THE COEXISTENCE OF DEVELOPMENT DYNAMISM AND RENT EXTRACTION: THE CASE OF ANDHRA PRADESH

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based on joint work with Gulzar Natarajan
Centre for Policy Research
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Plan

- Motivation
- Overview
- Politicians and business
- Politicians, voters and rent extraction
- Officials
- Development consequences

This work in progress!
A contrast: for both Andhra Pradesh and India

• Dynamic business and aggregate growth, poverty reduction, (some) human development

v.

• Extensive, systemic corruption
Rapid growth, pre-slowdown

Economic Growth Rates - AP Vs India (3-year average)
Part of India-wide corporate investment boom

Andhra Pradesh
--IT hub – Cyberabad
--pharma
--leader in infrastructure, PPPs

Source: Central Statistical Organisation
Substantial successes in inclusion

Poverty incidence cut by more than half in 16 years

Poverty HCR Estimates (based on Tendulkar methodology)

<table>
<thead>
<tr>
<th></th>
<th>1993-94</th>
<th></th>
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<th>2004-05</th>
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<th>2009-10</th>
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<td></td>
<td>Rural</td>
<td>Urban</td>
<td>Total</td>
<td>Rural</td>
<td>Urban</td>
<td>Total</td>
<td>Rural</td>
<td>Urban</td>
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<tr>
<td>Andhra</td>
<td>48.1</td>
<td>35.2</td>
<td>44.6</td>
<td>32.3</td>
<td>23.4</td>
<td>29.9</td>
<td>22.8</td>
<td>17.7</td>
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<tr>
<td>Pradesh</td>
<td>50.1</td>
<td>31.8</td>
<td>45.3</td>
<td>41.8</td>
<td>25.7</td>
<td>37.2</td>
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<td>20.9</td>
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<tr>
<td>All India</td>
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Source: Planning Commission based on NSS

Many high profile programs
- Leader in SHG movement
- ..in MGNREGA
- Innovations in post-matric scholarship & health insurance

with continuing problems:
- Education quality
- Maoist insurgency
- Perceived unequal gains feeding long-term resentment in Telangana
Dynamism with systemic corruption

Scandals and scams on a scale beyond old “corrupt state” narrative

• Satyam
• Reports of CAG, of state level anti-corruption body, ongoing CBI cases
• Disproportionate asset allegations on CMs
• Jaganmohan Reddy
• etc
Schematic relations between state-business relations and development

Development phase & sector

Mechanisms of interaction

Political settlement

Credible commitments

Incentives for industrial change

Mix of dynamism & innovation v. rent extraction & entrenchment

Source: author.
Mechanisms of resolution

- Credible commitment (for high investment): rent-sharing can *solve* this if there’s mutual interest in persistence
- Alignment or tension with productivity dynamics depends on growth phase
Parallel structure of relation with social groups/electorate

- Credible commitment to “deliver” for electoral success
  - Many mechanisms: patronage; public goods; populist programs

- May be in tension of quality of what is delivered:
  - Incomes, jobs, services, dignity, human capital formation
Andhra Pradesh as a *functional* rent-sharing system

**ACTORS**
- Business families
- Politicians
- Bureaucrats
- Citizens/voters

**FIELDS**
- Construction/PPPs
- Land deals
- Mining licenses
- Liquor licenses
- Private colleges
- Private hospitals

Self-enforcing? Mutual interest in continuance

Self-reinforcing? Endogenous processes leading to consolidation… and entrenchment
Politicians and businessmen

ACTORS

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Politicians
Bureaucrats
Citizens/voters

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Rent extraction and rent-sharing
Black and white money
Populist programmes

Rent creation and development dynamics

Political finance
Rent-sharing through allocation of publicly controlled resources

- Direct construction contracts
- Land & concessions for PPPs
- Mining leases
- Ownership of liquor licenses
Part of AP business dynamics—from local “nurturing” to global reach

• From first generation businessmen to large groups
• Spectacular growth of AP-based construction firms

Public contracts in irrigation and roads

Breakthrough with NHAI and power generation

4 of 5 five large airports on PPP
50% NHAI projects
33% national power capacity addition

Global projects
PPPs

- Majority of allotments for SEZs, power generation, real estate projects, tourism promotion

- Features of allotment
  - No land allotment policy – so discretionary
  - Land transferred at highly concessional rates
  - Managed via Andhra Pradesh Industrial Investment Corporation (APIIC) as channels for transferring land cheaply
  - 88492 Acres allotted in 2006-11 period
  - Private partner slowly marginalizes the government share and virtually takes over the project (CAG)

- In PPP contracts, aggressive bidding + renegotiation a standard pattern
GVK and GMR now

**GVK**
- Mumbai and Bangalore Airports
- Two airports in Indonesia
- 6000 MW of Power Projects
- $10 bn investment in an integrated coal mine, rail, and port project in Queensland, Australia
- Operates 2800 km of National Highway
- Operational Assets - $6 bn (2011)
- Spectacular growth since 2006 – its infrastructure subsidiaries incorporated

**GMR**
- New Delhi and Hyderabad Airports
- Istanbul Airport
- 5900 MW of Power Projects
- Operates 1300 km of National Highways
- 3300 Acre multi-product SEZ in Tamil Nadu
- Operational Assets - $5 bn (2011)
- Spectacular growth since 2007 – its infrastructure subsidiaries incorporated
…with spectacular growth in corporate debt

<table>
<thead>
<tr>
<th>Group Companies</th>
<th>Debt as on (in Rs Crore)</th>
<th>Compound Annual Growth Rate (in %)</th>
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<tbody>
<tr>
<td></td>
<td>2006-07</td>
<td>2011-12</td>
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<tr>
<td>Lanco group</td>
<td>1,700</td>
<td>29,300</td>
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<td>Adani group</td>
<td>4,400</td>
<td>69,500</td>
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<tr>
<td><strong>GVK group</strong></td>
<td>1,700</td>
<td>21,000</td>
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<tr>
<td>Vedanta group</td>
<td>9,500</td>
<td>93,500</td>
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<tr>
<td>GMR group</td>
<td>3,700</td>
<td>32,900</td>
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<tr>
<td>Jaypee group</td>
<td>8,100</td>
<td>45,400</td>
</tr>
<tr>
<td>Videocon</td>
<td>6,300</td>
<td>27,300</td>
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<tr>
<td>Essar</td>
<td>24,600</td>
<td>93,800</td>
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<tr>
<td>Reliance</td>
<td>26,100</td>
<td>86,700</td>
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<tr>
<td>JSW</td>
<td>13,200</td>
<td>40,200</td>
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<tr>
<td>Total debt of 10 groups</td>
<td>99,300</td>
<td>5,39,500</td>
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<tr>
<td>Banking system loans</td>
<td>1,75,700</td>
<td>42,89,700</td>
</tr>
</tbody>
</table>

The table is based on a report by Credit Suisse Group AG. Source: Bhuma Srivastava, Livemint, 21 August 2012.
**Mechanism: the intermingling of politicians and businessmen**

- **Large business leaders prefer Parliament over State Assembly**
  - 14 richest MPs (of the 61 from both houses) own large business groups
  - In all the 14 cases, fortunes made in infrastructure and public works contracts

- **MLAs and local politicians in lower-level business interests**
  - Sub-contracting large infrastructure contracts
  - Liquor shop licenses
  - Colleges and hospitals (see next)

**Average Asset Values of MPs and MLAs**

![Graph showing average asset values of MPs and MLAs across different states](chart.png)
Politicians and citizens/voters

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Political finance
- Rent extraction and rent-sharing
- Black and white money
- Populist programmes

Rent creation and development dynamics
Old and new means

Classic populist

Developmental innovations

New populist

Example: subsidies for farmers

Example: SHG movement

Tertiary health and education scholarships

+ political finance
Welfare programs that combine populism with rent-creation

- Post-matriculation scholarships - for professional courses
  - Rs 5500 crore budgeted for 2013-14
  - Doubling of engineering colleges and seats in 2008-11

- Eligible for BPL holders (~75% of population)

- Public money finances private organisations, often owned or controlled by politicians
The rapid expansion of tertiary education institutions

Number of Engineering Colleges

- Number of Engg Colleges
Post-matric scholarship trends

Number of students (000) vs Scholarship expenditure (Rs 000 Cr)*

- **Number of students (000)**
- **Scholarship expenditure (Rs 000 Cr)**

Data for years 2004-05 to 2011-12.
Welfare programs that support rent extraction and sharing—Aarogyasri

- Cashless tertiary healthcare scheme – Aarogyasri--
  - Similar structure: BPL, includes private hospitals
  - Covers nearly 80 mln people; 938 medical conditions
  - Nearly Rs 2000 crores pa
  - Trebling of specialty care capacity in private sector in 2007-12
• And MGNREGA?
  • Declining corruption over wages, shifting upwards into local rent-extracting and sharing system
Rent-transfer mechanisms—whitening and blackening!

**Whitening**
- Buy shares at inflated premium
  - Example (CAG) – investments made in Jagathy Publications (owned by YSR family) by beneficiaries of land allotments
- Invest in establishing hospitals and colleges owned by MLA/Minister in return for business favors
- Transfers add to politician’s legal asset base

**Black money (especially for political finance)**
- Investments in land – to be unlocked before elections
- Liquor licenses
A rent-transfer illustration

Shell Entity

Businessman

Minister/Politician

Minister’s business

Exit in a year by writing off losses

Capitalize the investment into the asset base

Purchase shares at inflated premiums or invest in land and capital equipment or provide large loans

Facilitate a permit or fiscal concession or resource transfer

Capitalize the investment into the asset base
Bureaucrats: roles and incentives

• Implementation and design of good and bad schemes, ranging....

• …from “developmental”: SHG, social audits

• …to participation in rent-sharing system
  • Collusion in local construction, mining deals
  • Post allocation as reward and punishment
Consequences: from “alignment” with development dynamics (with new forms of inequality) to development-sapping distortions?

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**Relations**
- Rent extraction and rent-sharing
- Black and white money
- Populist programmes
- Rent creation and development dynamics
- Political finance
Development consequences: dynamic period

Alignment
• Business dynamism and populist welfare programmes

With distortions
• Unrealized promises e.g. SEZs
  • More than 90% of these lands unutilized – project work not even started
  • In the 11 SEZ/IT Parks – only 0.26 lakh of the 5.93 lakh jobs created
• Proposals pending for diversion of many of these lands for real estate projects
• Plus new inequalities..
Is the system self-undermining?

Potential economic sources:
- Productivity dynamics
- Corporate solvency
- Fiscal solvency

Plus political entrenchment and new distributional fights
The consequences of economic and political entrenchment?

- Incumbent infrastructure firms increasingly dominant, with entry barriers
  - Growth and borrowing based on high actual and expected returns generated by rent-sharing: now under threat
- Resource misallocation and future sclerosis?
  - Little investment in power: why different from construction?
  - While employment doubled in construction, it declined in manufacturing in 2004-10
  - Entrepeneurial activity pulled into infrastructure and land
  - Slowing entry of new firms?
- Solvency issues of corporate and state sectors endogenous to the system
Summary

• A highly functional *system*
• Distorted but aligned with major dimensions of development during boom years
• Growing entrenchment?
• Increasingly self-undermining?