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# India 2014: The Challenges of Governance

## Introduction

In January 2014, India's government faced significant economic and social challenges. Economic growth rates had slowed from 10.5% in 2010 to only 4.9% in 2013. Inflation remained stubbornly high at 10.1%, despite sustained interest rates of around 10%, and the rupee/dollar exchange rate depreciated from 45 rupees in March 2011 to 62 rupees in December 2013.

The ruling Congress Party faced worsening political obstacles as well. After the 2009 elections, the government had found it very difficult to enact substantive new legislation, owing to gridlock caused by opposition political parties and the Congress Party's own coalition partners. A decision to allow foreign investment in retail megastores had been put on hold following objections by the Trinamool Congress, a key political ally.<sup>1</sup> In September 2012, legislation was passed to allow foreign investment in multi-brand retail stores in states which agreed to implement the decision.<sup>2</sup> After making more than 100 amendments to satisfy diverse stakeholders, a new Land Act was passed in August 2013 to enable the state to acquire land for industrial growth more efficiently, with increased compensation for landowners.<sup>3</sup>

Over the past few years, a series of high-profile corruption scandals had resulted in the resignation of several cabinet ministers and state chief ministers. These scandals included the misallocation of mobile phone licenses (estimated to have cost the country \$40 billion), the misappropriation of apartments meant for war widows, and the selling of parliamentary votes in the 2008 no-confidence vote.<sup>4</sup> Widespread citizen protests against corruption, and the government's poor response, tarnished the country's image in the eyes of foreign and domestic investors. After a previous failed attempt, the government finally enacted legislation in 2013 establishing a new anti-corruption institution called Lokpal.

None of these efforts won the government much popularity. In state elections held in December 2013, the results for Congress were "utterly disastrous," *The Economist* declared.<sup>5</sup> The party's principal rival, the Bharatiya Janata Party (BJP), took the major states of Madhya Pradesh, Rajasthan and Chhattisgarh, while the recently organized anti-corruption Aam Aadmi Party, with powerful support from young people who wanted an alternative to both major parties, formed a short-lived government in the capital city of Delhi.<sup>6</sup> Congress won only the small state of Mizoram.

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With national elections to be held by May 2014, a Congress Party veteran admitted, “Who can be even half-way realistic and expect the Congress to return to power?”<sup>7</sup> A typical poll suggested that Congress might pick up only 89 out of 543 seats in the parliament, while the BJP and allied parties might win 227 seats.<sup>8</sup>

However, BJP was not expected to win a majority, so it would have to form a coalition with other parties to govern.<sup>9</sup> Forming a coalition might not be easy. BJP was largely a regional party, dominant in the north where the December elections had been held but not in the south or east.<sup>10</sup> The sudden strength of the Aam Aadmi party in Delhi, as well as in some other states, which explicitly opposed BJP as well as Congress, showed how important regional parties could prove.<sup>11</sup> Moreover, many smaller parties had concerns about BJP’s leader, Narendra Modi, and might balk at forming an alliance with him.<sup>12</sup>

Hoping to lead the BJP to victory in upcoming national elections, Modi pledged to combat corruption, cut excessive business regulations, and revive the economy.<sup>13</sup> Markets rose to record highs and the rupee appreciated to a four-month high when BJP swept the December state elections.<sup>14</sup> But markets are faddish, and the longer-term prospects were far from certain.

## Country Background

In 2014, India was the world’s second-most populous country, with a population of 1.21 billion people living in an area of 1.3 million square miles. Its boundaries touched Pakistan, China, Nepal, Bhutan, Myanmar, and Bangladesh (see **Exhibit 1** for map). Population growth had slowed from 2.3% in the 1960s and 1.9% through the 1990s to 1.4% per year in 2007. The fastest-growing states were in the north. In Uttar Pradesh, there were 4.7 births per woman in 2007, compared with only 1.8 in the southern state of Kerala. Literacy increased from 18% in 1951 to 74% in 2011, according to the national census (see **Exhibit 7** for disparities among states). Yet challenges remained: India was still home to 40% of the world’s illiterate population.

Women continued to be particularly disadvantaged. India had only 940 women for every 1,000 men due to pervasive neglect and high rates of female infanticide; *The Economist* magazine estimated the number of “missing women” in India to be greater than 100 million.<sup>15</sup> Only 65% of women in India were literate in 2011, compared with 82% of men (**Exhibit 7**). They were also significantly underrepresented in the democratic process, accounting for only 10% of national legislators. Further, the nation recorded substantially lower school attendance for females.<sup>16</sup>

India’s population remained largely rural, with approximately 69% of people living in villages of fewer than 5,000. In contrast, 46 cities had more than 1 million inhabitants in 2011, including the country’s largest city, Mumbai, with a population of 12.5 million, and the capital, New Delhi, with 11 million.<sup>17</sup> Fifty percent of the people worked in agriculture, a sector whose contribution to GDP had declined from 34% in 1980 to 19% in 2011 (see **Exhibit 3** for economic indicators). Agriculture was also the slowest-growing sector. Over the past decade (2004-13), agriculture was estimated to have grown 3.4% per year on average, industry at 7.2%, and services at 9.2%.<sup>18</sup> One of India’s key challenges was to manage the transition of its workforce from the low-productivity agricultural sector to manufacturing or services.

India was a poor country, with a per capita GDP of \$1,561 in 2013; more than a quarter of the population lived below the poverty line in 2005 (see **Exhibits 3 and 7**). Since 1985, approximately 1% of the population had been lifted above the poverty line each year. The expansion of the middle class

demonstrated upward mobility. India's Gini coefficient, .37 in 2008, suggested greater equality than in most countries, including the United States (.45), China (.47), Brazil (.54), and Russia (.42).

India was a heterogeneous society, with a wide diversity of religions and languages. There were 22 official languages and more than 600 dialects across the country. Hindi, which was spoken by 30% of the population, was the national language. English, although spoken by only 3% of the nation, was frequently used in business and government. According to the 2001 census, religious groups included Hindu (80.5%), Muslim (13.4%), Christian (2.3%), Sikh (1.9%), Buddhist (0.8%), and Jain (0.4%). In the polytheistic religion of Hinduism, members were born into a specific "caste" of a structured hierarchy. The highest caste was the Brahmin (priest), followed by the *Kshatria* (warrior), *Vaishya* (merchant), and *Sudra* (peasant) castes. Each caste was broken into sub-castes, with varying restrictions placed on both social and professional activities. The "untouchable" underclass lay at the bottom of the hierarchy and was traditionally destined to a life of poverty and menial work.

The Indian constitution of 1950 outlawed untouchability, and quotas were set aside for members of the lowest castes in national and state legislatures, universities, and government jobs. Similar affirmative action was also provided to members of India's marginalized tribes. Many states also provided affirmative action for other backward castes, and such measures were provided at the national level in the 1990s. Political parties often made promises to secure benefits for members of specific castes, and the rise of such caste-based parties had been a significant feature of India's changing political landscape after 1989.<sup>19</sup>

## Political History

India became an independent nation in 1947, ending almost two centuries of British colonial rule. The British East India Company had obtained revenue rights over the province of Bengal in 1765 and gradually expanded its political control over large parts of the Indian subcontinent. Although a violent mutiny contributed to the disbanding of the company, the British reestablished a strong presence through the India Act of 1858 whereby India became a crown colony. The British transported their legal and educational systems, spread English as a common language of business and government, and began to build an infrastructure of railways and roads. Politically, however, the indigenous Indian population had little representation. Mahatma Gandhi led the call for national independence through civil disobedience, such as boycotts.<sup>20</sup>

At independence in 1947, due to tensions between the Muslim minority and Hindu majority, the crown colony was split into the secular democracy of India and an Islamic East and West Pakistan. Violence swelled as 10 million to 15 million Hindus, Sikhs, and Muslims migrated across the borders. By some estimates, 600,000 people died in the immediate aftermath.<sup>21</sup> Gandhi was a casualty of the conflict: in 1948, a Hindu extremist assassinated him during his call for unity among the various religious populations. Religious tension was exacerbated when the Hindu ruler of Jammu and Kashmir unified his state with India in 1947. Pakistan protested on the basis of the high concentration of Muslims among the population. India and Pakistan waged two wars over Kashmir, in 1948 and 1965.<sup>22</sup> A third war between them in 1971 resulted in the creation of the new country of Bangladesh out of the region that was formerly East Pakistan. By the mid-1990s, radical Islamists from Pakistan were driving the Kashmir insurgency, and they nearly caused a fourth India-Pakistan war in 1999.<sup>23</sup>

Since independence, India had been the world's largest democracy, enjoying a high degree of political stability with smooth transfers of power. India operated under a parliamentary government modeled on the Westminster system. The voting structure was called the "first-past-the-post" system; the winner of each electoral contest was the candidate who received the largest number of votes (not

necessarily the majority of votes). The party, or coalition of parties, that attained a majority in the nationwide elections formed the national government leadership. Likewise, the state governments were led by the party, or coalition of parties, that secured the majority in each separate statewide election.<sup>24</sup> The members of parliament and the state legislatures elected the president of India. Although the president served as head of state and high commander of military forces, day-to-day power lay primarily with the national parliament, state governments, and the prime minister.

### *One-Party Dominance: 1947–1977*

The Indian National Congress (Congress) Party had long been the country's dominant political party. The Congress Party led India's campaign for independence from British rule and "has remained a powerful force in Indian politics, transcending religious, ethnic and caste divisions."<sup>25</sup> Members of the Nehru-Gandhi family had been at the helm of Congress for most of its history, with Jawaharlal Nehru, his daughter Indira Gandhi, and her son Rajiv Gandhi all serving as prime ministers during the period 1947–1989. The party held power from 1947 until 1995, except for a few short interruptions, and again since 2004 in the form of a coalition government. Consistent with the Congress Party's roots and Nehru's vision, "one of [the party's] historic strengths was the ability to reinvent itself and absorb new currents of thought and significant blocs of the populace into its fold."<sup>26</sup>

From the very beginning, the Congress Party espoused a broad political ideology based on the concept of a free Indian nation. It embraced all Indians, regardless of religion or region, although members of the upper class or upper caste clearly held the top positions. As the national voting constituency grew, divergent political philosophies and demographic interests were absorbed under this umbrella. But as the democracy matured, the need for specific actions and attention to constituent needs became more obvious. Consequently, during the 1960s, observers noted the development of "widespread patronage networks which provided critical linkages between local demands and central responses."<sup>27</sup> The party-machine mechanism served to connect and invest a diverse population in a central, unified party.

### *1977–1989: Congress Faces Political Competition*

This patronage system began to break down during the rule of Indira Gandhi, the daughter of Jawaharlal Nehru. In 1972, she ended party elections and "started to appoint persons to both governmental and organizational positions for personal loyalty and not for their ability to articulate grass-roots demands."<sup>28</sup> The emphasis on personal loyalty over patronage deliverables undermined the practical operations of the Congress Party as "these [new] appointees did not have the capacity to influence local behavior and could not mediate between social and political conflicts."<sup>29</sup>

After allegations of election misconduct and a wave of protests in 1975, Indira Gandhi initiated an emergency declaration that temporarily suspended elections and other civil liberties for 21 months. In reaction against Indira Gandhi's controversial declaration, the Janata Party consolidated allies unified in opposition to the emergency, before the 1977 election. Together, the coalition was strong enough to wrest control from the Congress Party. However, the conflicting interests and rivalries endemic to multiparty coalitions strained the Janata Party to the point of collapse after two-and-a-half years in power.<sup>30</sup>

This watershed event demonstrated a new path to power for the Bharatiya Janata Party (BJP). During the 1980s, the BJP rose to prominence as a major political party poised to take an active role in national governance. Historically, the BJP had been connected to the Rashtriya Swayamsevak Sangh (RSS), an organization founded in 1925 to promote Hinduism as a way of life, through the cultural

and religious movement called the Sangh Parivar. The history of the RSS had been tainted when a member of the organization assassinated Mahatma Gandhi in 1948.

In contrast to the Congress Party's liberal political philosophy, the BJP positioned itself as the conservative option, upholding Hindu nationalism or *Hindutva*, the broad concept of common Hindu values. The primary principle was one of majoritarianism with the integration of non-Hindu minorities.<sup>31</sup> This worldview was particularly effective with small businesses and the middle class.<sup>32</sup>

The year 1984 brought greatly heightened ethnic violence within India. After deploying the army to quell a secessionist movement in the state of Punjab, Prime Minister Indira Gandhi was assassinated by her Sikh bodyguards in revenge. Ensuing riots against the Sikh community produced over 2,000 casualties. Rajiv Gandhi subsequently became prime minister. He led Indian intervention between the Tamil separatists and the Sinhalese government in Sri Lanka. In retaliation, a Tamil terrorist assassinated Rajiv Gandhi in 1991.

Politically, the late 1980s through the mid-1990s was a period of confrontation in which both the BJP and the Congress Party sought to achieve a majority by taking hard-line positions and fragmenting the electorate.<sup>33</sup> While purposefully inclusive of all castes, the BJP's emphasis on Hinduism alienated most of the Muslim population and was even called "anti-Muslim" by some critics. Caste divisions proved more compelling than *Hindutva* in some states, particularly North India. In an effort to distance itself from negative sentiments and appeal to the mainstream, the BJP "toned down its hardline Hindu-nationalist rhetoric."<sup>34</sup>

### *1989–2009: The Rise of Coalitions and Regional Parties*

In 1984, the BJP had only two seats in the Lok Sabha (India's lower house of parliament); by 1989, the party had won 86 seats, and by 1991, 119. By May 1996, the BJP constituted its first national government, although it lasted just 13 days. Two years later, the BJP assembled broad support with a 13-party coalition. Led by the BJP, the National Democratic Alliance (NDA) won a majority in the Lok Sabha in October 1999. This was achieved, for the first time, through a pre-electoral alliance.<sup>35</sup>

At least 28 political parties with strong regional identities became active on the national level by 1996.<sup>36</sup> The total number of parties in the Lok Sabha increased from 22 in 1984 to 40 in 1998.<sup>37</sup> Many of these regional parties mobilized "along the fault lines of social cleavages," appealing to specific caste, religions, or regional identities; in turn, this meant that constituents had increased expectations for representation of local and cultural interests on a national level.<sup>38</sup> These fault lines were further deepened by rural versus urban and wealth disparities. Thus, in some respects, an erosion of a cohesive national strategy had occurred.<sup>39</sup> Many regional parties were in power in state governments. The increased visibility and leverage of regional and local parties had "led to a gradual, but significant, transfer of power from the center to the states."<sup>40</sup>

In some circumstances, federal government inaction encouraged some states, particularly those in the south and west, to formulate their own economic policies. Growing disparity in economic programs exacerbated tension between states. Divergent growth rates led some municipalities to "exert their political muscle to ensure a reallocation of resources."<sup>41</sup> Author Mahesh Rangarajan further explained the situation:

There are different factors at work that are chipping away at the ability of the Union to intervene in state level politics and economies. One has been the decline of the role of the government in economic affairs with the onset of market-led reforms in the Nineties.

State governments are now able to raise funds directly from private investors and foreign agencies.<sup>42</sup>

Two parties from the northern state of Uttar Pradesh played key roles in national coalition politics. The Bahujan Samaj Party (BSP), founded in 1984, effectively translated caste issues into a political movement by unifying the lowest castes and all other minorities in opposition to the upper castes, as symbolized by the Congress Party. The BSP drew a sharp contrast with Congress Party's "one India." In 1993, the BSP achieved a political breakthrough in Uttar Pradesh by working with the locally based Samajwadi Party (SP) to win the state assembly elections. Led by Mulayam Singh Yadav and appealing mainly to the middle castes (also known as Other Backward Castes, OBC), the SP initially aligned with the BSP but later became a political rival.<sup>43</sup>

On a national level, numerous splinter parties like the BSP and SP filled the gaps that the lead party needed to achieve an election majority.<sup>44</sup> Despite their small size and often narrow regional focus, these splinter parties became integral to coalition decision making. The coalitions' dependence on their participation and cooperation forced their acceptance as "equal partners" and not merely appendages" to the lead party.<sup>45</sup> The nature of this relationship and its importance to the very existence of the coalition's power could create disproportionate representation of local interests, often resulting in the delay or halting of key legislation.

The actual and potential efficacy of the coalitions could be debated, given these complexities. Some scholars, such as Bidyut Chakrabarty, asserted that the pattern created a degree of paralysis on substantive and controversial issues: "The ruling coalition may not always be free to adopt policies in accordance with its priorities unless there is a consensus among the parties that are critical for its survival."<sup>46</sup> The number of parties within a power-share coalition increased from just 12 in 1996 to 24 in 1999.<sup>47</sup> Others acknowledged the difficulty of mobilizing policy support but maintained that several factors enabled progress. First, strong leadership could be crucial, especially with regard to economic policies. And second, even splinter parties might hesitate to vote against their own party. "A negative vote on a proposed piece of legislation," explained one analyst, "leads to the fall of the government. Therefore, even when some members of the ruling coalition are opposed to a policy change, they are unlikely to defeat it in Parliament."<sup>48</sup>

For the 2004 elections, the Congress Party created its own coalition government in order to secure a majority position in the Lok Sabha elections. During this time, Sonia Gandhi, the Italian-born widow of former Prime Minister Rajiv Gandhi, led the party. Under her guidance, the Congress Party cobbled together regional and state-based parties to form the United Progressive Alliance (UPA). Even in its victory, the UPA coalition had only 217 seats in parliament and required the support of an additional 55 in order to secure a majority. Left-wing parties, composed of four powerful political parties and their 59 associated parliamentarians, pledged support for the coalition without formally integrating into the UPA coalition.<sup>49</sup> (See **Exhibit 10** for the seat distribution in parliament.)

With its broad composition, the UPA continued to anchor itself as "the defender of India's inclusive, secular heritage" with an "appeal to voters across castes and religions, as well as to the poor."<sup>50</sup> After achieving electoral victory in 2004, Sonia Gandhi decided to appoint Manmohan Singh, an Oxford-educated economist, Reserve Bank governor, former finance minister, and much respected figure in India, as prime minister.

### *The 2008 No-Confidence Vote and Coalition Realignment*

The unstable UPA coalition governed by agreeing to a "common minimum programme." Many pieces of legislation were passed, designed to increase citizens' claims to government services and

their ability to monitor them. These included the Right to Information Act of 2005, which enabled citizens to request information on public projects from government, and the Right of Children to Free and Compulsory Education Act of 2009. An ambitious scheme to provide each Indian citizen with a unique national identification number was launched in 2009. The initiative was headed by Nandan Nilekani, former CEO of Infosys and one of India's most successful entrepreneurs. Employment security was considerably strengthened by the nationwide rollout of the National Rural Employment Guarantee Act (NREGA), which guaranteed 100 days of work to unemployed rural families. About 4% of total public expenditure was allocated for this scheme in 2009–2010.<sup>51</sup> Disagreements with the left parties meant, however, that little progress was made on privatization initiatives or labor market reforms.

In the summer of 2008, Singh led the negotiation of an India–U.S. nuclear pact that would expand India's capability to produce nuclear energy, largely through foreign joint ventures, while opening the nation to inspection by international authorities. The goal was to mitigate India's chronic energy deficits and to promote "energy security in a manner which will not hurt our precious environment and which will not contribute to pollution and global warming."<sup>52</sup> However, the left parties were strongly opposed to this deal and abandoned their support of the UPA government.

Losing the support of the left parties meant that the UPA government faced a no-confidence vote in parliament; if the UPA lost this vote, the government would be forced to resign. In the days leading up to the 2008 no-confidence vote, talk began to circulate about corruption. Members of the opposition, most notably the BJP, claimed that officials of the SP, which supported the Congress government in this vote, had offered anywhere from \$750,000 to \$2.25 million to lawmakers to abstain from the vote.<sup>53</sup> During the two-day debate leading up to the vote, parliament devolved into mayhem. The *Wall Street Journal* reported that "opposition politicians pulled large bundles of rupees out of bags . . . throwing the chamber into chaos."<sup>54</sup> Ultimately, the UPA emerged weakened but victorious. The margin of survival was 275–256, with 10 abstentions.

The episode "hard[ened] the already bitter political divides" and resulted in a realignment of political allegiances.<sup>55</sup> The defecting Communists forged a new bond with the BSP. Kumari Mayawati, president of the BSP and chief minister of Uttar Pradesh, was widely believed to have ambitions to lead the next coalition government as prime minister, and she duly increased the prominence of her party through the July events.

The BSP's partnership with the left parties and the SP's alignment with the UPA illustrated the shifting allegiances of coalition politics. A third front (left parties and the BSP) presented a new political threat. The BJP, a major opponent during the no-confidence vote, also remained very active in its attempt to oust Congress and the UPA from power.

### *The 2009 General Election: A Return to Congress Dominance?*

In the 2009 national election campaign, the ruling Indian National Congress Party promised to represent the *aam aadmi*, the "common man." Led by Sonia Gandhi, the Congress Party emphasized its social-welfare agenda, including the NREGA public works program. The party promised to strengthen the NREGA, guarantee food security for all, provide health insurance for poor Indians, and offer scholarships or long-term loans to all college students.<sup>56</sup> In addition to the "common man" campaign focus, the Congress Party also decided to forgo electoral alliances with regional parties in several states.

To the surprise of many analysts, the Congress Party scored a major victory in the 2009 general election, winning 206 seats in the lower house of parliament, the most any party had won in 25 years.

The UPA alliance obtained a total of 262 seats, only 10 short of an outright majority (see **Exhibit 10**). The BJP and its alliance lost 28 seats, and the parties that had defected from Congress in summer 2008 lost 44 seats. This strong mandate ensured considerable freedom from the extreme coalition politics of the past five years, providing Prime Minister Singh with greater latitude for formulating and implementing policies.

The political successes for the Congress Party were repeated at the state level. In state elections held in 2008 and 2009, Congress governments retained power in several states (Andhra Pradesh, Haryana, Delhi, Maharashtra), and also replaced opposition party governments in some states. However, as 2014 began, the Congress Party or its allies were in power in less than half of India's major states (see **Exhibit 11** for the parties in power in major states).

## Economic History

### *The Planned Economy*

From India's national independence in 1947 through the 1980s, it pursued a planned economic model for development. The Soviet Union's apparent success in modernizing through strict government control served as an example for the largely agrarian nation of India. In 1948, the Industrial Policy Resolution in India outlined government control of national infrastructure.<sup>57</sup> Subsequently, a newly formed Planning Commission developed the first Five-Year Plan in 1951. Although the strategic content and level of control had changed significantly by 2012, the government still formulated regular Five-Year Plans.

In India, a massive bureaucracy, nicknamed the "Permit Raj," implemented the planned economy. The Permit Raj was effective in controlling economic activity and restricting private-sector growth. By 1956, the Planning Commission managed over 12 sectors, including commercial banking, insurance, oil, chemicals, steel, and mining. Throughout the 1950s and 1960s, according to Kuldeep Mathur, "the problem of development was viewed in technical terms and was largely seen as a problem of correct policy and design." Further, economic policy discussions focused on the "prioritization of investment allocations, trade and industrial strategies." Any failures were deemed a question of implementation, rather than a problem with the fundamentals of a planned economy.<sup>58</sup>

During this period, most private-sector companies were regulated by the government, with regard to their location, production levels, and employment rules. Complicated licensing processes created significant delays, prohibitions, and barriers to entry. For example, the government's import substitution program imposed high tariffs and quotas on imported goods and materials; restricted goods and materials could take 4 years and 16 separate procedures for importation. Import policy frequently forced Indian companies to purchase inferior, but more expensive, domestically produced goods—consistent with the "import-substituting industrialization" model pursued by the government. Consequently, their competitiveness was compromised. Investment licensing further compounded production challenges. In the aftermath of British rule, the Indian government developed an aversion to foreign economic involvement and placed tight restrictions on foreign capital and foreign companies.<sup>59</sup>

Throughout the 1960s and 1970s, inefficiency, slow growth, and technological stagnation were hallmarks of the Indian economy. Even though the government tried to exert a high level of control over the economy, implementation of policy through the Permit Raj was corrupt, and industry operations were inefficient. Despite the government's explicit focus on agriculture, food shortages

persisted. Furthermore, the average annual growth rate, on a per capita basis, was only 1% during these two decades.<sup>60</sup>

India soon experienced balance-of-payments shortfalls. In response, the government began to loosen trade restrictions to promote exports in the late 1960s and early 1970s. Interventions included the devaluation of the rupee by over 57%, the Cash Assistance Scheme (which compensated exporters), and the Registered Exporters Policy (which permitted exporters to import otherwise restricted items).<sup>61</sup> Nevertheless, between 1950 and 1970, India's exports declined from 6.5% of GDP to 3.6%.<sup>62</sup>

In the mid-1960s, government policy became less favorable toward foreign firms, with the encouragement of joint ventures and the beginning of a 20-year economic relationship with the Soviet Union. (At the beginning of a war with Pakistan in 1971, India and the Soviet Union established a military and trading relationship.) As India's relationships with foreign firms from other countries soured, Indian-Soviet ties strengthened. In the 1970s, the Indian government placed a cap on foreign equity ownership after the oil shock. Multinationals, such as Mobil Oil and Coca-Cola, suffered financial losses as they liquidated their stakes.<sup>63</sup> As foreign firms withdrew from India, domestic companies consolidated control. Some 75 private business houses controlled about 45% of the formal sector.<sup>64</sup> By the 1980s, the government had nationalized almost half of the country's industrial assets and 100% of the country's banks.<sup>65</sup>

Eastern Europe proved to be a significant market for India's otherwise inward-oriented country. In 1980, 22% of India's exports were to that region. This volume continued throughout the decade, with the region representing 19.3% of trade in 1989.<sup>66</sup> Other than trade to this region, India's domestic industry was suffering. By the 1980s, the Indian bureaucracy had produced and subsidized 90,000 "sick units," or failing public-sector companies.<sup>67</sup> As Arvind Panagariya described it: "Continued deficits of this magnitude led to a buildup of very substantial public debt with interest payments accounting for a large portion of the government revenues."<sup>68</sup>

In the second half of the 1980s, India's public debt increased significantly as the government followed a policy of fiscal expansion; the average debt maturity shrank from 27 years to 20.<sup>69</sup> At the same time, the country was sowing seeds of industrial liberalization. Between 1988-1989 and 1990-1991, India's economy grew a remarkable 7.6% per year.<sup>70</sup>

Nonetheless, internal and external pressures put too great a strain on the Indian economy. India's current account deficit accelerated to 3.4% of GDP in 1990-1991.<sup>71</sup> The Persian Gulf War caused oil prices to soar, and the Soviet Union was crumbling. With insufficient foreign exchange reserves (under US\$1 billion), the Indian government experienced a balance-of-payments crisis.

### *Toward a Market-Oriented Economy*

The financial crisis in India began in June 1991 and lasted for about a year. India obtained a World Bank structural adjustment loan and support from the International Monetary Fund (IMF), and responded with a series of interventions designed to promote economic liberalization. These policies, as described by economist John Williamson, who coined the term "Washington Consensus," included: (1) deregulation, (2) privatization, (3) property rights, (4) fiscal discipline, (5) competitive exchange rates, (6) tax reform, (7) interest rate liberalization, (8) trade liberalization, (9) public spending on education and health, and (10) foreign direct investment liberalization.

During the turmoil in 1990-1991, two governments in India fell before Narasimha Rao of the Congress Party became prime minister, heading a coalition government. Rao recruited Manmohan

Singh (later appointed prime minister by Sonia Gandhi) as finance minister to play the critical role in regaining control of the economy. Singh swiftly replaced piecemeal reform with a systematic approach to improving national efficiency and removing barriers to growth. He reduced tariffs and taxes, encouraged foreign investment, eliminated numerous licensing requirements, and improved fiscal discipline. Singh also opened some public-sector industries, such as telecommunications, to private enterprise. Between 1993–1994 and 1996–1997, India experienced a growth rate of 7.1%.<sup>72</sup>

The post-1991 reforms ushered in an era of high growth and economic vibrancy. India's export volume continued to increase, rising 500% between 1988 and 2005.<sup>73</sup> In addition, the IMF's annual report noted that the nature of exports had improved, "steadily moving up the value chain."<sup>74</sup> Total factor productivity improved dramatically, growing at more than 4% in the post-2000 period (see **Exhibit 5** for growth and productivity data). India's economic success was largely attributed to the private sector, which accounted for 76% of total investment as well as a significant portion of employment and GDP.<sup>75</sup> Between 2005 and 2007, the GDP growth rate exceeded 9% per year. In 2007, India's 11<sup>th</sup> Five-Year Plan laid out a strategy to achieve a 10% growth rate by the end of five years.<sup>76</sup>

The reforms instituted by Manmohan Singh survived political change. The National Democratic Alliance (NDA) government, which had come to power in 1999, continued the reform process despite the BJP's resurrection of the concept of *Swadeshi*, or self-sufficiency, from India's independence movement. Authors Yogendra Yadav and Suhas Palshikar asserted that, as the political administration transitioned from the Congress Party to the NDA, "successive finance ministers shared the common policy space in the 1990s, making it possible for the Market project to be realized [and] . . . economic policy making was 'depoliticized.'"<sup>77</sup> Despite the excellent overall growth rates, the BJP's 2004 "India Shining" campaign failed to appeal to a large group of mostly rural and impoverished voters who were still suffering from stagnation. The Congress-led UPA government came back to power in 2004 and retained power in 2009.

### *Facing the 2008 Global Financial Crisis*

In 2008, GDP growth slowed to 5% as a result of the global financial crisis. Combined with a 23% shortfall of rain in 2009, this slowdown initially looked likely to be severe. The government quickly implemented a large fiscal stimulus package amounting to 3.3% of GDP in 2008–2009. It consisted of significant reductions in indirect taxes, expansion of public expenditure programs such as the NREGA, pay raises to government employees, debt relief to farmers, and a relaxation of the borrowing limits of state governments. Approximately 43 million households were provided employment under the NREGA scheme.<sup>78</sup> The central bank lowered reserve requirements for banks, as well as its benchmark interest rate to combat the downturn.

These efforts paid off: growth recovered to 8.3% in 2009, despite a very slow growth of only 0.8% in agricultural output. Manufacturing growth recovered from 4.3% in 2008 to 11.3% in 2009, and although exports were down in 2009, with the much of the world in financial crisis, they rebounded dollars in 2010 (**Exhibit 4** for India's balance of payments).<sup>79</sup> However, the country continued to have a current account deficit, as in the previous five years.

## Challenges Facing India

**Barriers to doing business** Despite a good recovery from the global economic crisis, India continued to have significant challenges to maintaining the growth process. India ranked number 134 in the World Bank's 2014 Doing Business index, which ranged from 1 for the country that was said to be best at facilitate doing business (Singapore) to 189 for the country that was said to be worst (Chad). Entrepreneurs in India faced significant barriers in terms of starting a business, obtaining construction permits, paying taxes, enforcing contracts, and resolving insolvency (see **Exhibit 9** for India's ranking in the World Bank's index). The government had passed few significant pieces of legislation since the 2009 elections, and the political uncertainty prevailing in 2014 meant that most investors did not expect any major reforms to be enacted. The fallout from the Congress Party's corruption scandals was also apparent in India's international ranking in the Corruption Perceptions Index. India was ranked 94 in 2013, down 10 places from 2009 (see **Exhibit 8** for India's ranking in the index).

**Foreign direct investment** Many restrictions on foreign investment remained in place. Foreign ownership in private banks and telecoms was capped at 74%; for defense, insurance, and publishing, ownership was capped at 26%. Foreign institutional investors (FIIs) could not invest more than US\$2.6 billion in government and corporate debt.<sup>80</sup> Still, since 2000 more than \$150 billion had been invested in India, as direct investment inflows reached \$33 billion in fiscal year 2009-10 and stayed in that range through 2012-13. (See **Exhibit 4**. The Reserve Bank of India keeps balance-of-payments accounts on a fiscal year basis, from April 1 through March 31.) A significant geographic disparity existed, with over three-quarters of all FDI during the previous decade going mainly to just six states in the west and south of India.

**Inflation** By January 2014, the Indian government faced a significant problem of inflation. Consumer prices had risen by 10% over the previous year. This continued a trend of high inflation since 2008 (see **Exhibit 3**). A particular concern was the fact that food prices had risen by more than 13% in 2013.<sup>81</sup> Food price inflation was not a major concern for developed economies; in fact, the "core" inflation rate in the United States excluded prices of food and energy. But food accounted for 67% of average household expenditures for the poorest quintile of Indian households, and food price inflation was therefore likely to result in a significant decline in their standard of living. The Reserve Bank of India had raised interest rates from 8.75% in 2013 to 9% in January 2014, but inflation was yet to decline to acceptable levels.<sup>82</sup> Persistent levels of inflation were exacerbated by the dramatic depreciation of the rupee.

**Fiscal budget** In 2013, India's public debt (federal and state) stood at 70% of GDP. A fiscal stimulus in response to the global crisis had increased the consolidated government fiscal deficit from 4% of GDP in 2007 to 8.3% of GDP in 2008, but it had remained in that range through 2012, the last year for which there were actual data (see **Exhibit 6** for the budget and public debt). For the first time, the Indian government had announced a cap on public debt, limiting federal and state government debt to 68% of GDP by 2013-2014. All states were further required to bring their budget deficits below 3% of state GDP by 2014-2015. In August 2010, legislation for a comprehensive Direct Taxes Code was introduced in parliament. Under this code, all direct taxes—income tax, dividend distribution tax, and a wealth tax—would be consolidated in a common system, which was expected to reduce tax evasion, improve the tax-GDP ratio, and reduce compliance costs.<sup>83</sup> The bill still had not passed. Negotiations were ongoing with the states to introduce a Goods and Services Tax (GST), in hopes of increasing revenue.

**Sector diversification** India's largest economic sector in terms of employment was agriculture. Half the workforce toiled in agricultural fields, yet produced only 14% of GDP. This sector was critical to both economic growth and political stability. Advancements had been made, but problems persisted. Less than a third of farmland was irrigated. As a result, the nation was particularly susceptible to weather fluctuations. Between 1992–1993 and 1996–1997, agriculture averaged a growth rate of 4.7%. Subsequently, the sector lost momentum.<sup>84</sup> Since 2000, growth had averaged just above 2%, falling short of the targeted rate of 4%.

By contrast, the service economy – especially in information technology (IT) and business process outsourcing – blossomed. The service sector contributed 60% of GDP in 2013, but employed only 25% of the population. Drawn by India's concentration of low-cost, technically sophisticated, English-speaking workers, numerous multinational companies flocked to the country for outsourcing services. American companies, in particular, began to rely heavily on India for back-office operations and call-center support. The time difference made high-quality, around-the-clock service possible.

Some companies, such as General Electric (GE), realized cost savings beyond outsourcing services. GE had invested US\$80 million in 2000 to launch the John F. Welch Technology Center. The 545,000-square-foot research center, located in Bangalore, built in-country intellectual capital in areas such as mechanical and electrical engineering, chemistry, and ceramics. It filed 185 patents.<sup>85</sup> GE had both grown and diversified from 11,000 Indian employees in back-office and call-center positions in 2002 to 14,500 employees in various positions in 2008. The company earned US\$2.8 of revenues in India in 2007 alone.<sup>86</sup>

Although the service industry had been the primary driver of economic growth in India, diversification was essential to sustained success. A senior official in the UPA coalition stated that dependence on the service sector was not sustainable, and manufacturing would be the next and most enduring engine of growth. In 2013, all industry, including manufacturing, constituted 26% of GDP. The government's goal was to increase manufacturing output to 33% of GDP.

Indian manufacturing had a competitive advantage on a global basis. The country offered relatively low labor costs, with compensation at approximately one-thirtieth of Germany's (at 2002 exchange rates). After allowing for productivity differences, effective unit labor costs were only 16% of those in Germany.<sup>87</sup> The development of the Tata Nano, an inexpensive automobile, demonstrated the possibilities for Indian manufacturing. The car was planned to sell for 100,000 rupees (under US\$2,500). However, disputes between local farmers and the company forced a move in facilities, which increased costs.<sup>88</sup>

**Infrastructure** India's transportation network had long been chronically underfunded and inefficient. The nation's extensive rail system was deteriorating, and the condition of roads and ports was similarly poor. In order to sustain an average annual growth rate of 9% to 10%, India needed to increase its government spending on infrastructure from 5% of GDP to 9%. This equated to an investment of approximately US\$500 billion between 2007–2008 and 2012–2013. An exception to India's infrastructure failure was air travel. Since the entry of private enterprise, air travel had become more affordable and increasingly efficient. In 2007–2008, air passenger traffic grew by 21%.<sup>89</sup>

The telecommunications infrastructure remained weak, even though the government had liberalized telecoms and encouraged competition. Growth, especially among mobile subscribers, had accelerated since 2000. Tele-density (the portion of phone subscribers) increased from 2.3% in 1999 to more than 30% by 2008. Still, overall penetration compared unfavorably to places like China, where mobile penetration alone was 41.4% in 2007.<sup>90</sup>

**Energy** Most pressing were India's energy needs. India depended predominantly on domestic coal reserves, hydropower, and imported oil for power. With deep coal reserves, India drew 62.2% of its power from coal. Likewise, 25% of its power came from hydroelectricity, and its potential was perhaps three times the current usage. India was the fifth-largest power producer in the world. Yet its distribution system was in disarray. Frequent outages often ran at 8%–15% of demand. The central government generated 34% of power; state-run companies generated 52%; and the private sector, only 14%. In 2003, the country implemented reforms to encourage private-sector involvement, although substantial improvements had not yet occurred.<sup>91</sup> (See **Exhibit 2** for projected energy supply and demand.)

**Education and health** Sixteen central universities with over 12,000 colleges serviced more than 7 million students by the twenty-first century. Many highly skilled graduates, however, had emigrated from India. According to a 2001 United Nations Human Development Report, this equated to a loss of US\$2 billion per year.<sup>92</sup> Additionally, the value of the government's investment in education had been questioned, especially given the poor quality of primary education. Even among graduates, there were the issues of the appropriateness of skills and the jobs to match the available skills. Formal unemployment in India stood at 8% to 9%. Furthermore, the gap between the educated and the uneducated was wide, and regional and caste disparities were still evident.

Education accounted for 11% of public spending.<sup>93</sup> In addition to undertaking a "massive" expansion of higher education and promising scholarships or very long-term loans to all students admitted to colleges and universities, the Congress Party pledged in its manifesto to create one new model school per year on every block during the next five years.<sup>94</sup> A bill proposed in March 2010 would make it possible for foreign universities to establish campuses in India, increasing the potential for high-quality university education in the country.<sup>95</sup>

Health care, which was largely the responsibility of individual states, was underfunded. Nearly all poor Indians lacked health insurance, and health spending, much of it for rural clinics, had been only about 3.4% of total government expenditure.<sup>96</sup> The Rashtriya Swasthya Bima Yojana (RSBY) health insurance program was beginning to cover some poor families but so far had a tiny budget.<sup>97</sup> The Congress Party pledged that within three years, every poor family would be covered under the program and hospitals would be upgraded to provide needed health services.<sup>98</sup>

In December 2011, the cabinet approved a Food Security Bill, which proposed to provide 5 kilograms of grains per person per month to families below the poverty line at highly subsidized prices. The scheme aimed to cover 75% of the rural population and 50% of the urban population. Initial estimates suggested that the bill would cost at least \$20 billion.<sup>99</sup> This bill was passed by parliament in August 2013.<sup>100</sup>

**Regional instability** A major constraint to the investment environment was the instability in India's neighboring countries. Growing instability and terrorism in neighboring Pakistan, a result of its escalating internal war against Taliban factions in 2009, was a concern to India. Terrorist groups based in Pakistan, notably the Lashkar-e-Taiba, had been responsible for several terrorist attacks in India's cities, including attacks on Delhi's Red Fort in 2000, the Indian parliament in 2001, Mumbai's trains in 2006, and several prominent Mumbai landmarks in 2008. There was instability in other neighboring countries as well: Sri Lanka and Nepal were in the process of recovering from prolonged civil wars, while Bangladesh had returned to representative democracy in 2009 after two years under a caretaker government.

**Regional disparities and internal conflict** Despite the recent period of high GDP growth, large disparities in human development persisted across the regions and people of India. The proportion of people living in poverty varied from 8% in Punjab state to 42% in Jharkhand. More than a quarter of rural residents lacked access to safe drinking water; infant mortality rates varied from 13 deaths per 1,000 live births in Kerala to 69 in Uttar Pradesh (see **Exhibit 7**).

A particularly severe consequence of noninclusive growth was the rise of internal conflicts in India over the past decade. Violent leftist groups, Prime Minister Singh said, were “the single biggest security challenge to the Indian state” – even bigger than Pakistan.<sup>101</sup> Concentrated in poor areas of central and east India and claiming to seek land redistribution, they were alternately called “Naxalite,” after a village where they were supposed to have arisen, or “Maoist,” their self-proclaimed ideology.<sup>102</sup> In early 2010, 223 of India’s 636 districts were estimated to be affected by these violent movements, up from 55 districts six years earlier.<sup>103</sup>

Prime Minister Singh emphasized the lack of development as a key driving force behind such movements:

Development, or rather the lack of it, often has a critical bearing, as do exploitation and iniquitous socio-political circumstances. Inadequate employment opportunities, lack of access to resources, underdeveloped agriculture, artificially depressed wages, geographical isolation, lack of effective land reforms may all impinge significantly on the growth of extremism. . . . Whatever be the cause, it is difficult to deny that extremism has huge societal costs.<sup>104</sup>

Other violent groups sought independence from India for their regions, attacking businessmen, infrastructure, and government buildings. For example, the United Liberation Front of Assam wanted its state in northeastern India to become a “sovereign, socialist Assam.” During the past decade, the government of India had pursued successful peace negotiations with some separatist groups in the states of Assam, Nagaland, and Tripura, but violence continued in many places in 2010.<sup>105</sup>

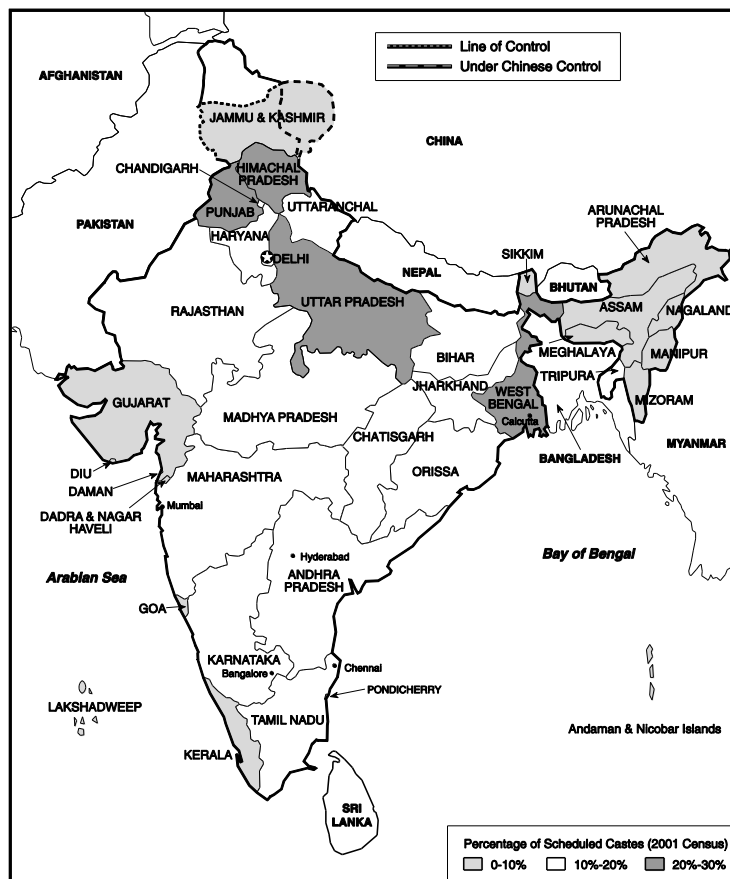
The year 2012 also marked the 10<sup>th</sup> anniversary of one of the worst episodes of religious violence in India’s recent history. In 2002, 59 Hindu pilgrims were killed in an attack on a train in Godhra town of Gujarat state. Subsequent violence between Hindus and Muslims in several cities led to the deaths of more than 1,000 people. The state government—led by Narendra Modi, BJP’s 2014 candidate for prime minister—was widely criticized for “inaction and negligence” during this time. Ten years later, New York-based Human Rights Watch accused the state government of “fail[ing] to conduct serious investigations and obstruct[ing] justice.”<sup>106</sup> However, a Supreme Court special investigation team cleared Modi from any criminal charges or involvement in conspiracy. In December 2013, the team’s report was upheld by a local court and this was widely interpreted as a “clean chit” for Modi.<sup>107</sup> Although religious violence had declined in the decade after 2002, it had not been eliminated: 658 communal incidents were reported across India in the year 2010, in which 111 persons lost their lives.<sup>108</sup>

## India 2014: A Difficult Road Ahead

Problems with the Indian economy were not likely to improve before the May elections. The government had restated its commitment to responsible fiscal policies, but Fitch's rating agency, among others, doubted it would exercise much restraint given the Congress Party's weak position.<sup>109</sup> The BJP's regional focus and the blame that had been cast on its prime-minister candidate Modi for inaction during deadly riots a decade earlier raised doubts about whether the party would be able to enlist coalition partners to form a government if it won the May election—or what conditions coalition partners would impose.

Then, if BJP did form a government, Modi would face a raft of questions centering on inadequate growth and governance. Which sectors would be the major drivers of India's growth going forward? How could India successfully help millions of people transition out of low-value agriculture? Could India invest enough in infrastructure, energy, education, and health to lift hundreds of millions of citizens out of poverty? And where could the government find the political will and citizen support to make progress on these difficult issues?

Exhibit 1 Map of India



Source: Reprinted with permission of TYPE A/Peter Amirault, <http://www.typea.com>.

Exhibit 2 Energy Supply and Demand, 2006–2007 to 2030 (estimated)

	2006–2007	2030
Oil – domestic demand (million barrels/day)	2.9	7.1
Oil – domestic supply (million barrels/day)	0.8	0.5
Natural gas – domestic demand (billion cubic meters)	38	117
Natural gas – domestic supply (billion cubic meters)	28	45
Coal – domestic production (million tons)	283	607
Coal – imports (million tons)	42	220
Electricity – consumption (TWh)	506	1935

Source: International Energy Agency, OECD/IEA, *World Energy Outlook 2008*, 2008.

## Exhibit 3 India's National Accounts and Financial Indicators

	1980	1985	1990	1991	1992	1995	2000	2005	2010	2011	2012	2013 <sup>a</sup>
Nominal GDP (Rs trillion) <sup>b</sup>	1.5	2.9	5.9	6.7	7.7	12.3	21.7	36.9	77.7	89.6	100.1	114.3
Components of GDP (%)												
Private consumption (% of GDP)	76.9	70.1	66.3	67.2	66.1	64.5	64.6	58.6	57.1	59.8	60.4	59.3
Government consumption (% of GDP)	9.3	10.5	11.3	11.2	11.1	10.9	12.6	11.0	11.7	12.3	12.6	12.6
Gross fixed investment (% of GDP)	16.5	18.9	22.7	21.8	22.3	23.7	22.8	30.4	32.5	32.5	31.5	30.4
Stockbuilding (% of GDP)	0.1	2.6	1.0	-0.1	1.2	2.0	0.9	2.8	3.2	2.2	3.8	3.0
Exports of G&S (% of GDP)	5.5	4.7	6.6	8.0	8.4	10.5	12.7	19.3	22.4	25.3	25.3	26.7
Imports of G&S (% of GDP)	8.4	6.9	7.9	8.0	9.1	11.7	13.6	22.2	26.9	32.2	33.6	32.0
Real GDP (Rs trillion, 2004–2005 prices) <sup>b</sup>	8.7	11.1	14.9	15.0	15.8	19.0	25.4	35.4	52.9	56.3	58.1	60.9
Real GDP growth (%) <sup>b</sup>	-	5.2	5.5	1.1	5.5	7.6	4.1	9.2	10.5	6.4	3.3	4.9
Population (millions)	678	755	838	854	869	918	1,004	1,094	1,184	1,202	1,220	1,238
Per capita GDP (US\$) <sup>b</sup>	279	313	390	323	337	399	473	762	1,441	1,555	1,508	1,561
Per capita GDP PPP (US\$) <sup>b</sup>	427	643	908	932	989	1,208	1,588	2,299	3,490	3,730	3,860	4,050
Industry of origin (% of GDP) <sup>c</sup>												
Agriculture	36	33	30	29	29	26	22	18	14	14	14	14
Industry	26	26	28	27	27	28	27	28	28	28	27	26
Services	38	40	43	44	44	46	50	54	57	58	60	60
Gross national savings rate (% of GDP)	16.8	21.4	23.4	22.6	23.5	25.3	23.4	32.0	31.6	30.3	28.8	29.0
Exchange rate (Rs/US\$, end of period)	7.90	12.20	18.10	25.80	26.20	35.20	46.80	45.10	44.80	53.30	54.80	61.90
M2 growth rate (%)	-	16.9	15.1	18.3	16.9	11.0	15.2	15.6	17.8	16.1	11.0	12.3
Consumer price index	10.0	15.6	22.7	25.9	29.0	37.4	53.9	65.5	100.0	109.6	120.3	132.4
CPI (% change)	-	5.5	9.0	13.9	11.8	10.2	4.0	4.2	12.1	9.6	9.7	10.1
Interest rates												
Deposit rate (%) <sup>b</sup>	-	-	-	-	-	-	10.0	6.3	7.7	9.3	9.2	9.0
Lending rate (%)	16.5	16.5	16.5	17.9	18.9	15.5	12.3	10.8	10.2	10.2	10.6	10.3
Foreign-exchange reserves (US\$ billion)	6.9	6.4	1.5	3.6	5.8	17.9	37.9	131.9	275.3	271.3	270.6	276.8

Source: Created by casewriters from Economist Intelligence Unit, Country Data, accessed February 19, 2014.

<sup>a</sup> 2011 data are either estimates or projections.<sup>b</sup> These data are for fiscal years, beginning in April 1 of the year indicated.

**Exhibit 4** India's Balance of Payments (US\$ billion)

	1980	1985	1990	1991	1992	1995	2000-01 <sup>a</sup>	2005-06	2009-10	2010-11	2011-12	2012-13 <sup>b</sup>
<b>Current Account</b>	-1.8	-4.2	-7.0	-4.3	-4.5	-5.6	-2.7	-9.9	-38.2	-48.1	-78.2	-88.2
Trade balance	-5.6	-5.6	-5.2	-3.0	-2.9	-6.7	-12.5	-51.9	-118.2	-127.3	-189.8	-195.7
Goods exports	8.3	9.5	18.3	18.1	20.0	31.2	45.5	105.2	182.4	256.2	309.8	306.6
Goods imports	-13.9	-15.1	-23.4	-21.1	-22.9	-38.0	-57.9	-157.1	-300.6	-383.5	-499.5	-502.2
Net services	0.0	-0.5	-1.5	-1.0	-1.8	-3.5	1.7	23.2	36.0	44.1	64.1	64.9
Services, credit	3.0	3.4	4.6	4.9	4.9	6.8	16.3	57.7	96.0	124.6	142.3	145.7
Services, debit	-3.0	-3.9	-6.1	-5.9	-6.7	-10.3	-14.6	-34.5	-60.0	-80.6	-78.2	-80.8
Net income	0.5	-0.8	-3.3	-4.0	-3.9	-3.7	-5.0	-5.9	-8.0	-18.0	-16.0	-21.5
Income, credit	1.1	0.5	0.4	0.2	0.4	1.5	2.7	6.4	13.0	9.6	10.1	10.3
Income, debit	-0.5	-1.3	-3.7	-4.2	-4.3	-5.2	-7.7	-12.3	-21.1	-27.5	-26.1	-31.7
Net transfers	3.3	2.8	2.8	3.7	4.1	8.4	13.1	24.7	52.0	53.1	63.5	64.0
Transfers, credit	3.3	2.8	2.9	3.7	4.2	8.4	13.3	25.6	54.4	56.3	66.8	68.1
Transfers, debit	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	-0.9	-2.3	-3.1	-3.3	-4.1
<b>Financial Account</b>	0.5	3.3	5.5	3.5	4.1	3.9	8.8	25.5	51.6	63.7	67.8	89.3
Net direct investment	0.0	0.0	0.0	0.1	0.3	2.0	3.3	3.0	18.0	11.8	22.1	19.8
Direct investment inflow				0.1	0.3	2.1	4.0	8.9	33.1	29.0	33.0	27.0
Direct investment outflow				n.a.	n.a.	-0.1	-0.8	-5.9	-15.1	-17.2	-10.9	-7.1
Net portfolio investment				0.0	0.3	1.6	2.6	12.5	32.4	30.3	17.2	26.9
Portfolio investment assets							-0.2	0.0	0.0	-1.2	-0.2	-0.9
Portfolio investment liabilities							2.8	12.5	32.4	31.5	17.4	27.8
Net other investment	0.5	3.3	5.5	3.4	3.5	0.2	3.0	9.9	1.3	21.6	28.5	42.6
Other investment assets	-0.3	0.1	-0.6	-0.8	0.9	-1.2	-4.8	-4.1	0.8	-3.1	0.4	-1.8
Other investment liabilities	0.8	3.2	6.1	4.2	2.6	1.4	7.8	14.0	0.4	24.7	28.1	44.4
<b>Errors and Omissions</b>	-0.4	0.5	-0.4	0.6	1.5	1.0	-0.3	-0.5	0.0	-2.6	-2.4	2.7
<b>Change in Reserves<sup>c</sup></b>	1.7	0.4	1.9	0.2	-1.1	0.7	-5.9	-15.1	-13.4	-13.1	12.8	-3.8

Sources: Data for 1980-1999: International Monetary Fund Yearbook 2008, <http://www.imf.org>, accessed November 2008. Data for 2000-01 through 2012-13: Reserve Bank of India, Table 140, "India's Overall Balance Of Payments, US Dollars (2000-01 Onwards)", <http://rbi.org.in/Scripts/PublicationsView.aspx?id=15261>), created by RBI Sept. 16, 2013; accessed Feb. 19, 2014.

<sup>a</sup> Beginning in 2000-01, data are for fiscal years from April 1 through March 31 (as available from the Reserve Bank of India).

<sup>b</sup> Data for 2012-13 are preliminary actual numbers.

<sup>c</sup> Minus indicates increase.

**Exhibit 5 Growth and Productivity<sup>a</sup>**

	1980	1985	1990	1991	1992	1995	2000	2005	2010	2011	2012	2013
Labor productivity growth (%)	-	3.5	3.7	-1.0	2.9	5.4	2.4	5.7	10.2	4.5	2.5	4.2
Total factor productivity growth (%)	-	1.9	1.6	-2.4	1.6	3.7	0.8	4.1	7.1	2.3	0.3	2.3
Growth of real capital stock (%)	-	6.5	7.8	5.9	6.3	7.1	6.5	10.0	10.4	9.5	8.3	7.4
Growth of real potential output (%)	-	5.6	5.8	1.2	5.4	7.4	4.2	9.4	10.6	6.9	4.4	5.3

Source: Compiled from Economist Intelligence Unit, Country Data, accessed February 20, 2014.

<sup>a</sup> All years are estimates.

**Exhibit 6 Government Budget and Public Debt (as percent of GDP)**

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12 <sup>a</sup>	2012-13 <sup>b</sup>
<b>Central government budgets and debt (% of GDP)</b>									
Current balance	-2.4	-2.5	-1.9	-1.1	-4.5	-5.2	-3.2	-4.3	-3.5
Current receipts:	9.4	9.4	10.1	10.9	9.6	8.8	10.1	8.4	9.3
Tax revenue	6.9	7.3	8.2	8.8	7.9	7	7.3	7	7.7
Non-tax revenue	2.5	2.1	1.9	2.1	1.7	1.8	2.8	1.4	1.6
Current expenditure, of which:	11.9	11.9	12	11.9	14.1	14.1	13.4	12.7	12.8
Interest payments	3.9	3.6	3.5	3.4	3.4	3.3	3	3	3.2
Major subsidies	1.4	1.2	1.2	1.3	2.2	2.1	2.1	1.6	1.8
Defense expenditure	1.4	1.3	1.2	1.1	1.3	1.4	1.2	1.1	1.1
Capital balance	-1.5	-1.5	-1.4	-1.5	-1.5	-1.2	-1.6	-1.5	-1.6
Fiscal balance	-3.9	-4	-3.3	-2.5	-6	-6.5	-4.8	-5.7	-5.1
Public debt	61.6	61.2	59.1	56.9	56.1	54.5	50.5	49.8	50.1
<b>Consolidated (central and state) government (% of GDP)</b>									
Fiscal balance	-7.2	-6.5	-5.4	-4	-8.3	-9.3	-6.9	-8.1	-7.2
Public debt	87.9	88	84.6	80.6	79.7	77.7	72.1	70.4	69.8

Sources: Budget figures and central government debt: Government of India, Ministry of Finance, Economic Survey 2009-10, Chapter 3, "Fiscal Developments and Public Finance," Tables 3.2, 3.6, and 3.12; and Economic Survey 2012-13, Chapter 3: "Fiscal Developments and Public Finance," Table 3.3, 3.9, and 3.10, <http://indiabudget.nic.in>, accessed March 16, 2010, and February 20, 2014. Consolidated government debt: Government of India, Ministry of Finance, Indian Public Finance Statistics 2012-2013, Table 7.2 (A), "Liabilities Position of The Centre and the States."

<sup>a</sup> Preliminary.

<sup>b</sup> Budget estimate.

Exhibit 7 Development Disparities across Major Indian States

	Population (million)	Rural (%)	Females per 1,000 Males	Domestic Product per Capita (rupees)	% of People below the Poverty Line			Literacy Rate (%)		Infant Mortality (per 1,000 live births)	Households with Safe Drinking Water (%)
					2011	2011	2011	2009-10	1983		
<b>India</b>	1,210	69	940	46,492	46	36	27	82	65	55	78
Rural	833		947		47	37	28	79	59		73
Urban	377		926		42	33	26	90	80		90
<b>Major States</b>											
Andhra Pradesh	85	67	992	51,025	29	22	15	76	60	54	80
Assam	31	86	954	27,197	42	41	20	79	67	66	59
Bihar	104	89	916	16,119	64	55	42	73	53	58	87
Chhattisgarh	26	77	991	38,059	50	44	41	81	61	59	71
Gujarat	60	57	918	63,961	33	24	17	87	71	52	84
Haryana	25	65	877	78,781	24	25	14	85	67	55	86
Himachal Pradesh	7	90	974	50,365	17	29	10	91	77	47	89
Jharkhand	33	76	947	30,719	60	55	42	78	56	48	43
Karnataka	61	61	968	50,676	38	33	24	83	68	47	85
Kerala	33	52	1,084	59,179	41	25	15	96	92	13	23
Madhya Pradesh	73	72	930	27,250	50	42	38	81	60	72	68
Maharashtra	112	55	925	74,027	44	37	31	90	75	34	80
Orissa	42	83	978	33,226	66	49	47	82	64	71	64
Punjab	28	63	893	62,153	17	11	8	81	71	43	98
Rajasthan	69	75	926	34,189	39	27	21	81	53	65	68
Tamil Nadu	72	52	995	62,499	55	35	23	87	74	35	86
Uttar Pradesh	200	78	908	23,132	49	42	33	79	59	69	88
Uttarakhand	10	69	963	55,877	25	23	40	88	71	48	87
West Bengal	91	68	947	41,469	57	37	25	83	71	37	89

Sources: Population and literacy data: Census of India, Census provisional population totals 2011, <http://censusindia.gov.in/2011census/censusinfodashboard/downloads.html>, accessed January 7, 2012. Income data: Reserve Bank of India, Table 8 : Per Capita Net State Domestic Product at Factor Cost - State-Wise (current prices). Poverty data: Perspectives on Poverty in India: Stylized Facts from Survey Data, Poverty Reduction and Economic Management Unit, World Bank, Washington, DC. (The official poverty line in 2004-2005 was approximately Rs 12 per day for rural areas, and Rs 18 per day for urban areas.) Infant mortality data: Economic Survey 2009-10, Ministry of Finance, Government of India, Table 9.5, <http://indiabudget.nic.in/es2009-10/chapt2010/tab95.pdf>, accessed March 15, 2010. Drinking water: Casewriters calculations from Census of India 2001 data.

**Exhibit 8** India's Ranking in Transparency International's 2013 Corruption Perceptions Index (CPI)

Country Rank	Country	CPI Score									
1	Denmark	91	47	Hungary	54	91	Sri Lanka	37	127	Mali	28
1	New Zealand	91	49	Costa Rica	53	94	Algeria	36	127	Nicaragua	28
3	Finland	89	49	Rwanda	53	94	Colombia	36	127	Pakistan	28
3	Sweden	89	53	Malaysia	50	94	Djibouti	36	127	Russia	28
5	Norway	86	53	Turkey	50				136	Kenya	27
5	Singapore	86	57	Czech Republic	48				140	Uganda	26
7	Switzerland	85	57	Namibia	48				144	Cameroon	25
8	Netherlands	83	61	Oman	47				144	Iran	25
9	Australia	81	63	Cuba	46				144	Nigeria	25
9	Canada	81	63	Saudi Arabia	46				144	Ukraine	25
11	Luxembourg	80	69	Italy	43	94	Philippines	36	150	Guinea	24
12	Germany	78	69	Romania	43	94	Suriname	36	150	Kyrgyzstan	24
12	Iceland	78	72	Brazil	42	102	Ecuador	35	150	Paraguay	24
14	United Kingdom	76	72	Serbia	42	102	Panama	35	153	Angola	23
18	Japan	74	77	Bulgaria	41	106	Argentina	34	154	Tajikistan	22
19	United States	73	77	Senegal	41	106	Bolivia	34	157	Burundi	21
22	Chile	71	77	Tunisia	41	106	Mexico	34	157	Zimbabwe	21
22	France	71	80	China	40	114	Egypt	32	160	Venezuela	20
28	Estonia	68	80	Greece	40	114	Indonesia	32	163	Chad	19
28	Qatar	68	82	Swaziland	39	116	Albania	31	163	Haiti	19
30	Botswana	64	83	El Salvador	38	123	Belarus	29	167	Yemen	18
36	Israel	61	83	Jamaica	38	123	Guatemala	29	168	Syria	17
36	Taiwan	61	83	Liberia	38	123	Togo	29	168	Uzbekistan	17
40	Spain	59	83	Mongolia	38	127	Azerbaijan	28	171	Iraq	16
41	Cape Verde	58	83	Peru	38	127	Comoros	28	172	Libya	15
41	Dominica	58	83	Zambia	38	127	Gambia	28	175	Afghanistan	8
43	Slovenia	57	91	Malawi	37	127	Lebanon	28	175	North Korea	8
46	Korea (South)	55	91	Morocco	37	127	Madagascar	28	175	Somalia	8

Source: Compiled from Transparency International, Corruption Perceptions Index 2013, [www.transparency.org](http://www.transparency.org), February 2014.

**Exhibit 9** India's Ranking in World Bank's Ease of Doing Business Index, 2014

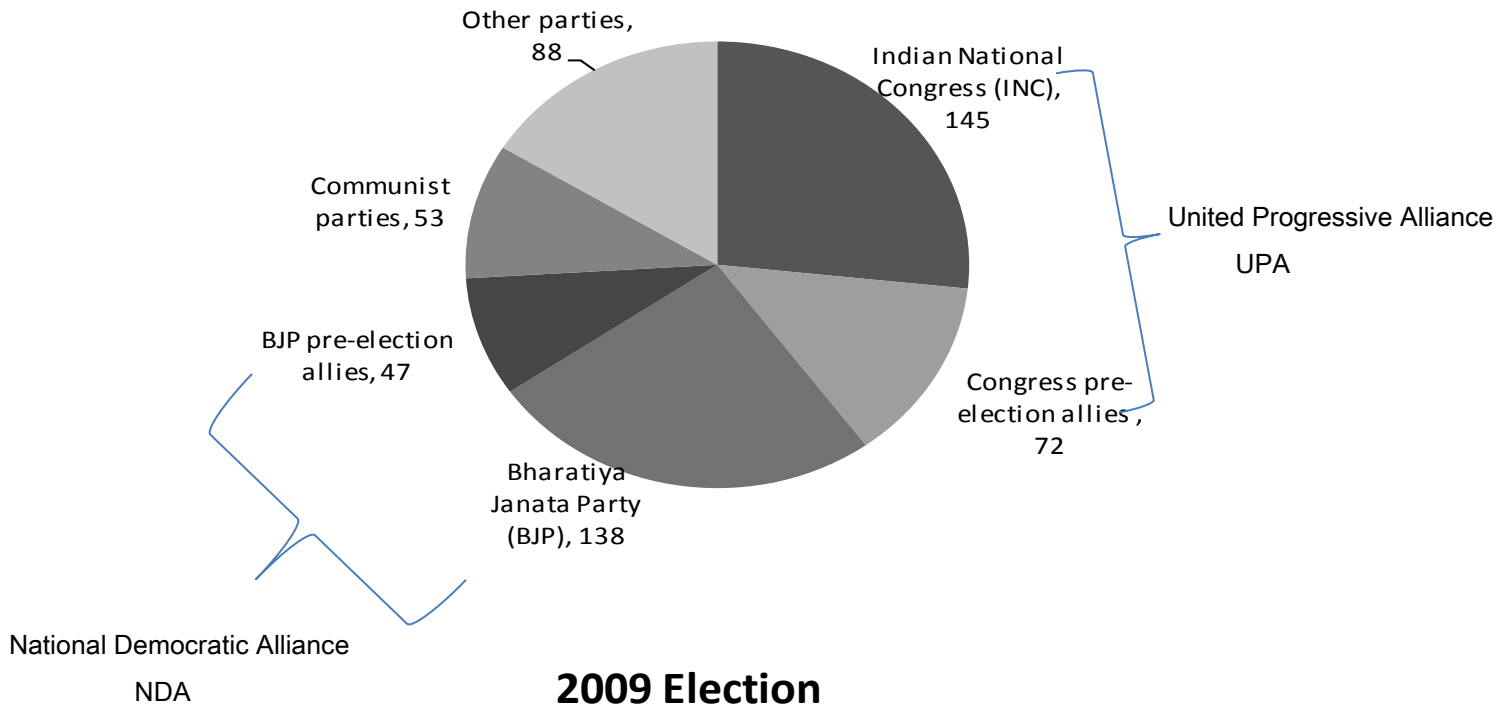
Topic	2014 Rank	2012 Rank	Change
Doing business	134	131	-3
Starting a business	179	177	-2
Dealing with construction permits	182	183	1
Getting electricity	111	110	-1
Registering property	92	91	-1
Getting credit	28	24	-4
Protecting investors	34	32	-2
Paying taxes	158	159	1
Trading across borders	132	129	-3
Enforcing contracts	186	186	No change
Resolving insolvency	121	119	-2

Source: World Bank, "Ease of Doing Business." rankings, [www.doingbusiness.org/data/exploreeconomies/india](http://www.doingbusiness.org/data/exploreeconomies/india), accessed February 20, 2014.

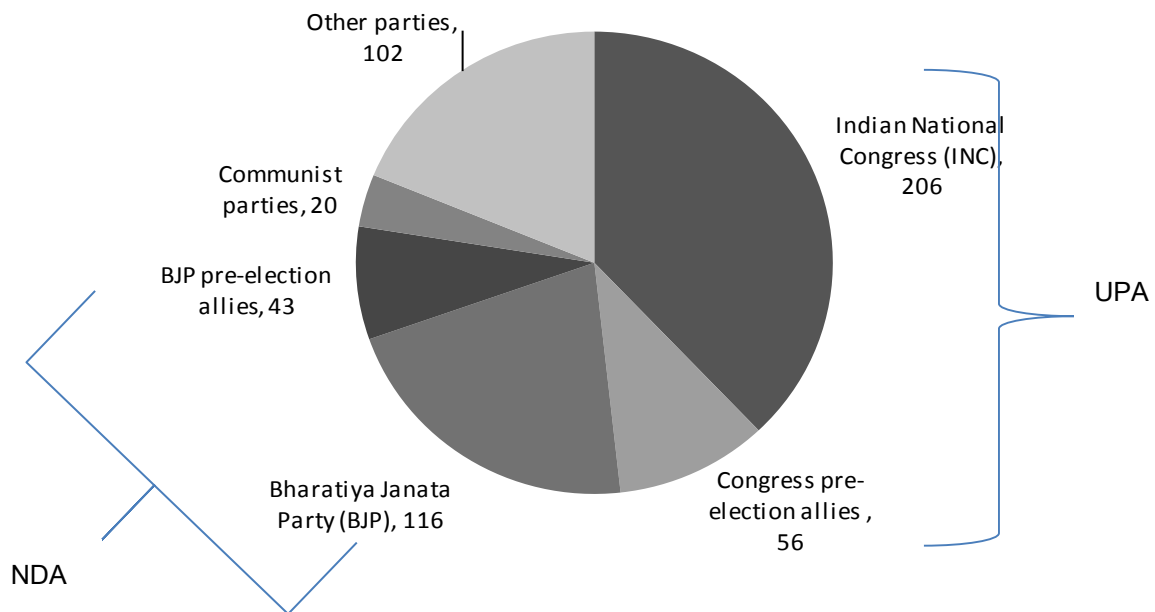
Note: Rankings range from Singapore at 1 (best) to Chad at 189 (worst).

**Exhibit 10** Distribution of Seats in Lower House of Indian Parliament (Lok Sabha), 2004 and 2009

### 2004 Election



### 2009 Election



Source: Created by casewriters using data from Economist Intelligence Unit country reports, June 2004 and June 2009.

**Exhibit 11** Parties in Power in India's Major States, January 2014

State	Chief Minister's Party Affiliation, January 2014	Party Coalition Status in 2009 General Election
Andhra Pradesh	INC	UPA
Assam	INC	UPA
Bihar	Janata Dal (United)	NDA
Chhattisgarh	BJP	NDA
Delhi <sup>1</sup>	Aam Aadmi Party	N.A. <sup>2</sup>
Gujarat	BJP	NDA
Haryana	INC	UPA
Himachal Pradesh	INC	UPA
Jharkhand	Jharkhand Mukti Morcha	UPA
Karnataka	INC	UPA
Kerala	INC	UPA
Madhya Pradesh	BJP	NDA
Maharashtra	INC	UPA
Odisha	Biju Janata Dal	Third Front
Punjab	Shiromani Akali Dal	NDA
Rajasthan	BJP	NDA
Tamil Nadu	AIADMK	Third Front
Uttar Pradesh	Samajwadi Party	Third Front
Uttarakhand	INC	UPA
West Bengal	Trinamool Congress	UPA

1. The AAP formed a government in January, but in February 2014, presidential rule was imposed on Delhi, dissolving the assembly. How long this situation will last was not known at the time the case was written.

2. The Aam Aadmi Party (AAP) was only formed in 2012, so it had no affiliation in the 2009 national election.

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