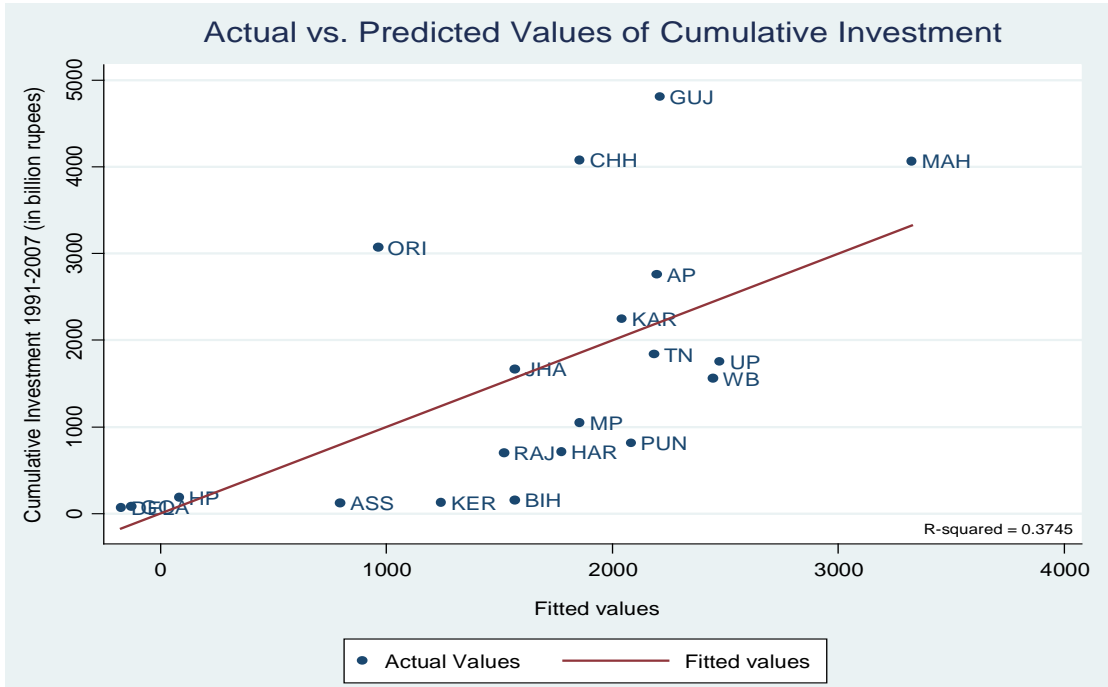


Figure 2: Overview of the argument

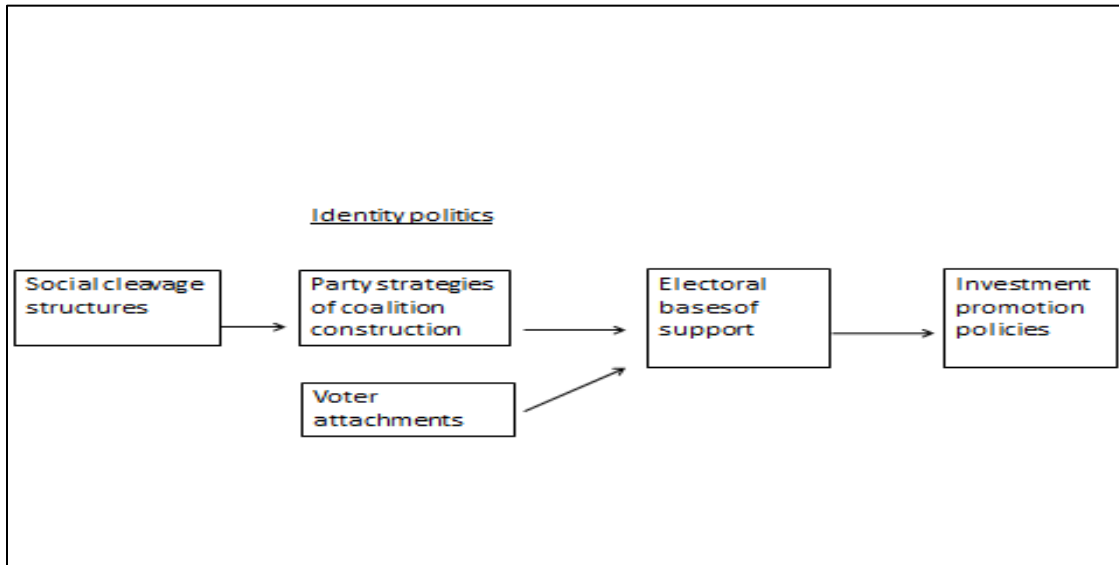
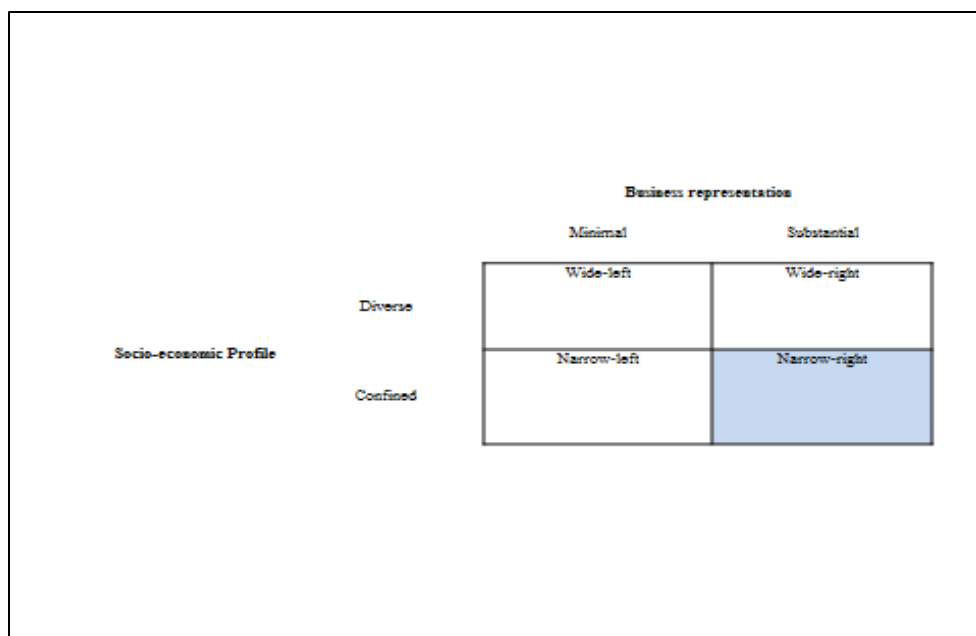


Figure 3: Classification of coalitions



**Table 2: Vote choice by social group (2002 Gujarat Assembly Elections)
(Percentage vote of respondents by caste and community)**

<i>Social Group</i>	<i>BJP</i>	<i>Congress (INC)</i>	<i>Others</i>	<i>N</i>
Muslims	8.96	65.67	25.37	67
Adivasis	25.45	52.73	21.82	110
Dalits	22.32	61.61	16.07	112
OBCs	55.53	37.40	7.06	524
Patidars	81.82	9.79	8.39	286
Upper castes	67.02	29.26	3.72	188
Others	33.33	66.67	0.00	3

Source: Calculations using raw data from the Centre

for the Study of Developing Societies (CSDS) post-poll survey of Gujarat Assembly elections, 2002.

Table 3: Vote choice by social group in Gujarat (2009 Lok Sabha Elections)

<i>Social Group</i>	<i>BJP</i>	<i>INC</i>
Brahmins	61	25
Patidars	87	9
Other upper castes	67	28
Koli (OBC)	45	41
Kshatriya (OBC)	43	51
Other OBC	60	37
Dalits	20	61
Bhil (Adivasi)	27	68
Other Adivasis	45	42
Muslims	13	69

Source: Jani (2009)

Table 4: Vote choice by social group in Gujarat

<i>Social Group</i>	<i>1995</i>		<i>1996*</i>		<i>1998</i>		<i>1999*</i>		<i>2004*</i>	
	<i>BJP</i>	<i>INC</i>	<i>BJP</i>	<i>INC</i>	<i>BJP</i>	<i>INC</i>	<i>BJP</i>	<i>INC</i>	<i>BJP</i>	<i>INC</i>
Upper Castes	67	20	76	18	77	13	77	16	67	26
OBCs	38	38	65	30	57	28	38	61	40	55
Scheduled Castes	17	61	61	35	47	45	33	64	24	67
Scheduled Tribes	29	59	34	55	43	46	33	67	48	46
Muslims	7	47	33	65	38	62	10	90	20	60

Note: *Lok Sabha elections. The rest are state assembly elections. The abbreviation INC is used for the Congress.
Source: Data from Shah (2007), table 6.4, p.173.

Table 5: Social identity and vote choice in Gujarat (2002 Assembly elections)

Vote choice for Congress is reference category

	BJP	Others
Constant	-2.84 (0.38) ^{***}	-2.22 (0.55) ^{***}
Social Group	0.61 (0.06) ^{***}	-0.10 (0.07)
Gender	-0.05 (0.13)	0.12 (0.21)
Education	0.17 (0.06) ^{**}	0.093 (0.092)
Locality	0.38 (0.17) ^{**}	0.74 (0.24) ^{**}
Pseudo R-squared	0.093	0.093
Log likelihood	-1080.60	-1080.60
Observations	1290	1290

Multinomial logit estimates with standard errors in parentheses; ** $p < 0.05$; *** $p < 0.01$ (two-tailed)

Table 6: Social identity and vote choice in Punjab (2002 Assembly elections)

Vote choice for Congress is reference category

	SAD-BJP	Others
Constant	-1.541 (0.42)**	-0.634 (0.458)
Social Group	0.036 (0.034)	-0.149 (0.038)**
Education	0.198 (0.066)**	0.219 (0.072)**
Age	0.018 (0.005)**	0.017 (0.006)**
Gender	0.105 (0.159)	0.041 (0.174)
Locality	-0.397 (0.112)**	-0.445 (0.127)**
Pseudo R-squared	0.0282	
Log likelihood	-1031.92	
Observations	1012	

Multinomial logit estimates with standard errors in parentheses; ** $p < 0.05$; *** $p < 0.01$ (two-tailed)

Source: Calculated using data from the Centre for the Study of Developing Societies (CSDS) post-poll survey of Punjab Assembly elections, 2002