



Big potential, big risks? Indian capitalism, economic reform and populism in the BJP era

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ABSTRACT

This paper reviews India's aggregate economic performance under the Modi/BJP/NDA administration through the prism of political economy. It argues that the inheritance of the UPA period was a combination of an unfolding "oligarchic capitalism" and a half-baked social democratic project. While the 2014 election victory was formally on a platform of "Minimum government, maximum governance" it always had deep ambiguities between a pro-business, pro-rules regime and an essentially nationalist project which subordinates commercial considerations. Some policy changes under this government, that we call Modi 1.0 – notably the GST reform and the Insolvency and Bankruptcy Code – constitute potentially substantive shifts to an efficiency-improving and rules-based approach. However, their effectiveness has been compromised by substantial delays, additional administrative burdens and increased uncertainty, not least over the actual implementation of the new rules. All this coincided with the legacy of a severe overhang in the financial system. This contributed to a chilling effect on private corporate investment. It has also gone alongside a continued major role of public sector banks and PSUs in the economy. The combination of an apparent increased concentration of mega-deals in some of the largest business houses, and continued, if anything rising, importance of state-managed subcontracting for infrastructure, has further contributed to the sense of an, at best, half-baked effort to reform India's capitalism. A top-down economic nationalist stance, state-driven action, political resistance to reforms, and attacks on accountability institutions, will actually continue to threaten long-run development dynamics. The demonetization episode was only the most vivid example of a growth-dampening policy. At the beginning of the new government – Modi 2.0—these contradictions are intensifying. With the Covid-19 shock, the associated tensions will only become sharper.

Introduction

At the end of 2019, India was experiencing an apparent paradox. The first administration led by Prime Minister Narendra Modi had swept to power in 2014 on a narrative that was pro-business, anti-corruption, and pro-government

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efficiency. With a diversified production base and deep domestic business capabilities India seemed poised for consolidated rapid growth. Analysis of India's production structure in international perspective further supports the view of great potential. The 2019 election brought an even more convincing victory for the Modi-led BJP and its allies, with a strikingly dominant share of electoral finance from the business community. Yet the economic atmosphere was of increasing gloom. The IMF reported India's worst growth performance in six years, and other commentators, including the former Chief Economic Adviser of Modi's first administration, were even more pessimistic.¹ Private business investment was sharply down, and the talk in the private business community was of lack of trust in the state. An overhang of non-performing assets in the financial system, alongside real concerns over shadow banking, presaged further slow growth.

This paper explores this through the lens of state-business relations, both from the perspective of short-run conditions, and in the context of longer-term interpretations of the political economy of relations between politics, the state and business in India.

Among the many characterizations of the evolving relationship between Indian business and the state in India, there is broad acknowledgment that the direct influence of business on politics has increased dramatically in the last thirty years: whether it is the number of business-men who are increasingly involved in as political leaders,² the increasing importance of "pro-business policies" in administrative and legislative spaces,³ the structural power that business exerts on state government policy through a competitive investment dynamic,⁴ or the skyrocketing costs of electoral campaigns which have increasingly attracted large corporate funding.⁵

What is understood in this literature is that business is now a larger part of both economic and political life, that states are increasingly catering to the needs of large business, and that there has been a "two-track" nature to Indian democracy which has created an electoral politics which thrives on patronage, but a policymaking arena trying to facilitate ease of business and market creation (Kohli 2006). The constrained optimization between these two often conflicting objectives has been at the core of business-state relations in India.

One dimension, which has been largely missing from these conversations, is what happens if the business class loses faith in the Indian developmental project? Much of the higher growth post-1990 has run on an engine of sustained (albeit somewhat cyclical) investment over almost three decades, with a striking rise in private investment as a key motor. It is almost taken for granted in certain parts of political discourse that India would remain an attractive site for continued investment, both by domestic and international investors. However under Modi's leadership, we have seen this assumption

being seriously challenged. This paper theorizes why some of these trends have emerged, and where the understanding between business and the state seems to have eroded, particularly over the course of Modi 1.0 into Modi 2.0.

A core theme is that state-business relations in India have always involved a blend of “rules” and “deals”, of formal processes and institutions, alongside a mix of “informal” short and long-run relationships between politicians, other state actors and business, with rent-creation and rent-sharing as the explicit or implicit contractual basis.⁶ There was a substantial break in the modality of the relationship with the shift to a “pro-business” orientation that started in the 1980s, the partial liberalization from the 1990s, and the associated burst in entry and private investment activity.⁷ This led to genuine increases in productivity.⁸ However, the government inherited in 2014 a capitalist system that had multiple faces: of crony capitalism, dynamism and a large informal sector. Especially in the 2000s boom, and under the two administrations of the Congress-led UPA, there was substantial alignment between high levels of private business investment, rent creation and sharing, rapid growth, alongside widespread, high-level corruption, that was associated both with private gains and with political finance.

Modi 1.0 had elements of continuity and change within this long-run blend of rules and deals. As already noted, it had pro-business rhetoric, and widespread support from the business community (as did Modi 2.0). It also developed a narrative of anti-corruption, and indeed substantially reduced high level corruption, even while the biggest business groups continued to reap benefits from major government contracts. However, we develop the argument that the Modi-led NDA government had a distinctly ambiguous performance and narrative: as a project *both* of “good government”, pro-business policies and efficient social designs *and* as an essentially top-down nationalist project. This was complemented by a continued central role for state-led institutions and concentrations of economic influence of some of the largest business houses. Despite some major “reformist” policies, we see the latter, essentially top-down nationalist (or populist), project as being the dominant underlying driver of policy and state behavior.

This ambiguous overall position is seen as the underlying reason for the mixed aggregate economic performance of the Modi 1.0 government – as most vividly exemplified by the falling-off of private investment. Policies aimed at reducing corruption and cleaning up the system – while potentially important – have suffered from weak specific designs, administrative burdens (the GST reform) or weak implementation (the IBC), even as uncertainty has risen over the – potentially discretionary – action on alleged corruption, amongst both bureaucrats and firms. This has gone along with a continued, and perhaps, rising role of public sector institutions in the economy, as the government sought to compensate for weak private sector investment.

This interacted with two other features of the economic situation: first, the heritage of NPAs in the financial system, that were a product of the heady years of growth and favored lending by public sector banks to major corporations; plus the slowdown in global economic activity. This paper does not assess the response to the Covid-19 pandemic. However, we see the issues analyzed here as providing important context, especially for the difficult challenges of recovery after the health and economic crisis.

In the rest of the paper, we first provide context, in terms of a conceptualization of the relationship between drivers of private investment, the political economy of state-business relations and longer-terms economic patterns, including specifically our interpretation of the 2014 heritage. We then discuss key features of the Modi 1.0 government, offer an overall interpretation, and provide initial comments on the situation at the beginning of the second Modi-BJP government in 2019. A concluding section puts this in a broader context, with a more speculative assessment both of India in comparative international perspective and of future prospects, including the potential risk of Indian getting stuck in a “middle income trap”.

Concepts and history: long-run patterns and the 2014 heritage

This section provides an intuitive sketch of the conceptual framework for our analysis. This is then used as a prism for interpreting India’s historical patterns of growth and inequality, ending with an interpretation of the state of Indian capitalism by 2014, that constituted the heritage that the Modi 1.0 government faced.

Concepts: business investment, deals and rents

The framework for this paper’s interpretation can be sketched as follows:

- (1) Investment – and especially business investment – is a key driver of long-term growth, through capital deepening and the productive upgrading and innovation embodied in investment.
- (2) Business investment is driven by (private) economic opportunities, finance and the credibility of the persistence of the business environment (including over risks of expropriation or reversals of explicit or implicit contracts).
- (3) Economic opportunity for business is a product of potential external and internal market opportunities and business capabilities (organizational and technical – themselves a product of historical production).
- (4) The political economy of state-business relations is key to the drivers of business investment. In India this is manifest in the mix of formal rules, and informal deals, where the latter are founded on reciprocal relations between politicians and business actors, mediated by other

- state actors – bureaucrats, regulators, accountability institutions and the judicial system.
- (5) Economic rents – returns in excess of competitive alternative uses of resources – are the cement for deals, shaping both the credibility of reciprocal relationships and the pattern of economic opportunity, especially between productivity-increasing and collusive, shared extraction of excess returns (e.g. in land deals, overpriced contracts or PPPs).⁹ The returns from rents can support private wealth or be channeled into political finance, that forms a pervasive element of the reciprocal politician-business relationship.

Let's outline history

Growth, investment and inequality

India's long-term growth story is traditionally cast in terms of large potential belatedly released. The foundation was built in the decades of License-Permit Raj. Then the base for an acceleration was effected through the shifts in policy that started in the 1980s, with a sharp inflexion point in 1991, involving a substantial deregulation, external opening and the development of the supporting institutions of capitalism, particularly independent regulators like SEBI and the Competition Commission of India. There was a historically spectacular acceleration of growth by the 2000s, that appeared to continue in the Modi 1.0 government, at least according to official statistics.

A major feature of India's growth acceleration was a dramatic rise of private investment and export shares. With respect to private investment – key to this paper – as [Figure 1](#) shows, private fixed capital formation increased by over ten percentage points of GDP between the early 1990s and 2000 boom. It has since fallen by about five percentage points by 2017. As discussed below, private investment likely fell further in the final years of the Modi 1.0 government and even further in the first year of Modi 2.0. How was the dramatic overall increase in national income distributed?

Household surveys from the NSS suggest expenditure inequalities in India are both relatively low by international standards (and much lower than in Latin America) and experienced only modest changes over the two-odd decades to 2014. This was associated with a large reduction in income/expenditure poverty. However, the NSS expenditure survey is well-known to poorly capture the top part of the distribution. The focus here is on changes in income and wealth associated with the large corporate growth. Two other sources are suggestive. Combining tax data with household survey data, Chancel and Piketty estimate a large increase in the income share of the top 1%, matched by a corresponding decline in the share of the bottom half of the population ([Figure 2](#)).¹⁰ By this measure, the difference in income growth between the top and the rest of the distribution was even greater than in China and the US – both notorious for their inequality rise.

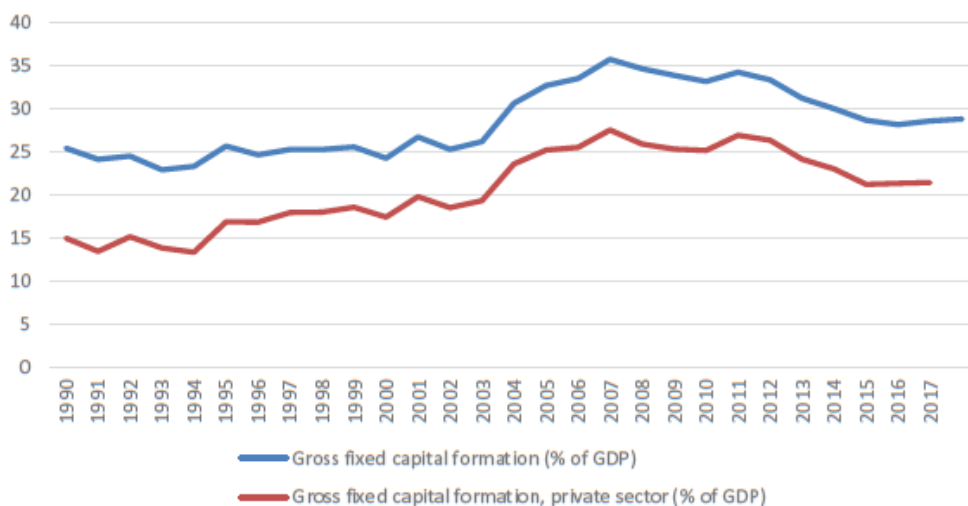


Figure 1 The large rise and partial fall of private investment in India, 1990–2017. Source: World Bank WDI

Top 1% and Bottom 50% income shares in India, 1951–2014

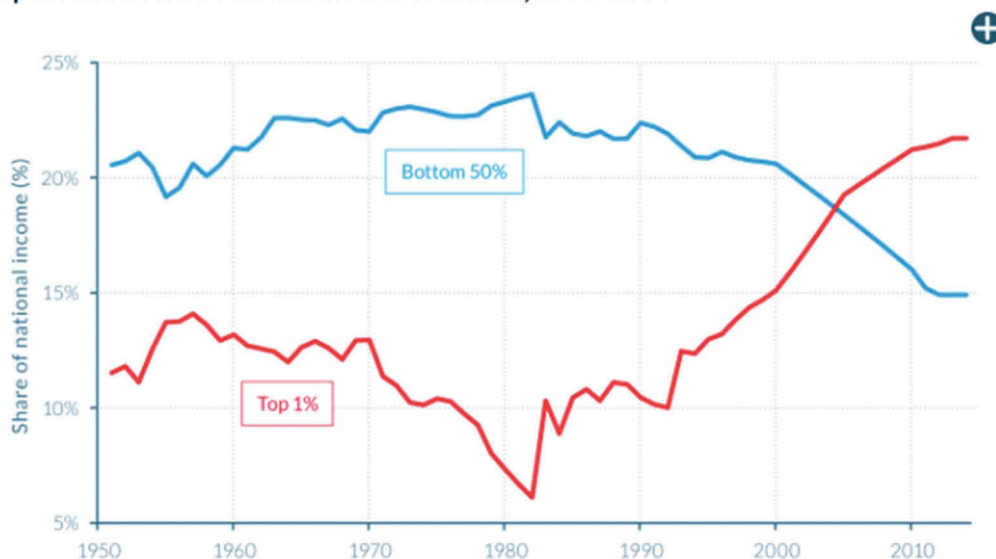


Figure 2. The rising concentration of income in India. Source. Chancel and Piketty (2017); see also World Inequality Report (2018)

A more specific manifestation is the rise in wealth of India's billionaires, as measured by Forbes. India went from almost no presence on the Forbes list in the early 1990s to having an unusually high ratio of billionaire wealth in relation to GDP for its level of income per capita (Figure 3). This is almost all associated with business wealth.

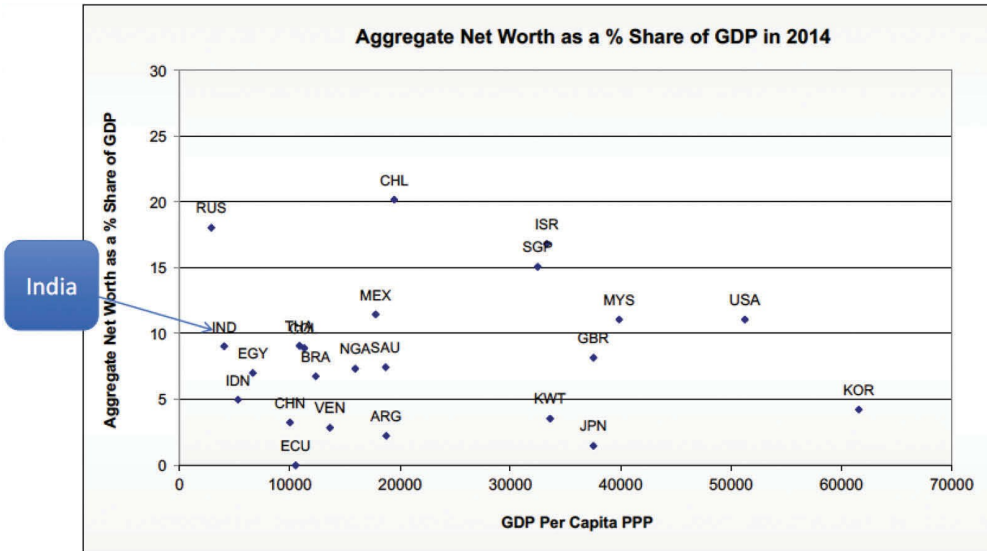


Figure 3. The net worth of India's billionaires was unusually large for her level of income in 2014. Source: Forbes.com and World Bank

Interpretation – India's productive potential and the state of Indian capitalism

How do we interpret the historical pattern? The License-Permit-Raj period was one of long-term politician-state-business relations with high credibility for insider business house, relatively low opportunity, low finance and limited entry (with the notable exception of Dhirubhai Ambani's Reliance). Investment and growth were low though steady, and, importantly, there was substantial long-term business capability creation, including in public sector companies.

The remarkable growth acceleration was genuine. The liberalization expanded economic opportunities for business, and the "pro-business" shift (Kohli, 2006), was as much as anything a consolidation of the credibility of the state-business relationship. The heady growth of the 2000s in the UPA governments, was due to an unusual favorable "sweet spot".¹¹ Externally there was buoyant global growth and relocations of global production. Internally, the rules-deal nexus worked well for politicians and business, with abundant finance, especially from state banks and especially for infra-structure and the intensification of both private rent extraction and (mostly illegal) political finance. Opportunity, finance and credibility all combined to underpin the blend of productive upgrading and extremes of private wealth accumulation. By 2014, relative to its income level, India had both a highly diversified economy and well-developed organizational capabilities in the business sector.¹² These in principle presage multiple opportunities to upgrade, reinforcing classic forces for "convergence" as the country catches up with those at the technological frontier. India's economy had evolved from being a case study in over-regulation to, functionally, a highly "successful" hybrid of rules and deals. Of the business-politics nexus, it can be said that "the relationship can no longer be understood as either developmental or crony capitalist: it is both".¹³

As noted, rapid growth was not a product of the ideal of competitive markets

across all parts of the economy. Indian capitalism has multiple faces. Parts are dynamic, competitive and productivity-oriented; other parts are connected, rent-extracting and corrosive of politics. Some sectors and companies are more “rent-extracting” than others.¹⁴ Many face both ways. Large Indian companies – such as the Reliance and Adani groups – seem to have both high productivity and high levels of influence. In addition, there continues to be a very large presence of public sector corporations (PSUs) – still some 40% of sales in the non-financial corporate sector in the 2000s according to data from firms reporting to the Prowess data base.¹⁵ Then beyond the corporate business sector, an additional face of Indian capitalism is in the form of the immense numbers of self-employed, small and medium-sized firms in the informal sector.

Both faces of capitalism were manifest in the UPA period. Even as GDP skyrocketed, India’s growth story was dogged by concerns over high-level corruption and rising inequality. A series of scams over natural resource allocation helped consolidate public anger around entrenched politician-business links, spurring the national anti-corruption movement. An elite coterie of Indians was seen to be pulling the strings of politics and business, and public sentiment rallied around these societal shifts. Both the rise of the Aam Aadmi Party in Delhi, and a larger thrust of the BJP’s messaging in the lead up to the 2014 elections was built on the back of a narrative of reducing cronyism. This was central to the narrative of Narendra Modi’s economic success story during his time as Chief Minister of Gujarat, though other accounts interpret this as a relatively efficient, and centralized, form of crony capitalism.¹⁶

A further, critical, dimension of the heritage was the continued dominance of the public sector in banking, and a deepening nexus of lending to the major business houses. A key example is the lending to major infrastructure firms, such as GMR and GVK from Andhra Pradesh, and the Adani group from Gujarat.

Social policies are not the focus of this paper. However, in interpreting the overall political economy the overall mix is of central importance to the heritage. The UPA governments, especially in UPA1 had a major theme that is best described as an attempt to extend social democracy in a developing society – as a complementary movement to the support for Indian capitalism. In practice it was a messy mix of creative designs (as in the basic design of the seminal MGNREGA) interacting with a blend of clientelistic, populist and corrupt local political and implementation realities. It was a “half-baked” social democracy.

Overall, by 2014, India looked like a relatively dynamic re-mix of a Latin American country. Heady growth, some real business productivity dynamics, plenty of corruption, rising politician-business linkages, and substantial concentrations of new wealth. As Pratap Bhanu Mehta commented in 2020, in this era “the two biggest worries India seemed to have were plutocracy and policy paralysis.”¹⁷

This was the heritage of the past for the Modi 1.0 government.

Policies and performance of the Modi 1.0 government, 2014–2019

The Modi 1.0 government swept to power on a promise of change. There were undoubtedly multiple interpretations of this in the extraordinarily complex Indian political reality. But some elements of the narrative stand out, under the headline theme of “Minimum government, maximum governance”: less corruption (whether high level or in daily experience), pro-business, pro-efficiency, with at least suggestions of a Hindutva strategy. This was backed by the impressive grassroots political mobilization of the BJP/RSS.

We here outline some of Modi 1.0’s signature policies of relevance to the argument, provide a brief summary of aggregate developments, and then discuss in more depth the key nexus of public sector banking, big business and other public sector companies.

Key policies

Relative to the promise and narrative of the BJP campaign, the policy story of the Modi 1.0 government is an ambiguous mix.

Transactional high level corruption was reduced (or at least suppressed) at the national level. Previously immune oligarchs and businessmen were put under investigation; many of the alleged worst offenders (for example Vijay Mallya, Nirav Modi, Nitin Sandesara) fled the country to delay or avoid prosecution. This was further associated with both a major concentration of decision-making in the PM’s office and heightened threats of prosecution for bureaucrats associated with favors.¹⁸ On the one hand there was a push on trying to improve state-level “doing business” indicators, though these are general known to be poor indicators of real business relations.¹⁹ On the other, the connectivity between business and the state was substantially reduced by the centralization and reluctance of bureaucrats to take decisions. A theme of “Make in India” was developed, though much of this was a repackaging of existing initiatives.

There were three initiatives that could be of real long-term significance: the institutionalization of auctions for government controlled resources (particularly in spectrum and mining), the 2017 GST reform and the introduction of the Insolvency and Bankruptcy Code, designed to resolve the bad debts of the corporate-financial system. All three initiatives were started under the UPA governments, though the Modi 1.0 government deserves credit for finally pushing them through.

The most dramatic policy was the 2016 demonetization, variously characterized as an attack on black (illegal) money and a move to promote a non-cash economy. As in UPA, there were an array of complementary social policies – again contrary to some expectations – including both the

continuance of existing policies (notably the MGNREGA), and high profile new policies (such as the Swachh Bharat program to provide toilets to all, the Aspirational Districts program to reach the poorest districts), and measures to reform subsidies (including various forms of direct benefits transfers, like the Ujjwala program).

Performance

Aggregate performance shows a mixed picture for Modi 1.0. Official statistics displayed continued high GDP growth – even overtaking a slowing Chinese economy! The official aggregate numbers are highly contested, however, as they seemed to be inconsistent with other sources of information. Even the Chief Economic Adviser for most of the period, Arvind Subramanian, presented analysis (after leaving his office) questioning the credibility of the aggregate numbers.²⁰ This paper does not need to adjudicate this debate, as other developments are more directly relevant.

Most striking is the slowdown of private investment – this in the context of a supposedly pro-business government. This shows up in the aggregate statistics, as seen in [Figure 1](#) earlier, and even more dramatically in the data on new investment approvals. According to CMIE's CAPEX database, there was a substantial decline in new investment approvals ([Figure 4](#))

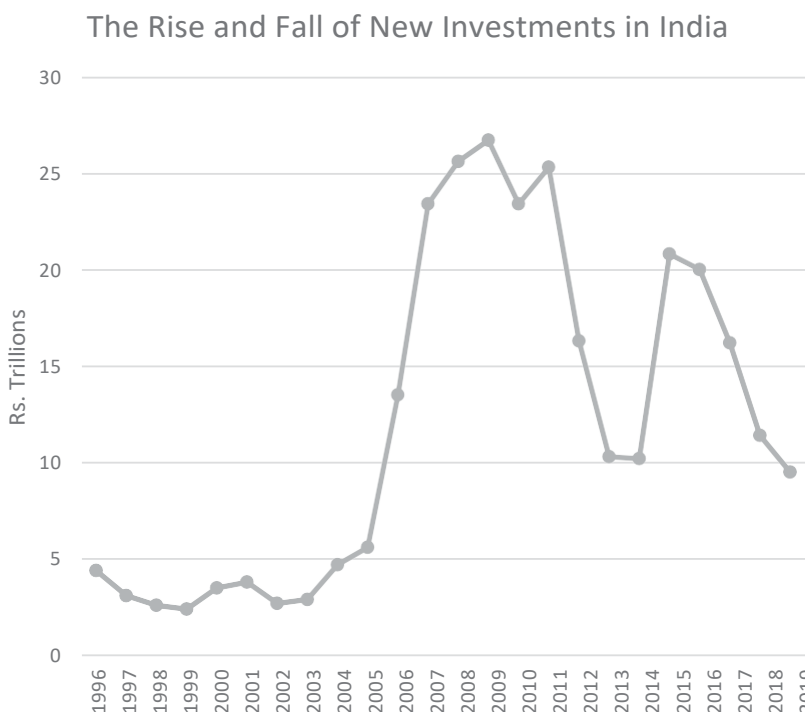


Figure 4. The rise and fall in investment proposals. Source: Center for Monitoring the Indian Economy

while the value of stalled private sector projects as a percentage of all projects reached an all-time (at slightly above 25%), rising significantly between 2014 and 2019.²¹

In a recently recovered report by the Tax Policy Research Unit, data shows that corporate investment fell by almost a staggering 60% the fiscal year after demonetization was implemented.²³ More importantly, the paucity of cash devastated small and medium sized businesses in India, with major drops in even basic consumption of fast-moving consumer goods.

In the case of GST, the goal of the consolidated tax and the long federal negotiations leading up to it was well-intended. But ultimately, the implementation of the digital solution, and the exponential increase in required filings (now that taxes were to be filed per quarter, per state for the same corporation) has led to continued dissatisfaction with its administrative costs, as well considerable uncertainty and delayed filing given the various different tax slabs and categories created under what was supposed to be a simplifying tax reform.

In response to these trends, one of the major actions of the Modi 1.0 government was to boost public investment significantly, as a partial offset to the decline in private investment. This was done both through big programs announced through the annual budget, and through ramped up spending by various large PSUs. In fact, one of the defining characteristics of this government has been its frequent use of PSU cash, bankability, CSR spending and public procurement to promote specific policy initiatives.

Finally, there is evidence of a continuing rise of extreme levels of wealth linked to the most important business houses. There was a significant rise in the number of individuals being counted as billionaires, from around 50 to over 100. This was associated with a large increase in measures of billionaire wealth. For example, the top ten billionaires (defined as those that feature in each of the years) enjoyed a rise in net worth of some 71% (Figure 5 and Table 1).

These are the overall patterns. We turn now to a more extensive assessment of the nexus between the public sector banking system, the corporate sector and public sector enterprises (PSUs), that is at the core of both economic performance and the political economy of Indian capitalism.

The public banking-business-PSU nexus

The Modi 1.0 government in 2014 inherited the problem of an overextended Indian banking sector. Since the Indian banking system is primarily in the public sector (over 80% of all corporate lending in India), the government has always had considerable control over directed lending and sectoral priorities. Entry of private banks has been tightly regulated, and few international banks engage in sizable lending in India. Almost all major projects in India, particularly in the area of infrastructure, have been debt-financed by various public sector banks.

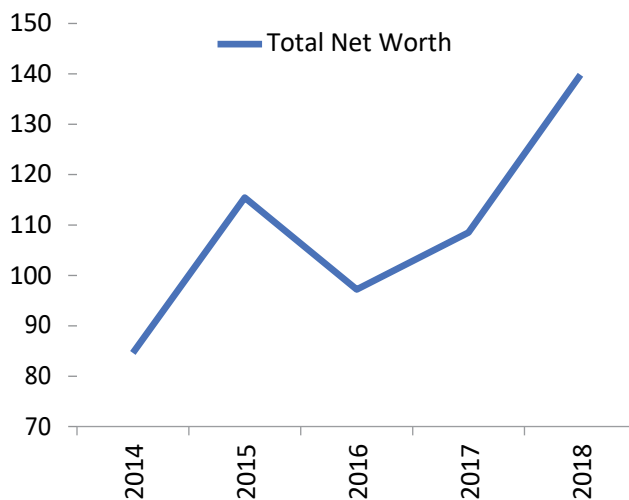


Figure 5. The wealth of India's top ten billionaires rose rapidly between 2014 and 2018.
Source: Forbes.com

Table 1. There were large rises in net worth of India's wealthiest billionaires between 2014 and 2019.

Top Ten	Change 2014–2019
Mukesh Ambani	176%
Gautam Adani	461%
Hinduja Brothers	56%
Pallonji Mistry	17%
Uday Kotak	289%
Shiv Nadar	30%
Godrej Family	3%
Lakshmi Mittal	-37%
Kumar Birla	37%
Bajaj Family	124%
Total Net Worth	71%

Source: Forbes.com India's Richest Rankings

As India's infrastructure spending boomed from the early 2000s onwards, India's public sector banks were used strategically to provide debt to a range of projects as part of the larger national developmental strategy. This essentially meant using deposits to lend for long-term projects. Such a strategy is not at all unusual for cash-strapped developing nations who cannot avail large amounts of foreign capital (China has notably used this strategy with considerable success). However, this approach tends to concentration; if too much money is given to one sector, or one group of companies, then their failure tends to affect the banks and the banking system particularly hard.

In an idealized banking sector, each bank makes lending decisions independent of each other, based on their own assessments of project viability, their own risk parameters, and their own networks among corporations. Part of the reason these risks have spread almost uniformly across Indian public sector banks (PSBs) is that very few PSBs actually have the staff or ability to properly assess large projects; rather, a few of the larger banks (like State Bank of India, PNB or Bank of Baroda) tend to originate projects, and then syndicate the loan among many PSBs – spreading the risk of the project across banks, though with limited or no spreading of the risk outside the public sector. This becomes a problem when the loans sour, as has increasingly happened in India (see Figure 6).

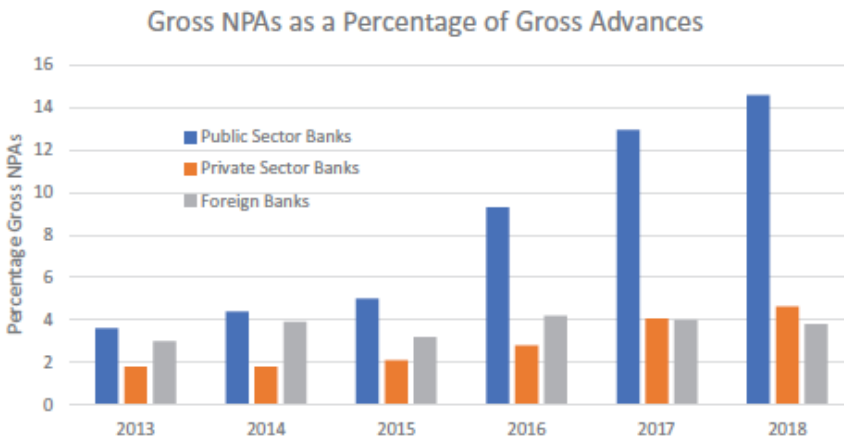


Figure 6. Recognized non-performing assets have risen dramatically, especially in public sector banks. Source: DBIE, RBI

A particularly egregious offender in India's NPA crisis has been the power sector, whose stressed projects add up to almost 40 GW of stranded power capacity and almost Rs.1.74 lakh crores of debt which may miss their repayment deadlines.²⁴ At one point the power sector was estimated to account for almost 40% of all delayed debt to Indian banks. Thirty-four of these projects have been referred to the Indian Bankruptcy Code process, a result of legislation the Modi 1.0 government passed in mid-2016. The NPA crisis was already at the gates when the government took power in 2014, and had not come out publicly because of the reluctance of many PSBs to report delayed payments, and take write-downs on these assets. The ever-greening of many of these loans had become standard practice for many PSBs, and this became a particular flashpoint between RBI governor Urjit Patel and PSBs when he issued a firm disciplinary circular forcing banks to disclose NPAs if loan repayment was delayed by even one day. Patel's unwillingness to dilute these norms and accommodate an ailing power sector was a key reason for his early departure as RBI governor in late 2018 and the appointment of Shaktikanta Das, an IAS officer and former Finance Ministry bureaucrat who was far more accommodating of PSBs' and the Finance Ministry's

expectations.²⁵

To what extent have the government's fiscal measures and macroeconomic interventions improved the immediate state of Indian banks? One of the most credible sources on this topic, Credit Suisse's Indian Corporate Health Tracker, shows, even three years into Modi 1.0, interest coverage across all debt had not improved at all.²⁶ More than 40% of all debt was not able to cover its interest obligations by the end of 2017. This situation has not improved much in the last few years.

What is even more problematic is the concentration of debt in a small number of large firms. As is made clear by Credit Suisse's "House of Debt" categorization, a disproportionate amount of the NPAs are concentrated in power and steel.²⁷ These debts have piled up over the last decade and a half, many made well before Modi 1.0 came into power. However, with the slow pace of bankruptcy courts, stuck projects and continued lending by PSBs despite their problematic balance sheets, Modi 1.0 avoided the deep surgery needed to address the problem early. Consolidating debt, creating separate asset reconstruction firms for bad debts, and taking write-downs (rather than waiting interminably for bankruptcy resolution) would have been a proactive way of addressing these problems. Rather, the preferred banking reform of choice has been merging larger, more capable banks with smaller banks (eg. SBI with its multiple offshoots, more recently the major proposed bank mergers in Modi 2.0). This may streamline decision making and bureaucracy, but does not address the underlying problem of bad investment decisions by PSB credit committees.²⁸

Central PSUs have contributed roughly 20% of India's GDP over the last three decades, primarily in the areas of oil & gas, utilities, mining, heavy engineering and of course banking.²⁹ Given Modi's record in Gujarat of turning around the state's PSUs there was some expectation that the government would work to streamline Central PSUs as well. But after the initial enthusiasm around disinvestment and reducing excessive state spending on loss-making PSUs, no major privatization or disinvestment occurred during the five years of Modi 1.0. In fact, the one major initiative to sell off Air India failed miserably, with such tight conditions and unrealistic bid expectations that private investors avoided the sale altogether.³⁰ Instead of raising money from selling low-value assets, most of the government's disinvestment income came from combining the most-profitable Central PSUs' stocks into an exchange-traded fund, and reducing government shareholding in companies like ONGC, NTPC, and Coal India by small margins. The other major sources of disinvestment income was from PSU to PSU sales; ONGC bought out an ailing Hindustan Petroleum, and the Power Finance Corporation bought out an ailing Rural Electrification Corporation. Essentially, this moved cash from the books of relatively liquid, well-performing PSUs straight into the government's coffers, while simultaneously worsening the acquiring companies' balance sheets.³¹ As if these moves were not enough, most profitable PSUs have paid abnormally large dividends, and engaged in share buybacks, further depleting their cash reserves. For example, between September 2017 and September 2018, ONGC's cash reserves plummeted from Rs.13,644 crore to Rs.170 crore, forcing it to borrow money for working capital.³² These moves were controversial enough to prompt a question in Parliament about how ONGC could pursue its normal activities under such a cash crunch.³³ Such asset stripping for short-term cash flow has faced resistance from the financial bureaucracies of PSUs, but these have usually been overruled by the board dominance of the IAS and other government representatives in major PSUs. Another example of aspirational, but ultimately misguided industrial policy is the automotive

sector. In both 2017 and 2019 (after the election) Niti Aayog (the newest avatar of India's Planning Commission) announced radical proposals to promote electric vehicles (EVs) in India. On both occasions, their roadmap for automotive transition included ambitious goals to ensure that all cars manufactured in India from 2030 onwards were exclusively EVs. Its ambitions for two and three-wheelers were even more ambitious, aiming to set a deadline of 2023 and 2025 for 100% electrification. Ambitious goals are not a problem in and of themselves, but both times they seem to have been reached without adequate consultation with private sector automobile manufacturers or even the Ministry of Road Transport and Highways. Not surprisingly, auto manufacturers protested heavily against these targets, and both times the government was forced to roll back its proposals significantly.³⁴ In the most recent case, Nitin Gadkari, the responsible Minister, publicly disowned these proposals and stated his intention a more gradual pursuit of EV transition in the auto industry.

This whole episode is problematic for a number of reasons. Firstly, given the constraints on charging infrastructure, the unreliability of India's power system, India's lack of battery manufacturing capacity, and the fact that over 98% of all vehicles produced in the country are still internal combustion engine (ICE) cars, none of these ambitions had any realistic chance of being met. But more importantly, Niti Aayog's simplistic analysis of the industry, without any consideration of business models and impacts on existing companies ended up reading more like a promotional document than reasoned analysis from a government think tank.³⁵ This episode is demonstrative of larger tensions in Modi 1.0 and Modi 2.0's philosophies around industrial policy. This is not gradual change through creating an environment for EV transition through incentives and gradual ratcheting up of regulation; instead it is more reminiscent of top-down command and control economies where the government sets targets and quotas, and producers are expected meet them without serious objection.

A further feature of Modi 1.0 was the apparent preferences for certain private sector actors. As mentioned earlier, much of investment in the last five years had been through government spending. A large chunk of this has been through the public tendering and floating of large projects designed by the government implemented by private companies. For example, the government's PPP Appraisal Committee brushed aside feedback from both the Department of Economic Affairs and Niti Aayog in awarding six out of six contracts for airport privatization to one company: the Adani Group (this was subsequently revised).³⁶ The Adani Group has also been one of the leading beneficiaries of renewable energy contracting (2623 MW of solar and 1547 MW of wind in the last five years), coal subcontracting (arguably the largest mine development operator for Coal India), city gas distribution (22 cities including JVs), and highway contracts. Many of these have been won through legitimate bidding processes, but the simple fact that the Adani group is known to be close to Prime Minister Narendra Modi³⁷ allows it to access capital in ways, particularly through External Commercial Borrowing (ECB) which are not available to other companies. The group is also known for its high degree of leverage, and complicated financial maneuvering which often recycles money between group companies in less than transparent ways.³⁸

Perhaps the most visible change for everyday consumers has been the gradual domination of the telecoms market by Reliance Jio, which only started its full service telecoms operations in 2016. It is estimated that they have more than 40% of market share in mobile services in India today, largely on the back of their rock-bottom pricing for data (which is being revised upwards from late 2019 onwards). A series of government decisions allowed Reliance Jio to take over this market in a very short time, including a prolonged and unresolved turf war between the telecoms regulator and the competition regulator on who has jurisdiction in this case.³⁹ As part of Jio's opening advertising salvo, they actually used Narendra Modi's images in their advertising, something they later apologized for, but suffered only negligible penalties.⁴⁰ With this kind of apparent, if unstated, preference, it is no wonder that industrial concentration in certain industries is becoming problematic.

In terms of actual practice, it is becoming increasingly clear that the Modi governments do not actually believe in the "minimum government" mantra at all. It may see the private sector as an agent fulfilling a grand vision, but it seems quite clear that the vision is not a joint one. The government expects the private sector to be a contractor, not an owner, of large parts of the industrial economy. Rather than make processes easier for all market participants, the state becomes the actor which navigates the ecosystem and gives a piece of the action to the private sector. For example, recently the Central government asked states to apply for environmental clearances for mining companies preemptively, to prevent undue delays in project execution, clearly muddling states' regulatory roles.⁴¹ In such an environment, can concepts like PPP models really work if the companies are not partners but primarily subcontractors?

This government seems to be open to allowing the private sector to enter and operate in newer services (telecoms, media, FMCG, healthcare, IT, ride-sharing, food & hospitality etc.), but not in many of the older industrial backbone industries (power, oil, heavy engineering, utilities, mining). This is symptomatic of continued state control of the economy, rather than a deep commitment to creating an ecosystem which allows the private sector to succeed (and sometimes fail). It is reminiscent of the incremental liberalization of the 1980s which could be considered pro-incumbent, but not necessarily widely pro-business.

Interpreting the Modi 1.0 government

An enduring paradox of the Modi 1.0 government was how little political capital the BJP lost despite the major economic consequences of both demonetization, and the GST roll out. Especially in the case of demonetization, the move devastated the informal economy as well as any business which was used to transacting primarily in cash. Yet despite this, as Tariq Thachil has speculated, part of the "Modi effect" may be a move by voters to identify with anti-elite, nationalist dimensions of the BJP's narrative and put less emphasis on economic concerns (at least for now).⁴²

What is well understood in Modi 1.0 is that power radiates almost exclusively from the top. Whether it is the use of Narendra Modi's image in the party's messaging and publicity, the concentration of bureaucratic power in the PMO, the effective neutralization of any real competitors in the BJP party structure, or the somewhat knee-jerk policy-making with little broader consultation, much more power has been concentrated in the Prime Minister than in any other point in the last few decades.

With these trends, India is being pulled in opposite directions. This has led to

a half-baked reform of Indian capitalism. There was a deep ambiguity within the Modi 1.0 government. At one level there was rhetoric about the improved ease of doing business, making India an attractive site for foreign investment, and exhortations to trust the business community. But while pushing for this rules-based system, it also seems that high level deal-making has not stopped, in spite of the initial suppression of transactional corruption. Despite the significant majorities obtained by the NDA, the government still has trouble overcoming political resistance to deep reform. Moreover, the repeated undermining of public institutions, and overt politicization of institutions of accountability (like tax authorities and the CBI) give little confidence to those who do not collaborate, or at least feign agreement, with the government's priorities. The attempt to shape a capitalist model with large amounts of state control and intervention seems to be failing in India.

In terms of our theorization of private business drivers, while the UPA experienced an economic and political economic sweet spot (albeit an unsustainable one), by the end of Modi 1.0, it was more of an adverse perfect storm: worsening external opportunities with slow global trade, a credit squeeze from the heritage of excess public sector lending, and a decline in the credibility of business transactions, as the previous rules-deal mix was replaced by heightened uncertainty – including of prosecution. The exception was the biggest and most connected business houses, who could both benefit from the centralization of decision-making and avoid the financial squeeze (through access to internal or international finance, and forbearance on over-indebtedness.)

The outlook for Modi 2.0

Initial measures

In the first few months of the Modi 2.0 government the apparent paradox sharpened. The BJP's sweeping election victory came with a strikingly high level of business support in election finance. Yet it then faced both a generalized business narrative of a "trust deficit", and a steadily worsening economic situation, whether in terms of headline growth figures, and a host of worrying indicators of economic slowdown, including, emblematically, sharp actual declines in auto sales and consumer goods.⁴³

If India in late 2019 (and beyond) were only suffering a temporary slowdown, associated with both domestic and international influences of a business cycle nature, then the policy issues would be in the domain of short-run macroeconomic management. However, our proposition is two-fold. First, that the approach to institutional changes of capitalism in Modi 1.0 was half-baked – some important new initiatives incompletely or ambiguously implemented, alongside rises in uncertainty and the apparent continuance of high level deals, the likely increased concentrations of economic power, and the predominance of a top-down state-driven approach to modern sector development. Second, that this mix was not a product of policy "mistakes", so much as a product of long-standing structural factors and patterns of influence, that if anything became strengthened under an essentially nationalist political project. These coincided with the fall out in the financial system that has been the proximate driver of the slowdown (Subramanian and Fellman, 2019).

From the early moves of Modi 2.0 it is already clear the government has been put on the back foot as the slowdown in consumption and lack of private investment across sectors challenged the credibility of their macro-economic management. The interim budget passed in February 2019 was largely scrapped and replaced by measures seeking to address these structural problems: a series of mergers of PSBs, a massive decrease in the corporate tax rate (from roughly 35% to 25% for all new investment), loan *melas* (fairs) planned across the country for agriculture and MSME credit, and predicted cuts in the interest rate.

At the same time, the impression of well-regarded technocratic management of ministries has been eroded. In Modi 1.0, Arun Jaitley in Finance, Suresh Prabhu in Railways and Commerce, Jayant Sinha in Civil Aviation, Nitin Gadkari in Roads & Highways and Piyush Goyal in Coal and Power gave the government credible faces who had a long history of dealing with the private sector and understood their concerns. The former three were not included in the new government's Cabinet,⁴⁴ and the latter two have become much less visible since the election. This has increasingly given the sense that more and more economic decision-making was taken out of the hands of individual ministers, and was rather being conducted through the bureaucracy, concentrated in the Prime Minister's Office (PMO) and running through the Secretaries of various ministries. While this is not an entirely unprecedented way of running the government, it does lessen the number of entry points and engagements for concerned parties and businessmen. Access to government and a fair hearing of concerns and anxieties of the business community is much tougher if the PMO is the only venue that has any real decision-making power. Simultaneously, given the closely curated public image of this administration and its reputation for not tolerating dissent or negative publicity, public articulations of corporate dissatisfaction with macroeconomic policy are lower than they have been in a long time.

The sharp cut in corporate tax rates in September 2019 may have long-term implications for private investment. Yet it was hardly relevant to the sources of the slowdown. The corporate tax cut is more likely to transfer resources to business owners than increase investment in the current climate. From the perspective of our framing it looks like a reciprocal response to business electoral support than rational economic policy. And the biggest source of concern is how the government will raise tax revenues; the July 2019 budget already had very high implied budget deficit numbers when the off-budget borrowings of PSUs were accounted for. In the estimation of the Comptroller & Accountant General, the recalculated budget deficit of 2017–2018 was 5.85% of GDP, a far cry from the 3.46% fiscal deficit stated in the budget.⁴⁵ If state-level debts are added to this, these numbers would be even higher.

A massive corporate tax cut only increases this deficit, which makes Modi 2.0 look dangerously profligate, and highly dependent on a significant turnaround in both demand and investment to recover the foregone taxes. If this fiscal profligacy continues, it is not clear how easily the GoI or its PSUs will be able to borrow money in the future. Rather than scale back spending and consolidate for a few years, one of the unfortunate consequences of Modi 1.0's economic policy is an increasing fiscal myopia.

Whether it is floating the idea of a sovereign bond issue in dollars (eventually shelved), courting international pension funds, doing Prime Ministerial roadshows in Houston to attract oil & gas investment, or floating a National Infrastructure Investment Fund, Modi 2.0 has shown an increasing willingness to pursue international capital. Given India's historic

suspicion of all forms of foreign financial inflows, this might be considered a welcome development. But this opening seems to be driven more by necessity than genuine ideological change; there are few other pools of liquidity left in India's public ecosystem to be accessed. Modi 1.0 and early Modi 2.0 have exhausted most of them. The echoes of Latin American economic history are here too.

One of the hopes is that the IBC process will eventually release a number of brownfield assets which have been lying underutilized for the last few years. As Chatterjee et al. have shown in their work, the National Company Law Tribunal (which is the venue for bankruptcy case resolution), has managed a reasonably quick disposal of its case load.⁴⁶ But it has also found plenty of unusual and legally questionable reasons to dismiss or reject large cases interpreted as not fitting within the purview of the tribunal. This has inevitably led to lengthy arbitrations with Committees of Creditors which have taken much longer outside of the IBC process. There has even been speculation that promoters seem to be actively avoiding the IBC process, since the decisions taken at this tribunal are harsher than the terms many of them are willing to accept.⁴⁷ Prompt resolution to all of these IBC and non-IBC processes will be crucial if the stalled pipeline of existing projects are to have any productive value in Modi 2.0.

One of the big dissatisfactions with UPA-2 was one of policy paralysis – that various arms of the state, particularly the bureaucracy, were unwilling to make decisions regarding resource allocation and contracts because of the potential of being prosecuted later on the “notional losses” to the Indian government as the underlying value of commodities changed; the 2G and Coal scams had directly led to this bureaucratic risk aversion. In Modi 2.0 we are observing a different form of policy paralysis with PSBs. Given the volumes of fraud and banker complicity which has been uncovered with bad debts in the private sector over the last five years, it is no surprise that public sector banks are being quite circumspect in their lending. This has manifested in a double-sided risk aversion, particularly in infrastructure: reputed developers are avoiding originating new projects, and PSBs are only interested in lending to highly rated, reputed developers. The crisis in India's Non-Banking Financial Companies (NBFCs) or shadow banks after the collapse IL&FS has only exacerbated this equilibrium. As a result, credit growth in India in FY20 reached its lowest projected levels (6.5–7%) in almost six decades.⁴⁸

In late 2019, Modi 2.0 was working hard to provide legal cover for bankers so that they resume their normal lending operations, start reengaging with NBFCs (which can perform a valuable role in debt intermediation), and reduce their costs of lending to “good” companies. But cheaper, less risk-averse debt can only solve the supply side money problem. Will project developers and private companies (primarily domestic, but also foreign) have the appetite to resume investment in India? Do they see enough reform measures to justify confidence in the Indian growth project? This will be one of the defining economic issues of Modi 2.0.

Alternative scenarios: political economy and the role of the state

India has great long-run potential to sustain rapid growth and convert this into human well-being. While the global context is much less favorable in the past, it has significant advantages because of its initial productive and organizational capacities. Whether or not this potential is realized will depend on a set of policy and institutional issues, that in turn will be shaped by underlying political economy issues.

We step back and cast these in terms of choices over alternative strategic

directions, with respect to both state-business, and state-societal relations. These are first sketched in terms of what two different paths could look like, a “dynamic, inclusive path” with 21st Century regulated capitalism and social state, versus a “crony populist” path. The sketch includes what is no more than a listing of constituent elements and associated policies. The contrast is heuristic; it is drawn to articulate the strategic directions of change, that will always be more complex and messy than suggested here. After this sketch, we turn to what we consider to be the central underlying issues around the role of the state and the underlying political economy.

A “dynamic, inclusive” path. This would involve a path of (a) dynamic, regulated capitalism and (b) an efficient social state: a 21st century middle income version of social democracy? We focus here on state-business relations.

For this path, the constituent elements are of high levels of corporate investment, especially in upgrading into new industries and services, competitive business dynamics, effective provisioning of infrastructure, and a deep, efficient and increasingly inclusive financial system

The policy and institutional underpinnings would include effective competition policy, protection of minority shareholders, transparent, auction-based allocation of resources (spectrum etc.), PPPs managed with competitive, and well-regulated concession arrangements, including third-party assessment of renegotiation, effective, unbiased, implementation of the Bankruptcy law, a broader associated unwinding of NPAs, the institutionalization of RBI independence, and financial sector reform, that would over time, involve either banking privatization, or at least a much larger role for private banks.

Contrast this with a “crony populist” path that would involve, a continuation, and perhaps intensification, of both (a) business dynamics closely linked to both particularist and sector-wide state-business deals and (b) social policies, broadly conceived, driven by populist-clientelist designs (including nationalist and Hindutva motivations).

In terms of state-business relations, the constituent elements of a cronyist path could include: the further entrenchment of established business groups, with continued or rising concentration of economic and political power, especially in infrastructure and other sectors of national monopoly, low aggregate private corporate investment, shifts in corporate investment and lobbying efforts into activities with greater potential for rent-extraction and rent-sharing, the (continued) concentration of infrastructure investment in the most important players plus the likely (also continued) backlog in broad-based investment, and financial system burdened by dependence on corporates with weak balance sheets. Overall this would lead to slower upgrading of the production system, in terms of diversification and complexity.

The policy and institutional underpinnings would be typically the other side of the “dynamic regulated” path, including weak competition policy, preferential treatment in terms of selective regulatory forbearance over NPAs, and biases in judicial resolutions of disputes

Here lies the central tension in Modi 1.0 and 2.0, in narrative and practice. The ambition, and associated narrative, is of transformation via the first path. Under any circumstances this would have faced the challenge of transition from the heritage of the deals-and-rules blend of UPA2, whether in terms of the NPAs in the public sector banks, or the practices and decision-making in interactions between state and private sector actors. This challenge has been sharpened by the “chill” induced by the uncertainty over application of new rules, concerns over continued discretion (whether in high level preferences or punishments over apparent malfeasance), and the resistance to change – all within a context of a weakening external environment.

Then underlying this is a potentially deeper tension. The transition to a

more competitive, rules-based path requires credibility of checks and balances in the polity and society, whether from the RBI, regulatory bodies, the CBI, the CAG or, of course, the judiciary. And this further requires as a complement an independent civil society. The nationalist impulse – that we see as central to the ambition of the Modi governments, comes with an associated authoritarian impulse, in the specific sense of reducing the independence of other organizations vis-à-vis the executive – a common feature of populist governments throughout the world in this period. This is a drag on rules-based processes, and especially so when it interacts with cronyist seductions, including those in which deals are ostensibly developmental.

It may be that the economic malaise of 2019 will indeed be largely cyclical, that business, small and large, will adapt to the GST and other parts of the new system, that the IBC will steadily catch up with the backlog, and the financial system gradually get back into a health state. But this is far from clear.

In the concentration of economic power and influence of major companies, apparently closely linked to a centralized political project, India under Modi increasingly resembles aspects of Latin American countries. These features resonate vividly with the “hierarchical capitalism” in Ben Ross Schneider's interpretation of Latin America.⁴⁹ This too can be seen as having three types of enterprise: connected plutocrats with major influence over the state system (such as Carlos Slim in Mexico, and other Mexican billionaires), the rest of the formal business sector (that struggles with regulation, poor infrastructure and weak skill development), and a very large number of small-scale/informal enterprises (with weak access to formal credit, legal recourse, infrastructure and modern productive support systems). Many countries also continue to have large parts of the economy in state enterprises – notably in oil in both Brazil and Mexico.

This kind of personification of political power is reminiscent of the *personalismo* phenomenon in Latin American politics with leaders like Juan Perón in Argentina or Alberto Fujimori in Peru, which was frequently associated with moves toward more authoritarian forms of management.

The continued central role of public institutions has echoes of Brazil. Populist responses to concentrated political and economic power is a regular feature of Latin America (though by no means a Latin American monopoly.)

As noted above India is shifting in the early phase of Modi 2.0 into a high public sector deficit, and looking to increased external borrowing, even while NPAs are, by international standards at disturbingly high levels. In the past, India's inflation-aversion, that has deep political roots, has provided a check on macroeconomic instability. But fiscal-corporate-financial drivers of crises are not always presaged by inflation accelerations. The interaction between this nexus, increased external exposure and nationalist-populist pressures could lead to macroeconomic troubles that could at best magnify a growth crisis and at worst lead to a real financial crisis.

Even if there is a short-term recovery, it is for Modi 2.0 to determine whether the following prediction from political scientist Yascha Mounk is prescient or a mischaracterization of the Indian experience:

Right-wing populists, by contrast, usually enjoy rising stock prices and investor confidence during their first few years in office. But as they engage in erratic policymaking, undermine the rule of law, and marginalize independent experts, their countries' economic fortunes tend to sour. By the time that right-wing populists have been in office for five or ten years, their countries are more likely than their peers to have suffered from stock market crashes, acute financial crises, or bouts of hyperinflation.⁵⁰

Conclusion

The legacy of Modi 2.0 will depend on its ability to restart India's economic engine. With the industrial backbone and banking sectors creaking, it remains to be seen whether foreign investment preference and lower tax rates can really encourage the kind of growth that was imagined in the ambitious narrative of both Modi campaigns. In this paper we have explored the issues in terms of the political economy of state-business relations. We have argued that the heritage of the UPA governments was of a capitalism with multiple faces – both dynamic and collusive, and functioning in a blend of rules and deals. Modi 1.0, despite the pro-business narrative and some potentially important policy shifts, was a half-baked enterprise in terms of reforming capitalism, if anything leaving state-business relations in an inter-mediate position with less credibility in transactions – except for the biggest and most influential business houses. This became more vividly apparent in the initial period of Modi 2.0. The production and, especially private investment, slowdown was probably going to occur in any case, but was not helped by the uncertainties of the transition and the “chill” around business interactions with the state – this interacting with the financial overhang. The short-run measures in Modi 2.0, while striking, smack more of desperation than a concerted policy design, and are associated with a mix of deficit expansion and absence of a credible policy mix for tackling the financial sector. While a path to an inclusive capitalism can (still) be imagined, the political economy pressures, and authoritarian temptations, are unlikely to support this in the medium to long term. Under these conditions, India could face Latin American scenario of rising, entrenched inequality, slow long-term growth and, even, macroeconomic instability.

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