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When Economic and Political Interests Collide: The Cases of Defense Procurement and Microfinance in India

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When Economic and Political Interests Collide:
The Cases of Defense Procurement
and Microfinance in India

Mackenzie Owens

Introduction

India is a growing democracy with an abundant population that seeks economic development; India is a democracy in an ever more important, strategic location. It is essential to better understand India, its politics, and its policies as geopolitical tensions rise in our world. India will be explored by a political economy approach through three sections in this paper: (1) The Political System of India; (2) India's Trade Policy toward Defense Procurement; (3) The Microfinance Crisis of 2010.

In the Political System of India section, this paper explores the set-up of India's government, its election system, its main political parties, along with the issues facing India. India is a populous diverse country which conducts the world's largest elections. The election process is long and extensive covering the entire country which is geographically vast with many differing terrains. The population is large, and many minorities exist, but the majority of the state's population is Hindu. This section looks to explain the relationship between population and who is elected to political office.

In the section on Trade Policy and Defense Procurement, India's growing domestic manufacturing initiatives are explored in terms of defense manufacturing. Prime Minister Narendra Modi is pushing a domestic manufacturing agenda, named "Make In India," to create self-reliance and jobs in India. This section looks to explain why India has evolved its defense trade policies toward a domestic orientation and protectionism while facing growing and proximate security threats. Key to this domestic orientation is a state centered trade policy pursuant of security interests in terms of domestic defense production.

The final section explores the 2010 Microfinance Crisis in Andhra Pradesh. This crisis of over lending was addressed by the Andhra Pradesh state government. The state government competed with private MFI loans, as they sponsored their own Self Help Group loans to the poor. Thus, the issue became a politicized and clientelism became central to this crisis. Clientelism is one explanation for the crisis of 2010.

India's Political System

Introduction

Despite India being a Hindu majority nation, it is geographically, linguistically, ethnically, and religiously diverse. India was under British imperial rule for almost 200 years until after World War II (Sen 2021). Prior to British colonial rule, India had established trade networks and was rather well off relative to other nations in the 18th century. Historian William Dalrymple noted that “In 1600, when the East India Company was founded, Britain was generating 1.8% of the world's GDP, while India was producing 22.5%. By the peak of the Raj [a period of British imperial rule], those figures had more or less been reversed: India was reduced from the world's leading manufacturing nation to a symbol of famine and deprivation” (Sen 2021). A divided India fell to British imperialism in 1757 during the Battle of Plassey and regained its independence in 1947. Today, India is a democratic state with a parliamentary congressional system. Its constitution, the longest in the world, has been in effect since 1950.

Government Structure & Elections

Federalism exists within India through a two-tier state and national government (Ghosh 2021). Indian federalism has been defined as a “holding together’ federation” as this type of federation occurs in “geographically vast and culturally diverse states” (Ghosh 2020). This holding together federalism gives states greater ability at self-governance and to represent local interests. The national government retains more power relative to that of state governments; central dominance exists within Indian politics.

India's democracy conducts the largest elections on Earth every five years with 879 million eligible voters (Vaishnav & Hinton 2019a). According to the rules set forth, every Indian citizen should have access to voting; Indian law puts a polling place within 2 kilometers of every community. All record of voting is electronic through voting machines as paper ballots are not acceptable. This leads to an extensive election process lasting approximately ten weeks with eleven million election workers. The statistics surrounding past elections are remarkable, for example, in 2014 there were more than eight thousand candidates and more than five billion dollars in campaign spending. The most recent election occurred in 2019. India follows the first past the post, majoritarian election system; the 2019 election left the Bharatiya Janata Party (commonly called BJP) as the majority with Narendra Modi as India's Prime Minister. Modi has been an influential player in Indian politics since 2001 when he was elected as the Gujarat Chief Minister; he was first elected as prime minister in 2014. His political career has progressed from the Gujarat state government to the federal government occupying India's highest government office.

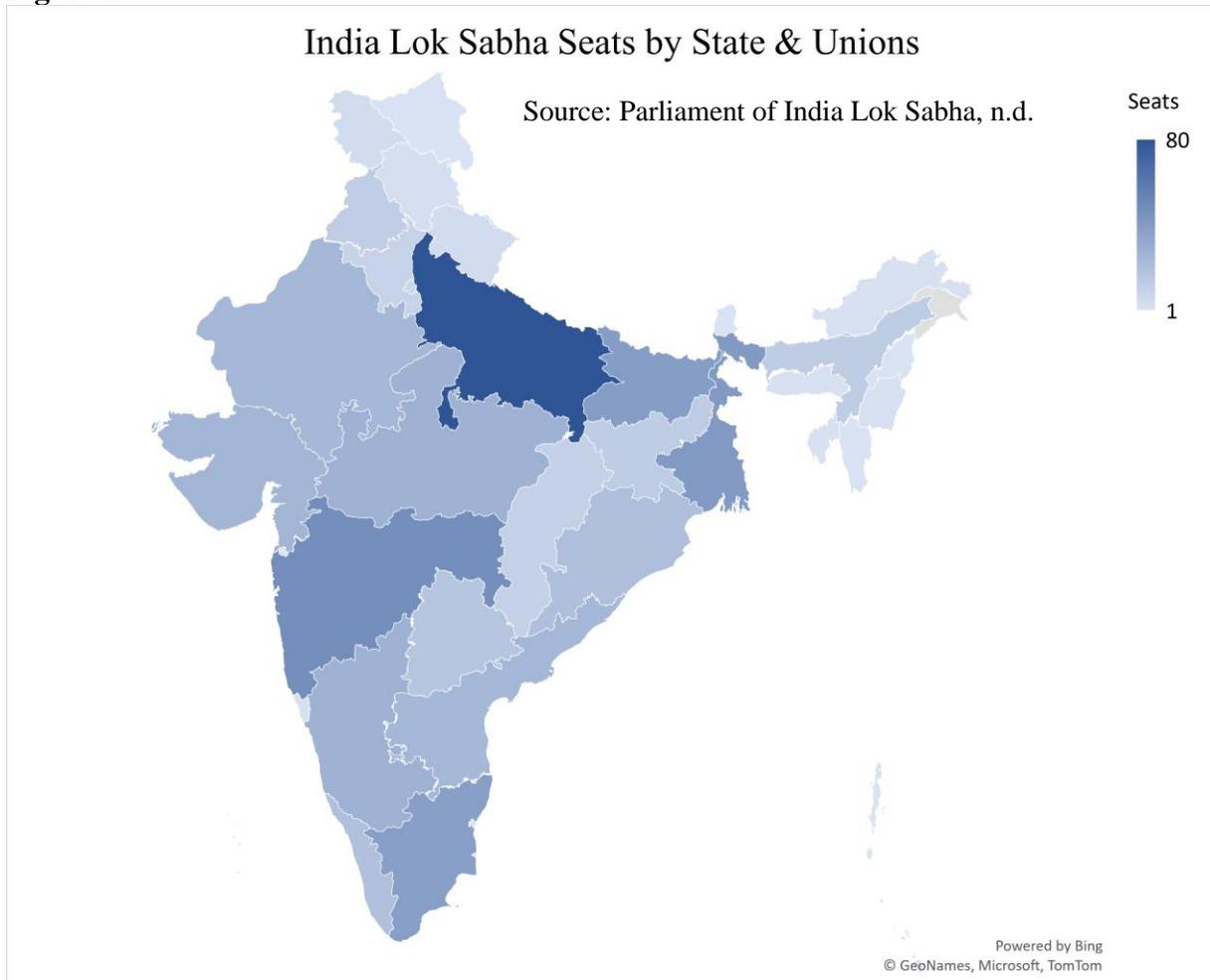
The Prime Minister is elected by the majority party in the Lok Sabha, which is the lower house of the Indian Parliament (Vaishnav & Hinton 2019a). The Indian Parliament is a bicameral body with the Lok Sabha (House of the People) and the Rajya Sabha (Council of States) (Government of India, n.d.). The more powerful of the two is the Lok Sabha, which has 525 seats. The Lok Sabha is the body that holds the government accountable through no-confidence motions, regulates spending and taxation, and has greater legislative power. The Rajya Sabha, the upper house, has 245 seats and is not a dissolvable body (Parliament of India, n.d.). Often the Rajya Sabha makes recommendations on policy formulated in the Lok Sabha, as

it has little power of its own to formulate national policy. The Raj Sabha is required to vote on new laws (Vaishnav & Hinton 2019c). Elections to each house are conducted in different manners. The Lok Sabha is directly elected by the Indian electorate, while the Rajya Sabha is indirectly elected (Parliament of India, n.d.). The upper house is “elected by the elected members of Assemblies of the States and two Union Territories [Delhi and Puducherry]” and an additional twelve members are nominated by the Indian President (Parliament of India, n.d.).

The President of India currently is Ram Nath Kovind (BJP), who was elected through an electoral college vote in 2017 and is the fourteenth individual to hold the title (Galvin 2017). The president holds a largely ceremonial head of state role as the president lacks executive powers (Biswas 2017). The president serves a five-year term, thus the next presidential election in India will occur in 2022. The power does not lie behind the president but the prime minister.

Proportional representation, as dictated in Article 81 of India’s Constitution, calls for states to receive seats in the Lok Sabha proportional to their population, see Figure 1 (Vaishnav & Hinton 2019b). This, however, is not required for the seven unions within India, for example, Delhi is considered a union (Vaishnav & Hinton 2019a). Parliament determines seats allocated to unions and seats allocated to states with populations less than six million people (Vaishnav & Hinton 2019b). Uttar Pradesh, a state with almost 200 million people in the 2011 census, had eighty seats in the 2019 election with 142.9 million eligible voters (Vaishnav & Hinton 2019a).

Figure 1

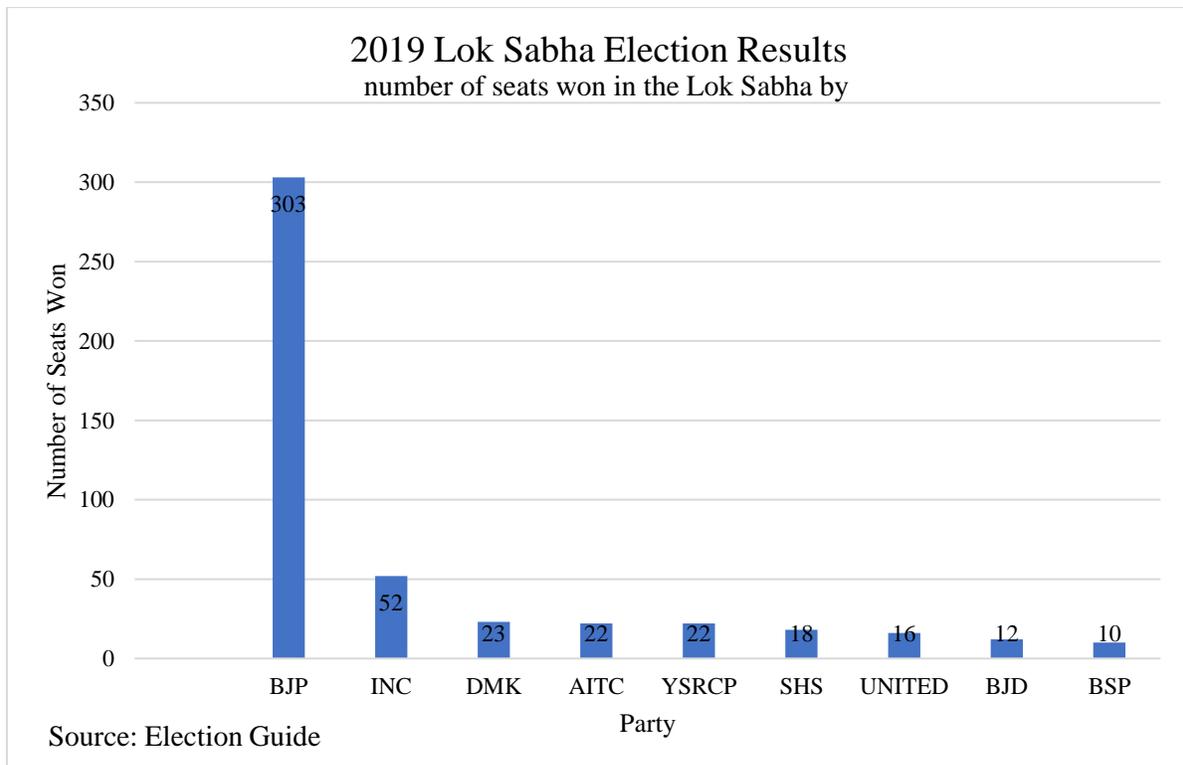


Source: Parliament of India Lok Sabha, n.d. These are the seat allocations by states and unions in the Seventeenth Lok Sabha (elected 2019). The darkest state, Uttar Pradesh, holds the most seats at 80, while less populated states, such as Nagaland hold only 1 seat. The more seats a state or union holds the darker the blue color of that state or union.

Political Parties

Two major national parties exist within India: the BJP and the Indian National Congress (INC). Many parties, however, are local and divided by caste; caste has influences the identity politics in India today (Finnegan 2019). Following India’s first elections in 1952, the INC became the majority and reigned for many years in India’s parliament under leaders such as Jawaharlal Nehru and Indira Gandhi (Dikshit et al., 2021). In recent years, India has seen the rise of the populist, Hindu nationalist BJP, see Figure 2. Currently, parliament has two main alliances: the BJP-led National Democratic Alliance and the INC-led United Progressive Alliance (Election Guide, n.d.). The National Democratic Alliance remains dominant as the United Progressive Alliance is fleeting.

Figure 2



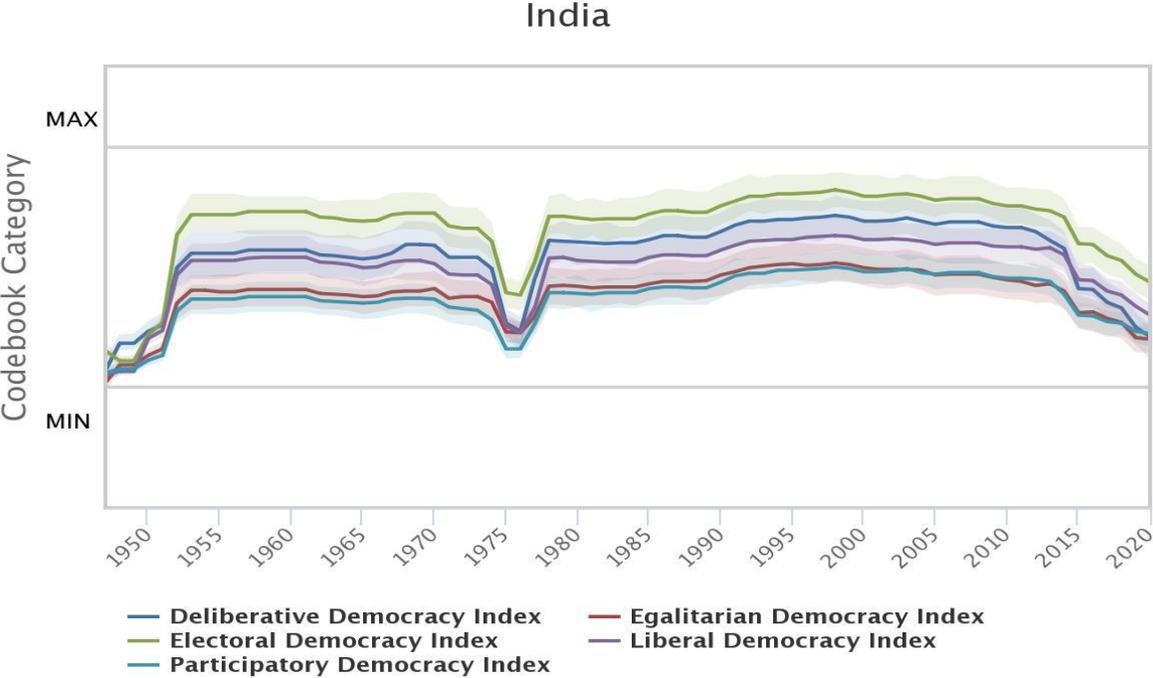
Source: Election Guide, n.d. These are the election results from the Lok Sabha in the 2019 elections. The BJP won a large majority with 303 seats; in comparison, the other national party, the INC, won only 52 seats.

The BJP rode a populist wave in the past two elections with policies that have embedded prejudices in the Indian government and policy, especially against minorities. There has been a history of mistreatment of minorities in India; the most acknowledged of these minorities is the

Muslim minority. Human Rights Watch has been monitoring India under the BJP and recognizes that “the ruling Hindu nationalist Bharatiya Janata Party (BJP) [has] infiltrated independent institutions, such as the police and the courts, empower[ed] nationalist groups to threaten, harass, and attack religious minorities with impunity” (Human Rights Watch 2019). The BJP has offered patronage for those who commit heinous acts of discrimination. Another minority that has been targeted is the Sikhs, a minority with prior separatist agendas. In November of 2020, hundreds of thousands of farmers protested the new economic BJP policy regarding the agriculture industry. The BJP and the media blamed the protests on the Sikhs. The BJP has not only promoted and protected those who target minorities but have cracked down on those who oppose the government and BJP rule.

Turning Point: Issues facing the Government

Figure 3



Highcharts.com | V-Dem data version 11.0

Source: V-Dem: Coppedge, et al.; Narendra Modi became prime minister in 2014. Since 2014 there has been democratic backsliding when measuring for democracy, reaching levels similar to those during Indira Gandhi’s 1975-1977 declared State of Emergency.

A major issue challenging India’s political system is growing wealth inequality between states within India (Vaishnav & Hinton 2019b). The top three richest states in India have approximately three times the wealth of the poorest states. Another issue is the change in demographics in certain regions which now call for the reapportionment of seats in the bicameral body of Indian parliament, yet this has not yet occurred, causing misrepresentation for states at the national level. Additionally, India has faced democratic backsliding in recent years under the populist, Modi-led government, see Figure 3. The two main dips occur around 1975 and the present day. The 1975 dip was due to a State of Emergency proclaimed by Indira Gandhi which restricted people’s civil and political rights, freedom of the press, and led to political prisoners of

the state. This period has come to be known as, “one of the darkest episodes in the nation’s 70-year history” (Chaudhuri 2018). Today, Modi’s government has worked to restrain the rights of non-Hindu minorities and the constitutional autonomy of territories, specifically Jammu and Kashmir (Ganguly 2019).

The 2019 win of the BJP marked the first time that a party has won back-to-back election majorities since the INC majority, which lasted for many decades after independence (Pong & Shrikanth 2019). This win has been recognized as a “turning point in India’s 72-year history as a democracy” (Pong & Shrikanth 2019). India is a democracy that is backsliding under the rule of the BJP. This popular Hindu nationalist government is changing the trajectory of Indian democracy.

India's Trade Policy toward Defense Procurement

Introduction

Prime Minister Narendra Modi has modified India's trade policies creating greater protectionist measures to foster internal development that have affected defense trade. As a large importer of defense systems and weapons, India's barriers to trade would seem contradictory to its interests. As hostility in the Indo-Pacific increases, US-India cooperation has become a key strategy to balance the rise of China. India looks to the US for defense cooperation (India and China have ongoing border disputes; India has hostile relations with its neighbor Pakistan who is an ally of China) and growth assistance to in future match China's economy. Despite these security concerns, India has pursued defense partnerships with multiple partners, including the United States and its adversary, Russia. In the process, India has pursued an arms deal with Russia which pressures the US to enforce sanctions. This paper looks to explain why India has evolved its defense trade policies toward a domestic orientation and protectionism while facing growing and proximate security threats.

Background

Historically, India has been protectionist of domestic industry. Following independence from its British colonizers, India engaged in little trade and foreign investment (Aiyar 2018). It pursued an import substitution industrialization policy – which replaces imports through domestic production (Panagriya 2020). The Indian government believed this strategy would allow India the protection it needed to become a world power; it failed. Unlike the other Asian economies who experienced catch up growth through the 1980's, India saw 3.5 percent growth per year for thirty years (Aiyar 2018: 3). India's percentage of global trade fell from 2.2 percent in 1950 to .45 percent in 1985. Protectionist policies have failed the Indian state before, which eventually led to an intervention by the International Monetary Fund (IMF) in 1991. IMF intervention required India to open its economy and abandon protectionism including fostering state-owned enterprises (SOEs); by the early 2000s, India was seeing 8 percent per year growth rates until the Great Recession. When Modi came to power in 2014, he promised growth and liberalization. Modi has been a critic of the domestically oriented, anti-globalization “America First” policies put into effect by the Trump Administration, yet the inward trade policies of Modi would seem to reflect these same anti-globalization sentiments.

With a goal to attract investment, India has implemented an “India First” policy which discourages foreign production and imports in designated sectors. ‘Make in India’ is a governmental program sponsored by Modi “to facilitate investment, foster innovation, enhance skill development, protect intellectual property and build best in class manufacturing infrastructure in the country” (Ministry of Commerce & Industry, n.d.). The program affects twenty-five sectors within India, of note for this analysis are aviation, defense manufacturing electrical machinery, and electronic systems. These sectors in India commonly import goods from the US (and Russia). For example, Lockheed Martin is looking to secure a contract with India for its air force. However, with the ‘Make in India’ requirements in place Lockheed Martin would be required to export its technology and produce a percentage of its products within India (intellectual property protection now becomes relevant to the issue of defense trade). India is an important destination for US weapons exports and is increasingly more important for US

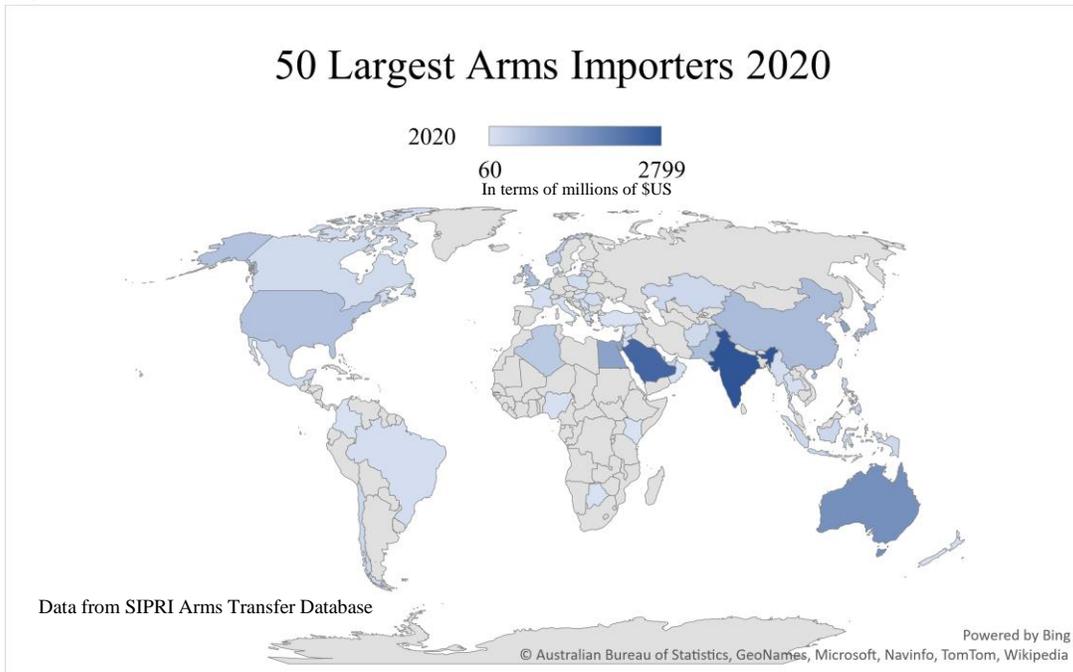
interests in the Indo-Pacific; however, Making in India may stifle cooperation with certain American corporations.

The geostrategic importance of India in the US' pursuit of continued freedom of navigation of the seas has risen in response to Chinese hostility in the Pacific waters. In 2001, the Bush administration opened defense trade between India and the US by lifting prior sanctions believing "it was in the United States' interest to facilitate the rise of a strong India" (Abercrombie 2018). Fifteen years later in 2016, the Obama Administration declared India a Major Defense Partner for the United States and accordingly has been recognized as having an "elevated status in U.S. export considerations" (Abercrombie 2018). This defense trade partnership is coupled with a larger security partnership the US is cultivating with India, for example, the US and India are experiencing increased involvement through military exercises, such as the Tiger Triumph and the Quadrilateral Security Dialogue (US, India, Japan, and Australia) (Bureau of Political-Military Affairs 2021; Smith 2021). By 2018, the US elevated India even further to "Strategic Trade Authorization tier 1 status" which "allows India to receive license-free access to a wide range of military and dual-use technologies regulated by the Department of Commerce" (Bureau of Political-Military Affairs 2021). Despite these important status designations, defense trade with India remains strained due to Prime Minister Narendra Modi's Defense Procurement Procedure (DPP), which sets the rules and regulations for contracting India's defense weapons, the 'Make in India' initiative, and India's defense trade engagement with Russia (Abercrombie 2018; McLeary 2021). Trade policy under Modi has taken a strong turn for protectionism despite India's geostrategic interests.

India Defense Imports & Policy

Today, India is one of the largest defense importers in the world, see Figure 4 (Aiyar 2018; International Trade Administration 2019; SIPRI 2020). However, for much of India's history it had been producing its own defense systems through state owned enterprises (SOEs), yet SOEs have been low performing and have often seen little growth (International Trade Administration 2019; Kim & Panchanatham 2019). In 2001, the country began to allow a privatized defense sector (Intl. Trade Admin. 2019). Despite both having both privatization and SOEs, India's defense industry lacked innovation due to underfunded research and development. This has resulted in India relying on imports in the 21st century; however, this reliance on imports is changing. While the production technology needs to be imported, as India has lacked R&D, India wants defense trade to be manufactured domestically.

Figure 4



Source: SIPRI Arms Database 2020. Largest arms importers in the world in terms of millions of US dollars in imports. India and Saudi Arabia receive the most arms imports. In 2019, SIPRI ranks India as the number one arms importer; in 2020 SIPRI ranked Saudi Arabia as number one.

In 2002, India published its first Defense Procurement Procedure, which was updated in 2016 under Modi’s guidance. The revised DPP came into effect in 2016 which “prioritized the promotion of locally designed, developed and manufactured defense equipment and encouraged increased participation by Indian companies, particularly small and medium enterprises” (International Trade Administration 2019). The 2016 DPP also, “increased the offset threshold for mandatory local content to 20 billion Indian rupees (approximately \$300 million) for defense industry companies contracting with the Indian government” (US Trade Rep. 2020: 249). With the introduction of Modi’s ‘Make in India’ in 2014, privatization increased thanks to outside influence from international institutions (such as the World Bank) (International Trade Administration 2019). With both policies in place, a Strategic Partnership Model (SPM) was developed for cooperation between the Indian government and foreign corporations and/or governments who engage in defense trade. The SPM requires that foreign corporations and/or governments be selected by India’s Ministry of Defense and that production of defense systems happens domestically (within India). It looks to partner domestic defense corporations in India with the foreign vendors (Behera 2021). American firms remain skeptical of SPM as it pushes for the transfer of technology because India has weak intellectual property (IP) rights enforcement (US Trade Rep. 2020). The US placed India on the Priority Watch List (part of in USTR’s Special 301 report); this report measures IP protection and enforcement around the world (Office of the US Trade Rep. 2021). India is one of nine nations which are trading partners with the US on the Watch List which does not properly enforce IP protections. This requires US firms to engage in India’s markets with caution.

In 2020, India introduced the Defense Acquisition Procedure (DAP) to “[ease] the procurement and acquisition of upgraded technology, products and services for the Tri-Services

and other allied [defense] services” (“Make in India,” n.d.). This initiative looks to gage FDI, boost domestic defense manufacturing, and eventually reach self-sufficiency in defense manufacturing. The DAP 2020 created a new procurement category for defense systems: “Buy Global- Manufacture in India”, which encourages foreign companies to move production to India (Behera 2021: 5). In the 2020 DAP domestic defense production targets were raised for all procurement categories. In four of the five categories, 50 percent of defense systems are now required to be produced within India. This is a 10 percent increase from the 2016 DPP. In addition to these barriers, the initiative for self-reliance in India called “Atmanirbhar Bharat Abhiyan” (Self Reliant India) has a negative import list; this list bans certain imports and is to be enforced through the 2020 DAP. The negative import list’s 101 items will be banned and “implemented in a staggered manner up to December 2025” (Behera 2021: 8). The goal of such policy is to create greater manufacturing in India, provide assurance to the manufacturer, encourage investment from manufacturers, and plan for the future. The US Trade Representative (2020) has called these policies “discriminatory” and “at the expense of foreign companies” (249). The implementation of barriers is meant to act as a development strategy for the domestic defense manufacturing sector. Import substitution industrialization is the policy India is pursuing again, bringing back a policy which left India in need of IMF intervention (Panagariya 2020).

Modi is focusing on a state centered trade policy pursuant of security interests in terms of domestic defense production. The election of the BJP majority led to a 12 percent boost to defense spending; this was promised on the campaign trail as Modi “promised to assert India’s military prowess and meet the security challenge posed by a rising China and long-running tensions with Pakistan” (Wilkes 2014). Domestic defense has been an industry known for notable delays and prior leaders have been criticized for becoming too reliant on the state-owned defense industry. Encouraging foreign direct investment into defense manufacturing in India has become key. Companies in India see their opportunity to expand and invest in defense manufacturing; returns on investment look to be very large as the government looks to prioritize Indian made defense systems over those imported. Modi has said, “My government has taken important steps in improving indigenous defense technology ... We can guarantee peace if our military is modernized” (Wilkes 2014). Peace and domestic defense manufacturing work hand in hand as Modi looks to improve India’s military and its ability to defeat threats from its neighbors.

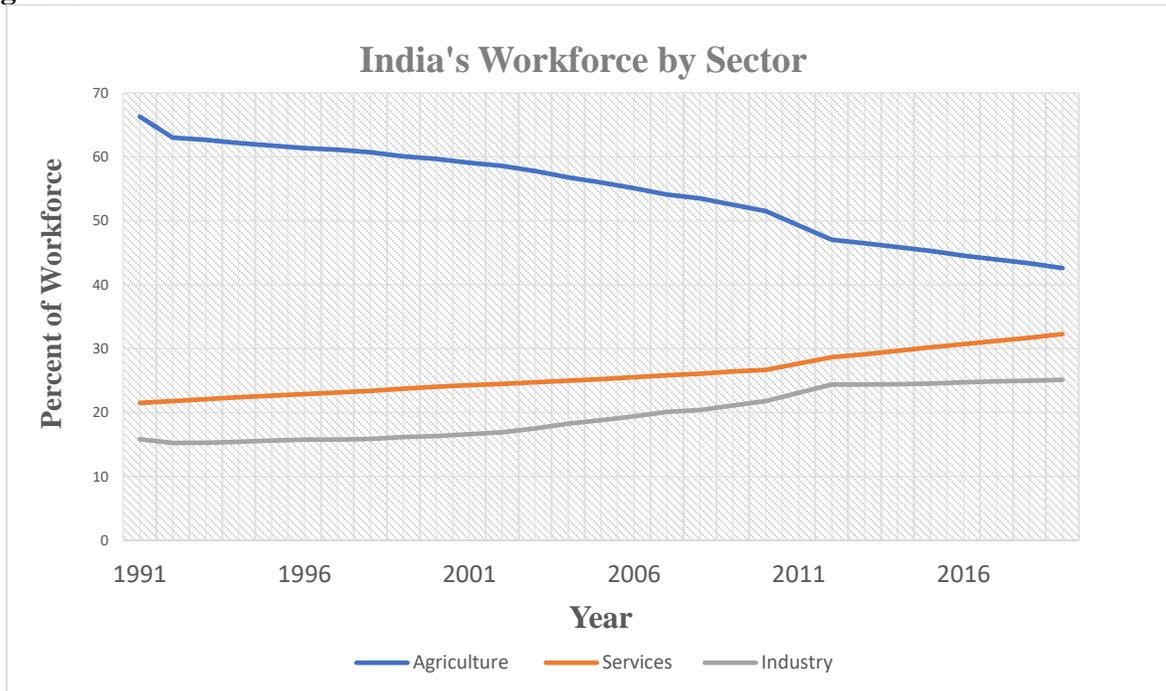
Who Shapes Defense Acquisition?

The BJP is a right-wing party whose economic identity does not align with acknowledged conservative economic policy (Aiyar 2018). While most conservative leaning parties are pro-big business and privatization and anti-union, Modi’s BJP is pro-small business, anti-multinational corporations, and believes in the welfare state (Aiyar 2018). These policies reflect beliefs of the voters of the BJP. Small business owners have long been supporters of the BJP and in return, the BJP looks to protect those voters from outside competition. The largest trade union in India, Bharatiya Mazdoor Sang, is run by the BJP, as a result protective labor laws have not been liberalized under the BJP. This has led to some to recognize Modi as a selective liberalizer who is “willing to reverse gears when it seemed likely to pay political dividends” (Aiyar 2018, 6).

The sectors of the labor force, shown in Figure 5, affect India’s trade policy. With such a large percentage of the population in agriculture and industry, protectionism is a trade policy

concern. Despite protecting some sectors, the Modi government recently introduced laws removing trade barriers for agricultural products. This led to a strong negative response by farmers. The longest running farmers protests swept through India in 2020 lasting until 2021. The laws, as the protestors argue, will reduce the profit farmers make from selling their crops. The industry is protected, and these new laws chipped away at protection for the agriculture industry. The farmers were quick to organize; they account for almost half the population yet only 15 percent of total GDP. They are arguably India’s largest “lobby.” Lobbying, however, is viewed by most Indian citizens as corrupt behavior (Desai 2015). It is regarded as bribery and is not commonly practiced in comparison to lobbying in the US. There is no lobbying regulation in India and the “ambiguity surrounding lobbying in India is further exacerbated by the country’s endemic corruption” (Desai 2015). While not recognized private enterprises within India can exert influence over politicians who decide on policy and the future of SOEs (Khanna 2012). With unregulated lobbying and large parts of the population being proponents of protectionism, Modi’s protectionist policies would not seem as surprising (despite prior failure during India’s post-colonial time).

Figure 5



Source: The World Bank 2019. This breakdown of India’s labor force from 1991 through 2019. The agriculture sector has been on the decline, and accordingly serviced and industry (manufacturing) has been growing.

India’s Newest Defense Trade Deals

Bilateral relationships may be sustained via the new trade requirements with foreign direct investment in India’s defense sector. Two nations central to India’s defense imports are the United States and Russia. The US has been cultivating security cooperation with India and has lessened barriers to defense trade. Modi has engaged the US far more than previous administrations with a focus on bilateral security cooperation against the People’s Republic of

China (PRC) (Hicks, et al. 2016). This is the reason for Modi's pursuit of security interests, as a developing nation, however, he has also placed a focus on a state centered trade policy in terms of domestic defense production. Yet, India still engages with those who violate US interests, but also those who would seem to be in contradiction to India's own interests. India seems to defy growing cooperation and engagement with the US and turn to a historic adversary for the US.

While Russia is a historic adversary for the US; it has been a constant ally to India throughout its history. Russia is India's largest arms supplier, yet the US and Israel have increasingly been supplying India's military needs with attack helicopters, drones, and other surveillance equipment (Miglani & Soldatkin 2021). Russia has been cooperative with India's 'Make in India' agenda, and an arms deal between the two follow the required production within India quota. According to Miglani & Soldatkin (2021) of Reuters, "India has made Russian MiG fighter planes and Su-30 jets under license and the two countries have collaborated to develop and produce supersonic BrahMos cruise missiles in India." Domestic production is a part of the weapons deals between Russia and India and is an integral part to Modi's economic development strategy codified in 'Make in India' and the DAP.

In 2018, India and Russia signed an arms trade deal worth \$5 billion (US) (McLeary 2021; Miglani & Soldatkin 2021). This trade deal, expected to be fulfilled in December 2021, will secure India five Russian S-400 air defense systems. These same defense systems were transferred to China and Turkey from Russia; both nations face official sanctions from the US government over its purchase through the Countering America's Adversaries Through Sanctions Act (CAATSA). Senate Foreign Relations Chair Sen. Bob Menendez (D-N.J.) warned "if India chooses to go forward with its purchase of the S-400, that act will clearly constitute a significant, and sanctionable, transaction with the Russian defense sector ... it will also limit India's ability to work with the U.S. on development and procurement of sensitive military technology" (McLeary 2021). Despite threats of sanctions on India, Modi has pressed for the weapon system acquisition deal to go through, and Modi has further cooperated with the Kremlin and secured a 2023 trade deal to receive Russian frigates and a 2025 deal to lease a Russian nuclear submarine (McLeary 2021). Condemnation from the US has done little so far to affect the defense trade transactions.

With a growing number of issues between India and China, whether over border disputes or economic growth competition, why does India cooperate with Russia as Russia sends its weapons to China? India is receiving the same weapons technology from Russia that it previously bestowed upon the Chinese government. Considering the Quadrilateral Security Dialogue and other agreements between India and the US (and Japan and Australia), how is cooperation with a nation helping Chinese military development in the interest of India (especially considering land disputes)? Despite the ideological similarities between Xi Jinping and Putin, India presents no query to cooperation with Russia, even with growing US efforts for cooperation. This is an important question that needs further explanation but falls outside the scope of this essay.

The Future

US companies while skeptical of intellectual property protection cannot lose business with India's markets, especially as it is one the largest purchasers of defense equipment. With a defense budget comprising 13.73 percent of total government expenditure, India is the world's third largest defense spending nation (Bhalla 2021; Peter G. Peterson Foundation 2021). US

firms are looking to partner with Indian firms in order to compete within the rules of the DPP and DAP (Intl. Trade Admin. 2019). As US firms look to establish these partnerships, as well as supply chains, India has been working to formally address IP protection within its nation. While efforts may not be satisfactory as of now (i.e., India was placed on the 2020 Watch List), the nation seems committed to overcoming IP barriers. In 2016, India focused on “creating IP awareness and capacity building with enforcement officials” and in 2018, it agreed to the World Intellectual Property Organization (WIPO) Internet Treaties (Cabeca 2020). In 2019, India further worked to ratify many other treaties established through WIPO. As with any nation, risk is involved when IP is involved; firms must take proper steps to insure IP protection.

Conclusion

Prime Minister Narendra Modi has modified India’s trade policies creating greater protectionist measures to foster internal development that have affected defense trade. As a large importer of defense systems and weapons, India’s barriers to trade would seem contradictory to its interests. However, India is pursuing import substitution industrialization for development, despite it being a policy which once failed the nation. Today this pursuit is coupled with the ‘Make in India’ initiative and the Defense Procurement Procedure. Modi hopes to make India self-reliant, especially in relation to the defense sector. Self-reliance and development are the focus of Modi’s trade policies. India has pursued these policies knowing the growing threats from its neighbors; Modi’s policy is a state centered trade policy pursuant of security interests in terms of domestic defense production.

Microfinance in India

“Nothing can stop an idea whose time has gone. And micro-finance is in a danger zone. It is a discredited model. It has raised more questions that it has answered. To think that we are going to alleviate poverty is a tall claim. Microfinance has promised more than it has delivered, created more problems than actually solved and continues to promise much more than what it actually puts on the ground.”

(Jairam Ramesh, Indian Rural Development Minister, 2012)

The Andhra Pradesh 2010 MFI Crisis

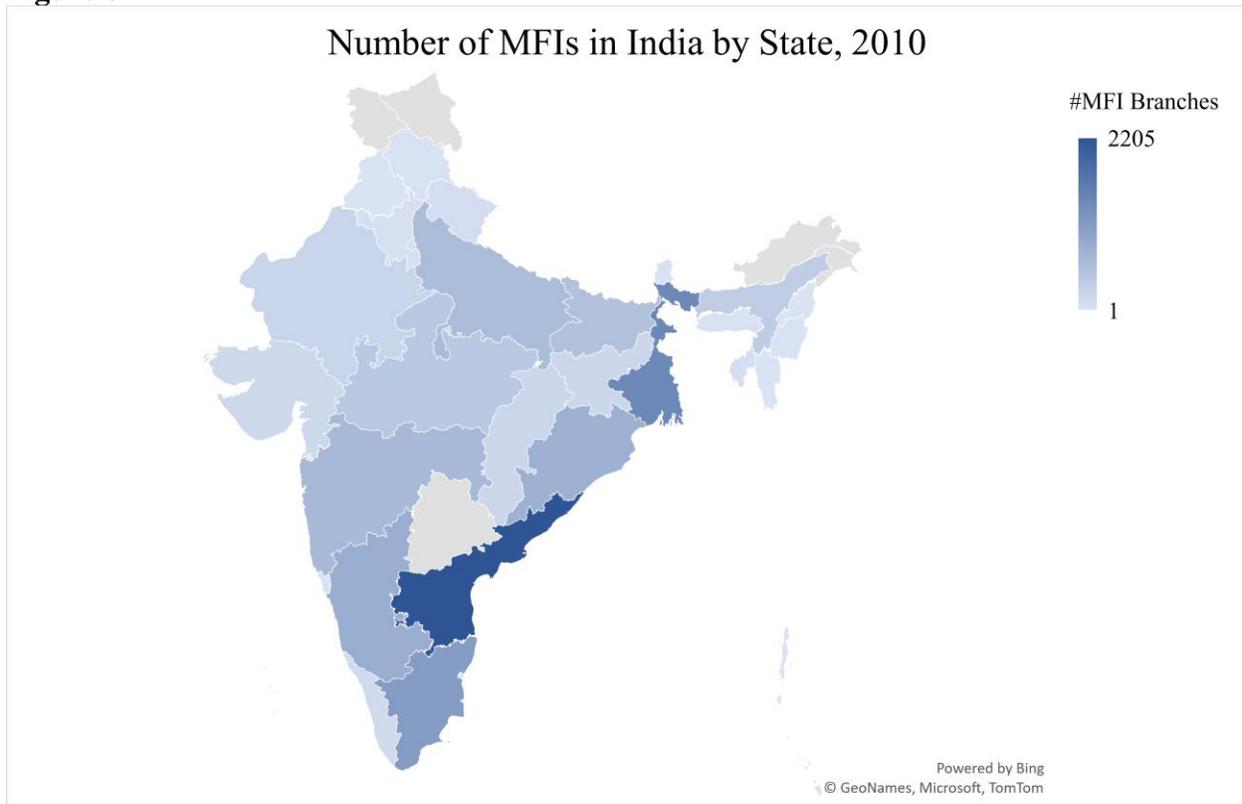
In 2010 over 80 farmers committed suicide in India in a matter of months from the state of Andhra Pradesh (Biswas 2010). Yet this would not normally make headlines as farmer suicide in 2010, as today, is unfortunately common; in 2019 approximately 28 farmers committed suicide a day (Sengupta 2020). Despite farmer suicide in India being common, these deaths reverberated throughout the country and nearly ruined one of the largest, booming industries in India: Microfinance Institutions (MFIs) (The Economist 2010). Farmers heavily indebted from microfinance loans began committing suicide when they did not have the funds to repay. In October of 2010 microfinance faced its greatest crisis since its inception in the state of Andhra Pradesh (Mader 2013). In response, the government of Andhra Pradesh intervened which leads one to ask: how does an institution established with the intention to allow the poor to have access to credit and that has helped many escape poverty, turn into the target of the state and require intervention?

MFIs and microfinance are meant to alleviate poverty through access to credit with lower interest rates in small batches which allow the poor, especially women, to be entrepreneurial in an affordable manner (Banerjee & Duflo 2011). MFIs are different from moneylenders in that they give smaller loans, require regular repayment (often weekly), and offer lower interest rates (20% to 40%, whereas moneylenders charge from 24% to 120%) (Banerjee & Duflo 2011; Gokhale 2009). The poor face much higher interest rates than those in the developed world due to risk and to a lack of access to formal financial institutions. Repayment rates on MFI loans are high, nearing 100 percent, due to the coercive nature of MFI loans which rely on societal pressure and shame to force repayment (Gokhale 2009; Banerjee & Duflo 2011). Many MFI loans are group loans which require all members to repay for more loans in future to be disbursed; this pressures and shames citizens to repay loans when they lack the funds (Gokhale 2009). The proliferation of moneylenders in microfinance hubs is one side effect of this coercion (Mader 2013). Government officials blamed the coercive and shaming nature of MFI loans for the more than 80 suicides by farmers.

Toward the end of the first decade of the 21st Century, MFIs in India were growing fast, the fastest in the world (Mader 2013). These MFIs had large returns to their foreign investors (27.5% in 2008 and 25% in 2009), and investors perceived microfinance loans as risk averse with their high repayment rates. The growth and profits led to a breeding ground in Andhra Pradesh for highly indebted citizens. In Andhra Pradesh, “84% of households had two or more loans” and over 10 million households held MFI loans (Mader 2013; Biswas 2010). These statistics translated into Andhra Pradesh holding 30 percent of MFI loan portfolios in 2009 in

India despite being home to only 7 percent of India's population, see Figure 1 (Mader 2013). Households in Andhra Pradesh were spending more than 60 percent of their income on loan repayment (Biswas 2010). Warning signs emerged that households in Andhra Pradesh were in more debt than they were capable of repaying, but it was overlooked as returns on investment were high (Mader 2013).

Figure 6



Source: Champatiray et al., 2010. MFIs were very prevalent in India in 2010. The darkest shaded region, which holds the most MFIs at 2,205 MFIs in the state, is Andhra Pradesh. All non-shaded, grey areas had no data regarding number of MFIs.

In response to the stress farmers were under to repay MFI loans, the government of Andhra Pradesh has worked to rein in MFI and its coercive lending practices. However, opponents of regulating microfinance do not agree that MFIs are to be blamed for farmer suicide but that other underlying issues are to blame since it is not novel. Another lens on the issue involves recognizing the underlying competition between different poverty reduction programs within Andhra Pradesh.

Why Andhra Pradesh?

Andhra Pradesh (AP) has experienced a longer history with microfinance than other states within India. In the 1970's AP became involved in such social banking with loans looking to raise the poor out of poverty through land and capital accumulation through the Integrated Rural Development Programme (Taylor 2011). Dating back to the 1980's, the state government

partnered with the National Bank of Agriculture and Rural Development to form the Self-Help Group Bank Linkage Programme (SHG-Bank Linkage), which is a microfinance institution dominated by the state and offered even lower rates than MFIs (Rai 2010). The SHGs were formed of mainly women looking for access to credit and were used to build credit. The SHG-Bank Linkage fostered an environment for other non-profit microfinance institutions within AP, which has been termed the Mecca of Microfinance, see Figure 1 (Rai 2010; Taylor 2011). This initiative was assisted by World Bank loans “under conditions of trade liberalization and state retrenchment” (Rai 2010; Taylor 2011, 484). In the 1990’s and early 2000’s the state of AP was liberalizing its markets, allowing room for the many MFIs to come (Taylor 2011).

With market liberalization came transitions within the microfinance industry in Andhra Pradesh. In the 1980’s many MFIs were non-profit NGOs; however, in the 1990’s MFIs became mainly for profit and dropped their NGO status for that of non-banking financial companies (NBFC) (Taylor 2011). This allowed the MFIs to garner outside investment creating competition between MFIs and financial incentives for those with a large borrowing base. Borrowers began getting credit from not only the state led initiative but from MFIs, many with MFI loans overlapping (Rai 2010). Households in AP had Rs. 65,000 in debt, while India’s national average was Rs. 7,000 (CGAP 2010). MFI loans were being paid back faster and at the expense of the state led loan program which aimed to reduce MFI and moneylender loans (Rai 2010; CGAP 2010). Rai (2010) argues the crisis in Andhra Pradesh is the result of a “the fallout from a long-standing competition between MFIs and the state government, each of which believes it should be the source of financial services to the poor.” Recognizing the question of competition between a state poverty reduction enterprise and the private MFI enterprises is essential when evaluating government response and reaction to common farmer suicide.

States Responses at Different Levels of Government

There were three major responses to the MFI crisis: (1) an ordinance from the state government, (2) the Reserve Bank of India looked to regulate the NBFCs, and (3) the Lok Sabha looked to pass regulations on MFIs. This paper focuses on the state response, but the implications of the crisis were national in scope, so much so that the national assembly (Lok Sabha) and the central bank (Reserve Bank of India) were involved.

MFIs and the state government of AP found themselves in conflict over the origins of the crisis. MFIs argue the suicides cannot be connected to their loans and that evidence is lacking (CGAP 2010). Also, MFIs recognize the coercive nature of their loans and that some debt repayment regulators went too far in recouping loan payments, but they argue microfinance is still a useful tool in poverty reduction. The government in Andhra Pradesh disagreed. This 2010 incident is not the first time the government and MFIs have come to a head. In 2006 the government reined in MFIs following a crisis in Krishna shutting down four MFIs operating in AP. Since 2006, MFIs and SHG have taken two different approaches to poverty reduction through loans; the Consultative Group to Assist the Poor (subsidiary of the World Bank) noted MFIs and SHG’s have a “rivalry... that has been simmering” since 2006. (CGAP 2010, 4). In 2010, the state government responded most unfavorably to MFIs with an ordinance that placed more conditions on MFIs, including “district-by-district registration, requirements to make collections near local government premises, a shift to monthly repayment schedules, and other measures that affect how MFIs operate” (CGAP 2010, 4). The government also urged heavily indebted borrowers to stop repayment on MFI loans; this left MFIs unable to refinance

loans for the poor. Calling for non-repayment was politicized into a populist message by state politicians. If governments call for non-repayment of MFI loans, could that undermine SHG loan repayment as well? Undermining repayment institutions can have ramifications on lenders other than MFIs.

Clientelism as One Explanation for the State's Crackdown on MFIs

Calling for non-repayment not only lost MFIs money, but MFI loan defaulters are disqualified from future MFI loans, leaving the citizens to rely on SHG loans (Saxena 2014). Elizabeth Rhyne of the Center for Financial Inclusion notes, “the government capitalized on the increasing dissatisfaction with MFIs to suppress private competition with the government’s self-help group (SHG) programs” (Yerramilli 2012, 191). This competition between government program and private MFIs further interrupted the political environment in Andhra Pradesh because development assistance has been associated with political power. Specifically, it has been associated with politicians’ ability to gain votes via clientelism through development programs (Yerramilli 2012). With private MFIs interfering with clientelism in AP via SHG, politicians saw an opportunity to politicize suicide and, in turn, ruin their competition (Yerramilli 2012). By offering development loans, MFIs were interfering with the lending base of the SHG loans. Thus, state politicians looked to undermine MFIs and their loans to regain or expand their reliant base. During the crackdown the AP government placed substantial regulations on MFIs making it difficult for MFIs to operate. MFIs pursued their interests through the court system. In the state court system, the case sat, and the judge, in the meantime, allowed the ordinance to remain in effect while the case was working its way through the AP courts (Sriram 2012).

Clientelism is driven by benefits and reliance; when competition exists, the state cannot monopolize loans and create the benefits and reliance needed for clientelism (Yerramilli 2012; Anderson, et al. 2015). Politicians drive clientele politics that reward their voters. Some have noted it is an interesting case that India is a democracy with so many poor, yet the poor’s interests are not represented and advocated for by its elected politicians. Anderson, et al. (2015) notes that “these democratically elected governments have been extremely rare champions of the interests of the poor, who are the vast majority of their constituents” (1780). The social and economic hierarchies (Caste System) that still permeate through Indian society can be an explanation for the lacking representation of the poor. While democratic policies may be enacted and the poor majority elect officials to represent them, the elites can leverage the caste system to their advantage. The poor are from the lower castes while the elites come from the top of the caste system. While the caste system may not be enforced via law today, its impact on the social hierarchy remains.

The caste system can affect who holds power and whose interests are represented. Clientelism can be borne of the social hierarchy. This inequality in representation is further explored by many scholars. Mukherji and Zarhani (2020) recognize that, “India is a clientelistic democracy where political parties purchase votes in return for particularistic privileges rather than seeking to benefit the citizenry at large” (8). This indicates clientelism is not a localized issue but a national issue. Clientelism is associated with the slow growth of India and the inability of the state to properly represent and provide for its population. Historically, AP has been home to patronage politics of the Congress Party, there have been protests against this system, but they “were absorbed into the ongoing system, showing the historic capacity of patronage politics to accommodate new claimants” (Elliott 2016, 23). Clientelism offers benefits

in exchange of votes/patronage; the system seems to capture those against and offers them reward. Clientelism can often be difficult to identify (Anderson, et al. 2015), but in the case of the AP 2010 Microfinance Crisis, it seems quite apparent.

Clientelism allows politicians to retain supporters and garner votes. Farmers, as shown in prior section on trade policy, make up a large portion of the Indian population. In Andhra Pradesh farmers are prevalent composing approximately 55 percent of the population in 2013-2014 (Government of India 2014, 23). Responding to crises affecting farmers is essential for any politician. For example, at the national level (see mention in Trade Policy section) there were farmers protests for months due to new laws changing the price setting system for crops from state regulated to market prices. This meant farmers would lose agriculture profitability as market prices are set below state regulated prices. In the process of protesting 670 farmers died and have been recognized as martyrs for the cause. Additionally, 60 percent of Indians rely on agricultural income. On November 19, 2021, the Modi government announced it will repeal the laws that caused the outrage of farmers (The Economist 2021). This goes to show the influence the farmers have on national policy (recall that farmers number have been falling in recent years, yet still hold much influence), and this same influence also transfers to state government policy. The Andhra Pradesh government had to respond to farmer suicides stemming from associations with MFI loans because farmers make up their “selectorate.”

Political priorities and motives were intertwined with the government response to the microfinance crisis in Andhra Pradesh. Clientelism and maintaining political power came to the forefront of the state’s response. With such politicization, the MFI industry has suffered, not only in terms of profitability, but in terms of reputation as a formidable source for poverty alleviation and economic growth.

Was There Really a Microfinance Crisis?

Andhra Pradesh saw a microfinance crisis in 2010: MFIs overlent. This crisis tainted the reputation of MFIs, and it is an incident that has been politicized by a government who wants citizens relying on state loans via SHG rather than private MFI loans. Clientelism seems to be at the heart of this crisis. The quote at the beginning of this section on microfinance states: “Microfinance has promised more than it has delivered, created more problems than actually solved and continues to promise much more than what it actually puts on the ground.” MFIs overlent and had horrific consequences. Yet, the AP government and its goals of clientelism are not blameless in this crisis. The goal of MFIs is to relieve poverty. The goal of SHG is to relieve poverty. Each system of poverty reduction appears to have found its limits, MFIs through the quest for profit and SHGs through the quest for power.

Conclusion

If anything, this paper has shown India is a developing country which faces the institutional and economic issues many developing countries face. It looks to develop its domestic industries, grow investment, while defending its interests and sovereignty. India is a diverse democracy that has become domestically focused with institutions that have been used historically not to address the needs of the poor majority of the nation but the elite politicians. As India is now experiencing democratic backsliding, there is much change the country must undergo to move toward a fully developed democracy.

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