From collusion to collaboration:

State-business relations and economic performance in India

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From independence and till the early 1990s, the Indian economy was characterised by a command and control regime, whereby the state essentially shaped the investment decisions of the private sector and the public sector occupied the 'commanding heights' of the economy. Most commentators are of the view that such a dirigiste regime led to a collusive and rent-seeking relationship between the state and the private sector, and that this had significant negative impacts on economic performance.

There were signs even in the early 1980s that the attitude of the Indian state towards the private sector was changing. In 1991, the Indian economy underwent major economic reforms, and the command and control regime was dismantled. Along with this, there was a clear shift in the Indian state away from a hostile relationship with the business sector, towards a closer and more collaborative relationship with private capital. However, given India's federal structure and the significant political autonomy and independence in legislative powers enjoyed by state governments, the evolution of state-business relations (SBRs) has not been the same across Indian states, with more collaborative relationships forming in some states and not in others.

Has this change in the nature of SBRs in Indian states, from a collusive to a more collaborative relationship, had any impact on economic growth? Strikingly, although economic growth in India has been strong since the mid-1980s, not all regions in India have benefited equally from the improvement in overall economic performance. States like Andhra Pradesh, Gujarat, Karnataka, Kerala and Tamil Nadu have grown at a rate of per capita income that has exceeded 4.5% per annum during the period. On the other hand, states such as Assam, Bihar and Madhya Pradesh have grown at around 2% or less in the same period. These variations in economic growth across states in India have been strongly correlated with poverty declines in India, with high and persistent rates of poverty in states such as Assam and Bihar as compared with Andhra Pradesh and Gujarat. Improving Institutions for Pro-Poor Growth (IPPG) research has shown that variations in regional institutional quality captured by the quality or effectiveness of SBRs can explain variations in economic growth in Indian states.

Cali et al. (2009) measure the nature of SBRs in India across states and over the period 1975-2004. They find that this measure shows an unambiguous improvement in the functioning of SBRs across most Indian states, especially from the 1980s. However, the rate of improvement has differed widely across states, and has occurred at different points in time in different states. This suggests that state-specific political processes have shaped the nature of SBRs in any given state, and that these factors have differed across states and over time.

Using the SBR measure, Cali and Sen (2009) examine the impact of functioning of SBRs on economic growth in Indian states. Taking into account other determinants of economic growth, they find that effective SBRs have contributed significantly to economic growth across states in India. They also find that that the key dimensions of SBRs that stimulate economic growth seem to be those related to the actual operations of the interactions between states and businesses. On the other hand, the creation of formal organisations (both public and private) per se does not seem conducive to economic growth. An important policy implication of their finding is that business associations should support and broker more collaborative relations between sub-national states and the private sector. Overall, their research illustrates the importance of active cooperation between agencies of the state and the private sector towards the goals of policies that both parties expect will foster investment and increases in productivity.

To better understand the micro-foundations of the relationship between SBRs and economic growth, IPPG researchers have also examined the effect of SBRs on productivity growth at the industry and firm levels. Kathuria et al. (2009; 2010) find similar positive effects of well-functioning SBRs on industrial productivity growth and manufacturing firm performance in India. The research suggests that one important route by which better SBRs can affect economic growth is increasing total productivity growth, especially in the industrial sector. Interestingly, the authors find that the growth in industrial productivity is mostly confined to the formal sector of the manufacturing sector: the benefits of effective and formalised SBRs do not seem to reach the informal sector, where most of the poor reside. This suggests that, although effective SBRs matters for economic growth, they do not matter for poverty reduction to the same degree.

IPPG researchers have also attempted to understand of the provenance, evolution and forms of informal institutional interactions between states and businesses and to identify the factors that affect relations between states and businesses and shape the institutions (both formal and informal) that govern them. One important finding of the research has been that institutions that shape SBRs are path-dependent, and are resistant to change. This has been found in the case of West Bengal, a coastal state in eastern India and unique among Indian states, not only by virtue of being ruled by an uninterrupted Leftist regime for the past 32 years but also because it witnessed a turnaround in its outlook towards private capital by the state government from an outright hostile position in the 1980s to a more positive one in the early 1990s. Chakravarti and Bose (2009) show that this change in policy by the state government towards the private sector did not have desired outcomes in bringing about an increase in the rate of growth of the formal manufacturing sector, with most manufacturing activity remaining in the exploitative and low productivity informal sector. They attribute this to 'sticky' political institutions, such as existing attitudes towards the private sector among lower-level functionaries of the ruling party, which has been resistant to change.

In contrast, for the Indian state of Andhra Pradesh, Alivelu et al. (2009) identify the coming to power of Chandrababu Naidu as Chief Minister of the state government in 1995 as the 'critical juncture' that explains the rapid improvement in SBRs in the state and its subsequent successful record in economic growth. The Andhra Pradesh case study highlights how leaders and elites can work to form positive growth or developmental coalitions. On the other hand, the West Bengal case study suggests that such growth coalitions cannot be had to order, but are the product of ongoing political negotiation and reconstruction as the relative power of each side undergoes (often slow) transformation in the context of local, national and international circumstances – political, social and economic (Leftwich, 2009).

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