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**Violence, Rents and Investment:
Explaining Growth Divergence in South Asia**

Adnan Naseemullah

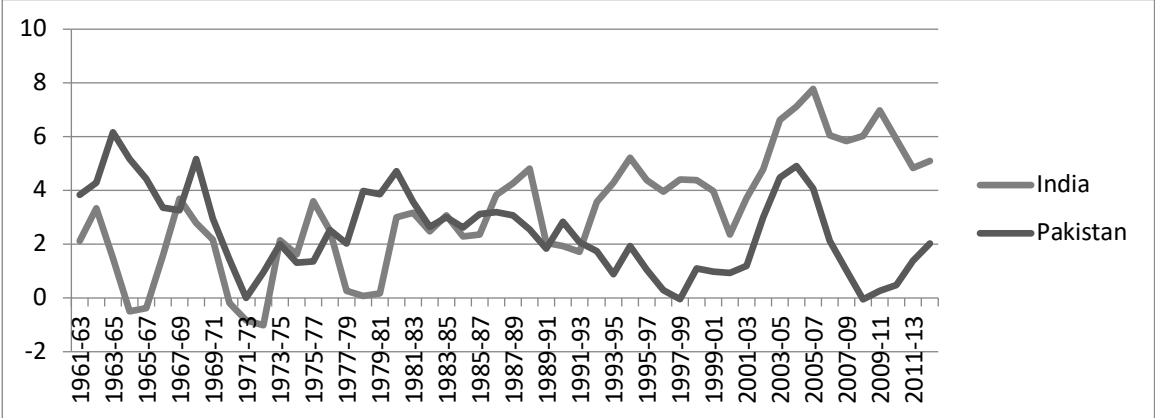
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Abstract: Why have growth rates have dramatically diverged between India and Pakistan since the 1990s? This article argues that differences in perceptions of instability among the Indian and Pakistani bourgeoisie, through the salience of political violence, has led to significant differences in economic growth since the 1990s. In Pakistan, kidnapping and terrorist violence in major cities has led to the domination of rent-implicated investment as a form of managing risk, thus limiting growth. In India, by contrast, political violence – in the form of remote urgencies or the targeting of minorities – remains socially distant to the perspectives of investors, leading to a balance between rent-implicated and more productive investment, and thus higher overall growth. The article thus provides a new set of explanations for differences in growth among middle income countries by highlighting political instability and the salience of violence, the demand for rent-implicated investments and the limits of institutional explanations for growth outcomes.

Why have economic growth rates in India and Pakistan diverged markedly since the early 1990s? India has been generally accepted as a rising economic power, with aggregate growth rates approaching double digits, while Pakistan generally perceived as an economic basket-case, with stagnating growth. Between 1991 and 2016, India’s per capita GDP growth rate averaged 4.9 percent, whereas Pakistan’s averaged 1.8 percent. Yet, this divergence is a relatively recent phenomenon. From 1965 until 1990, the average per capita growth rates of the two countries were 1.7 and 3 percent respectively, with several reversals that suggest the absence of a systematic relationship (figure 1).

Figure 1: GDP per Capita Growth Rates, three year rolling averages, 1961-2014



Source: World Development Indicators

The timing of this economic divergence renders implausible many of the most obvious explanations for economic success and failure among developing countries. Factors like geography and ethnic makeup are invariant over time. Others, such as the strength of institutions or the relationship between the state and the economy, represent little significant difference between the two countries.

This article, by contrast, argues that political *instability* – specifically expressed by the nature of political violence – has dragged down Pakistan’s economic prospects relative to India’s over the last quarter-century. India is not free of conflict by any measure, but its particular forms

of political violence – insurgencies in rural hinterlands and peripheries, and riots that target minorities in urban slums or the countryside – have been less salient for the Indian bourgeoisie. By contrast, in Pakistan, insurgent conflict and terrorist campaigns in major cities has led to a sense of instability among the wealthy and middle class.

Perceptions of such instability are transmitted to growth outcomes through investment decisions. Pakistanis holding capital, faced with such perceptions, have largely chosen to invest their resources in rent-implicated activities with a greater certainty of yielding short-term returns, but at the cost of fixed capital investment and long-term growth. The Indian economy is hardly free from such *rentier* activities, but a greater sense of stability has enabled investors to balance rentier with more entrepreneurial investments, and thus enabled higher levels of growth.

The article contributes three key insights to the political conditions behind economic growth in developing countries. First, while it is generally understood that violence and instability has negative impacts on growth, these factors have been underemphasized outside cases of civil war. In failed states, economies have contracted dramatically as production has halted, mobile assets and skilled workers flee violence, and predation without consequence becomes widespread. But many middle-income countries, from Mexico to Turkey to Sri Lanka, have maintained functioning states and productive economies despite serious and sustained internal violence. We currently have an insufficient understanding of the causal mechanisms that link political instability and violence to growth outcomes outside extreme cases.

Second, the pervasiveness of rents in a national economy may be a function of investment decisions informed by the broader political context. While scholars have often found durable links between high levels of rentier activity and low levels of long-term development, these dynamics are not often explored outside rentier states. Rents are, however, a feature of

many economies, but the reasons for any individual to choose rent-implicated investments are obscure. This article presents a perspective on the relationship between rents and growth that is informed by the demand, and not just the supply, of rents. It suggests that felt instability might drive investors to concentrate on rent-implicated investments.

Third, this analysis strikes a note of caution regarding popular neo-institutional explanations for cross-national variation in growth. Comparative analysis of Pakistan and India suggests that, despite many differences, the two share many of the same core micro-institutional frameworks as concrete legacies of the British *raj*, and the relatively recent divergence in growth suggests that such sedimented and slow-moving features as legal and administrative institutions cannot account for a recent divergence. It suggests more broadly that neo-institutionalist theories are more capable of explaining extreme cases of national wealth and poverty than understanding variation among a common universe of developing countries with similar institutional frameworks.

This article proceeds as follows. First, it presents a comparative overview of the nature of growth trajectories in India and Pakistan, and provides some evidence against the most obvious explanations for divergence and its timing. Second, it presents differences in the perceived nature of political instability for elite and middle-class Indians and Pakistanis, through an examination of the differing nature of political violence in the two countries. Third, it presents some evidence that the greater salience of instability among Pakistani investors has led to lower long-term growth through a stronger preference for rent-implicated investments over those in India. The article concludes with some broader discussion of how we might understand growth variation in developing countries.

Explanations for Growth in India and Pakistan

The nature of economic development in India and Pakistan are politically important for their respective populations, and as such, they underline much of their national politics. The processes and mechanisms that drive growth, and their outcomes, have thus received significant scholarly attention in South Asian political economy, though rarely comparatively. The next section presents an overview of development trajectories in India and Pakistan, and then motivates the puzzle of the post-1991 divergence of economic growth by assessing the extent to which popular theories can explain the timing of this divergence.

Trajectories of Development in India and Pakistan¹

For all the differences in terms of initial conditions at Partition in 1947, India and Pakistan followed remarkably parallel trajectories of state-led development. India, under the premiership of Jawaharlal Nehru, constructed a framework that linked interventionist trade and industrial policy in the service of rapid economic development; its policies included the establishment of state-owned enterprises, the provision of subsidized capital to private industry, and a system of licenses, permits and controls.² In Pakistan, industrial development was understood as a national priority to reserve resources for security in the context of “systemic vulnerability.”³ The Pakistani government from the early 1950s established industrial assets to transfer to merchants and bankers who had migrated to Karachi at Partition to create an industrial bourgeoisie with close relations to the state.⁴

As a result, both the Indian and Pakistani economies were oriented toward state-directed industrial development, and both experienced significant industrial growth in the early to mid-1960s. During this period, Pakistan stood out as an exemplar of post-colonial development under bureaucratic authoritarianism.⁵ Pakistan had particular advantages over India, including

irrigation-enabled agriculture, production of high quality cotton, and crucially, the coercive capacity to extract agrarian surplus from East Pakistani cultivators to provide resources for industrial investment in West Pakistan.⁶ In India, by contrast, powerful agrarian conservatives politically challenged efforts in surplus extraction by the development planning apparatus, limiting the resources available for intersectoral transfer.⁷

In the late 1960s and early 1970s, both countries faced a series of crises. Economic sanctions levied on both after the 1965 Indo-Pakistani War, combined with two years of drought, led to economic slowdown and rising political discontent. In Pakistan in the late 1960s, popular opposition to the authoritarian regime by the Bengali nationalist movement, as well as peasants and workers in West Pakistan, led to the resignation of President Ayub Khan. Bengali nationalist assertion and demands for autonomy around the 1970 elections led to brutal and deadly military repression, leading to armed conflict, Indian intervention and the independence of Bangladesh in 1971. In India, conflicts over economic policy led to a cracking of the nationalist consensus through splits in the Congress party and the formation of non-Congress governments in the key states of Uttar Pradesh, Tamil Nadu and West Bengal.

In the 1970s, oil shocks and turbulence in the world economy replaced the relative stability of the previous decade. This instability, through inflation, inspired feelings of economic discontent and political exclusion, which were harnessed by the populist politics of Indira Gandhi and Zulfikar Ali Bhutto. Both sought to bypass extant political structures by appealing directly to the masses, through such slogans as Gandhi's *gharibi hatao* (eliminate poverty) and Bhutto's *roti, kuppri aur makan* (bread, clothing and shelter).⁸ Both implemented similar policies, including the parallel nationalization of banks and key industrial enterprises. And both faced serious political opposition as a consequence. In India, mass mobilizations against the

government combined with an unfavorable High Court ruling led to Gandhi's declaration of a "state of emergency" and authoritarian rule between 1975 and 1977, followed by a non-Congress coalition government once elections were held. In Pakistan, mass organized opposition to Bhutto and allegations of fraud in the 1977 elections led to General Zia ul Haq's coup and Bhutto's subsequent execution.

In the 1980s, the Zia regime and Congress governments struggled with a more fragmented interest group landscape but also increasingly ceded control of economic governance to a new generation of more market-oriented technocrats, such as Mahbub ul Haq in Pakistan and Manmohan Singh in India. During the decade, both governments took steps to reverse previous nationalizations and otherwise deregulate the economy. In the aftermath of a third spike in oil prices from the 1990 Gulf War, both countries faced a crisis in the balance of payments, and governments under Narasimha Rao and Benazir Bhutto, under the pressure of similar IMF adjustment programs, began a comprehensive program of liberalization of the economy, involving the devaluation and then floating of the currency, the dismantling of trade protection and membership of the World Trade Organization, the rolling back of industrial licensing, the marketization of credit and an overall retrenchment in the size of the state. In this way, throughout the 1990s, the relationship between the state and the economy fundamentally shifted away from statism, though not necessarily towards governance by market institutions.

The point of this historical overview is not to comprehensively assess Indian and Pakistani development from independence through liberalization, but to present remarkable parallels over the course of their developmental trajectories. Policies and institutions repeatedly reflected one another. During the period of high statism, development programs were formulated and governed by Planning Commissions in New Delhi and Karachi then Islamabad, and industry

was financed through long-term, subsidized loans from the Pakistan Industrial Credit and Investment Corporation (PICIC) and the Industrial Credit and Investment Corporation of India (ICICI).

Pakistani and Indian macroeconomic reform also took parallel forms, driven by similar challenges, the common perspectives of pro-market technocratic reformers and by the parallel demands of structural adjustment programs. Both countries have subsequently liberalized to similar degrees, with similar outcomes: average government consumption as a proportion of GDP in India and Pakistan is quite similar: 10.8 and 11.5, respectively between 1990 and 2014. In the Heritage Foundation's 2015 Index of Economic Freedom, Pakistan and India maintain similar, though middling, positions: the former has an economic freedom score of 54.6 and a rank of 121 and the latter a score of 55.6 and a rank of 128.

Alternative Explanations

If their developmental trajectories are so similar, are there other compelling explanations for recent growth divergence between the two countries? As previously mentioned, the particular *timing* of this divergence complicates the search for an explanation. In the 1970s, even after the independence of Bangladesh, the average per capita growth rates in India and Pakistan were 0.6 and 1.8, respectively; in the 1980s, they were 3.3 and 3.4. For 13 years out of these two decades, Pakistan grew faster than India, with several reversals that do not signal a gradual emergence of divergence. It is only since the early 1990s that we see significant and sustained differences, at no point during which Pakistan's growth outpaced India's. Differences in growth today thus cannot be attributed to Pakistan's initial economic successes before 1971.

Geography, demography and ethnic diversity also cannot explain divergence. India has roughly double the population density as Pakistan, but this has remained roughly unchanged

since independence. Similarly, the ratio of land area to coastline – 425 in India, 761 in Pakistan – has remained constant since 1971. India is more diverse than Pakistan: ethnolinguistic factionalization is 0.89 for India; ELF dropped in Pakistan from 0.65 to 0.54 with the independence of Bangladesh.⁹ Religious factionalization is dramatically different, with India scoring 0.54 and Pakistan scoring 0.04. But these figures have not changed significantly between the 1970s and today.

Domestic policies addressing inequality may be at play; Tudor has argued that the differences in the class-coalitional base of rival nationalist movements led to more successful land reform in India and the continued domination of landlordism in Pakistan.¹⁰ But the actual practice of land reform in India was underwhelming; outside Kerala and West Bengal, reforms succeeded only in redistributing land from absentee landlords to dominant proprietary agricultural communities.¹¹ Moreover, land reform legislation was enacted in India in the 1950s and 1960s, thus unlikely to have much impact on growth divergence three decades later. Such policies of the Indian state have not yielded much concrete difference in inequality relative to Pakistan; Gini coefficients in India and Pakistan have not been dramatically different either before or after liberalization: 0.32 and 0.33 in 1987 and 0.34 and 0.30 in 2010 respectively.

Different forms of international economic engagement might also explain differences: Pakistan's economy was more open than India's during the period of statist development, and benefitted from both labor remittances and bilateral aid, principally from the United States. While it is true that remittances in Pakistan were substantially higher than India's in the 1980s, Pakistan has maintained higher levels of remittances than India: 4.1 to 2.8 percent of GDP on average between 1991 and 2016. US aid to Pakistan has been tied to international security and thus spiked in the 1960s, the 1980s and the 2000s, but the first two periods were associated with

Pakistan's higher growth relative to India, whereas during the latter, Pakistan's growth improved – in the context of a worldwide boom – but did not overtake India. Further, Pakistan has also consistently received more bilateral aid than India both before and after liberalization: 1 to 0.3 percent as a proportion of GDP, on average, between 1991 and 2016.

They also have common forms of trade engagement: India and Pakistan have equal volatility in the terms of trade as well as equal trade scores in the World Bank's country profile and institutional assessment (CPIA). Average trade-weighted tariffs are higher in Pakistan, at 9.2 to India's 6.2 percent in 2013, but this has not made a substantial difference, given that from the 1960s until 2007, Pakistan had a higher proportion of merchandise trade as a proportion of GDP. And while India has been more successful at attracting foreign direct investment (FDI) than Pakistan, both countries had comparably negligible levels of FDI at 1990, suggesting that this could be a consequence of differences in growth rather than a cause. South Asia's limited regional trade is certainly a barrier to further trade, investment and development, but one that should negatively affect India as well as Pakistan.

Regime type is seen as a key difference between the two, with India as a consolidated democracy and Pakistan a hybrid regime that has been under authoritarian rule for roughly half of the years since independence. But periods of authoritarian rule were associated with successful growth relative to India in the 1960s and 1980s, but not in the 2000s. Further, the 1990s represented a shift in Pakistan's regime characteristics, during which multiparty electoral competition became institutionalized and the constitution, suspended or replaced regularly before 1988, has remained in place; in 2010, it was stripped of its more authoritarian elements, including the power of the president to dismiss parliament. Between 1999 and 2008, the authoritarian regime of Pervez Musharraf reversed Pakistan's democratic progress. Since the fall

of this regime, two elected governments have ruled Pakistan, with the country's first peaceful, democratic transition occurring in 2013. These tentative steps towards greater democratic consolidation have coincided with sharp divergences in growth between India and Pakistan.

Further, the theoretical mechanisms that link democracy to higher levels of growth are not evident in these two cases. The persistent legacies of authoritarianism in Pakistan in the military's 'reserved domains' of control over foreign, defense and internal security policy are not associated with fears of asset seizure, the abrogation of property rights or the non-enforcement of contracts by autocrats.¹² Second, Gerring et al. argue that democracies invest in higher human capital.¹³ Yet in 1990, Pakistan and India were 36th and 37th respectively in the UNDP's Human Development Index (HDI) rankings, with scores of 0.423 and 0.439, suggesting quite similar human capital investment. Third, the legacies of military authoritarianism might suggest high levels of military spending that might crowd out investment, but in Pakistan, military expenditure as a proportion of GDP has *decreased* from 7.2 in 1991 to 3.6 in 2016, even as growth has stagnated.

Finally, differences in the strength and quality of institutions are unlikely to explain these differences, because Pakistan and India share much the same local institutional structures and practices for the protection of property rights and the enforcement of contracts on the ground, as persistent legacies of British colonial rule.¹⁴ Pakistan's military regimes have been repressive, but they have also been technocratic and bureaucratic. Throughout the various civilian and military regimes, magistrates and district courts have remained in place to adjudicate contract disputes and assert rights to property through statute and common law, much as in India. Colonial India's system of district governance has persisted in maintaining local bureaucratic structures in both countries, though with significant variation in their power and purpose within

national territories. Evans and Rauch, associating growth with the capacity and autonomy of national administrative structures, place India and Pakistan at 10 and 11 respectively, out of a possible 13, on their scale of ‘Weberian-ness.’¹⁵

This is not to suggest that institutions work well in either country, but there is no obvious difference between the two countries on the effectiveness of these institutions. In the 2015 Ease of Business survey, India and Pakistan are in the same middling decile, and Pakistan scored higher than India on key measures such as registering property, enforcing contracts and resolving insolvency. Across an average of ten indicators of institutional quality in the World Bank’s Country Policy and Institutional Assessment (CPIA) in 2010, India’s score was 3.68 and Pakistan was 3.31 out of 6: different, but not radically so.

Instability, Political Violence and Growth

This article argues that in order to understand the divergence in the rate of growth since the early 1990s, the nature and consequences of instability and the closely related concept of violence during this period are important. It might be commonsensical for Pakistan to be characterized as unstable relative to India, purely on the basis of regime and government turnover. But Pakistan, for all its recent political drama, has been remarkably consistent in the formulation and execution of economic policy since liberalization, with technocrats or businessmen regularly holding key positions in fiscal and monetary governance, suggesting that there may be some underlying, if implicit, consensus among a wider coalition of political actors.¹⁶ Other common measures of political instability do not differ dramatically between the two countries; inflation has only been a point higher, on average, in Pakistan than India over the last quarter-century.

Political violence can, however, prove to be a highly salient and impactful form of instability. Besley and Persson have argued that, over time, violence affects both political

stability and cohesiveness, leading to a decline of investments in the fiscal and legal capacities of the state and thus a self-perpetuating cycle of conflict, weak states and low growth.¹⁷ At least in the South Asian context, it can be argued the eruption of political violence and its forms and manifestations are conceptually distinct from either regime or institutional variables that could potentially confound theoretical relationships.

It is worth considering whether contemporary violence in Pakistan might itself be a product of *macro-institutional* imbalances and constitutional failures – particularly between regions and ethnic groups – that could lie at the heart of violence, and might also be driving negative growth outcomes. Such factors, after all, lay at the heart of the Partition of 1971. Yet in the 1970s and 1980s, Pakistan was relatively stable, whereas India was suffering sustained political violence, including urban insurgent conflict, in areas of economic significance: Marxist violence in West Bengal in the early 1970s and brutal ethnic conflict in Punjab in the 1980s. Violence in these two Indian states in earlier decades, like violence in Karachi and northwestern Pakistan subsequently, are in part products of common if insalubrious features of these states since Partition, including the chronic maldistribution of income, internal security paranoia and the related repression by central governments of ethnic demands. India, because of its sheer size and its more flexible and balanced federalism, has been able to better manage some of these conflicts, but by no means all. Further, horizontal inequality plagues both countries. The income per capita of Pakistan's richest province, Sindh, is roughly 2.4 times of its poorest, Balochistan, while the per capita income of India's richest populous state, Maharashtra, is 3.5 times that of its poorest, Bihar. At the very least, after 1971, neither India nor Pakistan are strangers to common forms of violence, endemic inequality and regionally imbalanced growth.

This article further argues that the political instability that is associated with recent economic stagnation in Pakistan relative to India relates to the nature and consequences of violence and thus its salience to the bourgeoisie. In India, political violence is largely hidden from bourgeois view, either in peripheries and forested hinterlands in which insurgencies rage, or else in the targeting of minority communities in urban slums or poor villages that are socially, if not physically, remote from the homes and workplaces of those who own and direct investments. In Pakistan, by contrast, violence has become prevalent in urban areas and thus elite and middle class spaces; kidnapping and terrorist attacks, which the bourgeoisie cannot easily ignore, became widespread particularly in the mid-2000s. As a result, the Pakistani bourgeoisie have recently been more sensitive to the instability associated with political violence relative to the Indian bourgeoisie.

The Salience of Political Violence in Pakistan

Endemic conflict has become virtually a leitmotif for Pakistan; images of the aftermath of terrorist attacks have appeared with depressing regularity in the last decade. What is less apparent is that, although insurgencies have occurred in its northwestern and western peripheries, there has been a sharp rise of urban violence and insecurity over the last two decades. Disorder in Pakistani cities, not insurgent conditions in the mountains of Waziristan or the deserts of Balochistan, is much more likely to drive economic outcomes.

The first major challenge to the stability of urban Pakistan in the 1990s was the rise of political violence in Karachi, Pakistan's commercial capital, main port and the site of most industrial investment. This conflict has its roots in the marginalization of Urdu-speaking migrants (*muhajirs*) from India concentrated in urban Sindh, and the subsequent armed mobilization of the Muhajir Qaumi Movement (MQM) against perceived threats to their

community from a hostile (democratic) central government. In 1992, the army was deployed to counter the threat of MQM militants in the city. Over the next three years, an urban insurgency raged, and over three thousand were killed as armed cadres clashed with security forces on the streets of the city.¹⁸ Economic activity ground to a halt; during 1995 alone, the MQM violently enforced citywide road closures on 34 days, costing the city's economy over \$1.2 billion.¹⁹ This period saw an exodus of capital and investment away from Karachi. Noman, in his assessment of the challenges of development in Pakistan, identified ethnic conflict between Muhajirs and Sindhis to be "the most serious political problem facing Pakistan" and stated that its resolution was required for sustained economic growth.²⁰

Since the 1990s, the landscape of conflict in Karachi has further fragmented into ethnic enclaves and dominated by a mosaic of protection rackets, violent entrepreneurs and extremist organizations.²¹ Sectarian conflict, and particularly the targeting of the prosperous Shi'a business community, has joined ethnic competition as a main driver of political violence in Karachi.²² In 2010, units in the city's industrial estates were reporting production losses of up to 75 percent as a consequence of violence.²³ Between January and August of 2011, more than 1,400 people were killed in targeted assassinations between rival ethnic and sectarian groups.²⁴ In 2013, 2,507 people were killed in a combination of targeted killings, suicide bombings and gang warfare, despite the deployment of the paramilitaries.²⁵ The BFRS Political Violence in Pakistan dataset records 2,585 incidents in Karachi between 2002 and 2011, more than twice that of North and South Waziristan, the regions at the epicenter of the Taliban insurgency, combined.²⁶ Karachi, the country's biggest city, is still an important location of finance, manufacturing and commerce, but regular surges of violence and political conflict has produced existential uncertainty among

the elite and middle class, even as recent paramilitary operations have succeeded in stemming some of the violence.

As a result of violence in Karachi, central Punjab had been seen as a refuge for business. The ancient metropolis of Lahore, along with a surrounding belt of industrial cities in central Punjab, has served as Pakistan's economic engine over the last two decades. But the Taliban insurgency in the mid-2000s has had disastrous effects on the perception of Pakistan's security even there, as warfare in the Northwest has been accompanied by a terrorist campaign spanning the country. This campaign targeted heretofore unaffected and economically vital areas of the country, including Lahore, Islamabad and Rawalpindi. This wave of violence included suicide bombings at the High Court, the Federal Investigation Agency offices and a siege of the Manawan Police Training School in Lahore, the assassination of former prime minister Benazir Bhutto in Rawalpindi in December 2007, the truck bombing of the Marriott Hotel in Islamabad in 2008, a dramatic attack on Pakistan Army's General Headquarters (GHQ) in Rawalpindi in October 2009, and the assassination of prominent industrialist and Governor of Punjab Salman Taseer by one of his bodyguards in daylight outside a popular café in Islamabad in early 2011. Peshawar and Quetta, provincial capitals and thus the centers of regional growth, have borne the brunt of this violence, with regular bombings and targeted assassinations. Prominent politicians, bureaucrats, military officers and activists have been targeted throughout the country; kidnapping the family members of the political and economic elite increased as a way of simultaneously funding terrorist operations and challenging the state's authority.

The fact that militant groups, sometimes acting in coordination, were able to reach so deeply into the heart of urban Pakistan and execute devastating attacks against the military, the bureaucracy, the political elite and its most important clients has shaken wealthy and middle

class Pakistani society. Perceptions of this insecurity have affected many different aspects of life for the elite in Pakistan, not least economic decisions.

The Non-Salience of Political Violence in India

The 1990s and 2000s in India were hardly peaceful. Separatist conflicts and leftist insurgencies persisted in the northwestern, eastern, central and northeastern regions. Deadly communal riots and the targeting of minority communities have been a feature of political life particularly in northern and western India.²⁷ Yet political violence has been less visible for elite Indians and outside investors alike, because insurgent violence has largely remained in remote hinterlands and peripheries and rural hinterlands and riots have targeted the poor in urban slums and rural villages. As a result, over the last two decades, the Indian bourgeoisie have not seen political violence as a particular threat to their own personal security or the security of their investments.

The most significant recent threats to political order have been territorial insurgencies in Kashmir, in the Maoist belt of central and eastern India and in the Northeast. Armed rebellion in Kashmir began after a rigged election in 1987. During the 1990s, Mujahidin-affiliated radical militias, supported by clandestine Pakistani agencies, emerged as the leading edge of violence against Indian security forces, shifting the focus from Kashmiri nationalism to radical Islam.²⁸ In the eastern and central hinterlands of the country during the 2000s, Maoist insurgents in the states of Andhra Pradesh, Jharkhand, Chhattisgarh, Bihar, Orissa and West Bengal have engaged Indian paramilitaries in forested areas with majority tribal populations.²⁹ And in India's Northeast, an overlapping array of separatist insurgencies has maintained conditions of militancy in the states of Assam, Manipur, and Nagaland.³⁰

But the Indian states with active insurgencies are associated with states with mostly rural, minority or tribal populations and relatively little private economic investment. The high-growth

states in southern and western India, by contrast, are at some geographic and significant psychological remove from insurgent conflict. Of the nearly four thousand companies listed in the Bombay Stock Exchange in 2013, only sixteen were registered in any of these insurgency-affected states. There is significant private investment in mineral extraction in Maoist-affected areas, but these investments are highly asset-specific and thus not easily substitutable, and mining conglomerates pay protection rents to Maoist guerrillas to continue production.³¹ The Indian government's generous incentives for private investment in Kashmir increase the benefits relative to the costs, and imply implicit government guarantees.³²

Other forms of political violence are not geographically remote. Religious conflict, as Varshney and Wilkinson have argued, tend to occur in cities.³³ The 1990s and early 2000s saw a wave of deadly Hindu-Muslim riots across northern and western India after the destruction of the Babri Masjid in Ayodhya in December 1992 by Hindu nationalists, which claimed the lives of over 1,200 people. An anti-Muslim pogrom in the state of Gujarat in 2002 led to more than 2,000 fatalities and widespread displacement. Yet investigators have found that this violence was perpetrated against Muslim neighborhoods and businesses concentrated in poor and lower middle-class wards and informal settlements.³⁴ These marginalized Muslim-majority areas are spatially segregated from elite neighborhoods and business centers, even within the same city, and thus have little impact on elite perceptions of insecurity. More generally, the impact of riots is disproportionately borne by the poor and marginalized.³⁵ Inter-caste violence occurs in both cities and the countryside, but again, the targets of such violence are those without resources or status, and are thus often forgotten. Boo powerfully illustrates the extent to which elites are literally shielded from the structural and actual violence that occurs just minutes away in locations of concentrated wealth and investment.³⁶ Such segregation between elites and the

downtrodden is ubiquitous in Pakistan as well, but particular forms of urban violence – bombings, insurgent attacks, kidnapping – can shatter the bubble of safety and security that the elite construct.

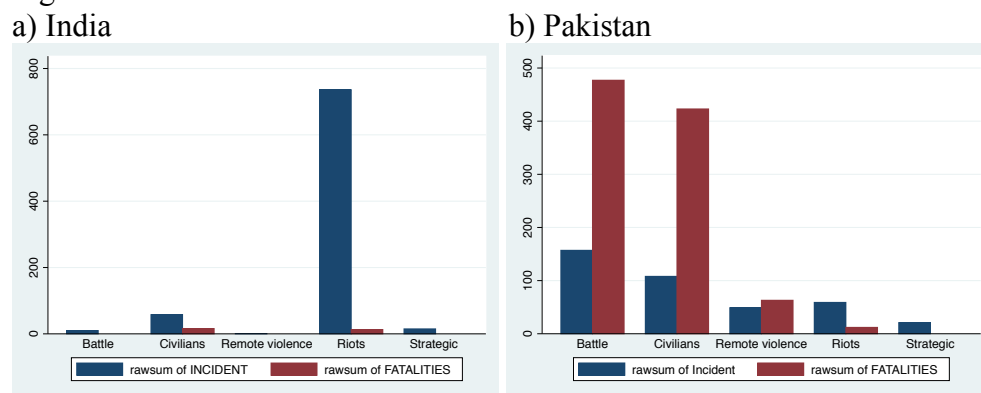
Comparing Violence and its Salience in India and Pakistan

In order to more systematically compare the incidence and salience of violence in the two countries, analysis from common datasets is useful. The Armed Conflict Location and Events Database (ACLED) has recorded, based on multiple, cross-listed media reports, geocoded incidents of violence and contention across South Asia in 2015 and 2016.³⁷ Although the ACLED data represents a cross-sectional snapshot rather than the dynamics of conflict over time, its granularity affords the possibility of analyzing the nature and spatial configuration of violent events, beyond aggregate levels of violence, across national territories.

During this period, the distribution of violent events in India and Pakistan has been significantly different. Out of 4,998 incidents and 1,641 fatalities in India, only 16.4 percent of incidents and 1.8 percent of fatalities occurred in urban areas, while out of 1,088 incidents and 3,959 fatalities in Pakistan, 36.2 percent of incidents and 24.6 percent of fatalities occurred in cities.³⁸ The Rand Database of Worldwide Terrorist Incidents records 1,230 incidents for Pakistan and 1,915 terrorist incidents for India between 1990 and 2008; 43.4 percent in Pakistani incidents during this period occurred in urban areas, in contrast to 7.8 percent of India.³⁹

Further, the nature of violent incidents in urban spaces is quite different between the two countries based on the ACLED data, with violent incidents in urban India mostly “riots, while in urban Pakistan, incidents and fatalities are more evenly distributed among “Battle,” signifying insurgent conflict, “civilians,” signifying targeted violence against civilians, and remote violence (figure 2).

Figure 2: Forms of Violence in Urban India and Pakistan



These stark differences in not just the level of urban violence but also its form can have significant impact on the salience of violence to the bourgeois population.

Salience of course cannot be measured directly, but some suggestive evidence does exist of a difference among investing populations in India and Pakistan. In World Bank Enterprise Surveys in 2013 and 2014, in response to questions on “the impact of crime, theft and disorder,” 30.8 percent of respondents in Pakistan found it to be either a very severe or a major obstacle, in contrast to just 4.5 percent of respondents in India. There is little evidence that quotidian crime and larceny is a more serious issue in Pakistan than in India, given the presence of organized crime in both countries, perceptions of “disorder” – the salience of political violence – might well be driving these results.

The Mechanism: Growth and Rent-Implicated Investment

Thus, perceptions of the nature of violence in India and Pakistan might be quite different, in ways that can have serious economic consequences. Violence can impact growth because

individuals with capital act differently to secure returns on their investment when faced with greater perceptions of endemic instability and insecurity. Specifically, in Pakistan relative to India, we tend to see a stronger preference for rent-implicated investments. These actions, while individually rational, have a cumulative impact in dampening growth.

Rents and Growth

Economic rents are normally defined as returns to factors of production that are substantially higher than the costs associated with that factor's mobilization. Rents are associated with natural or contrived scarcity of particular assets with high and stable demand. Thus creating and capturing rents means generating and preserving scarcity, often through government intervention or social manipulation, gaining exclusive access to assets that are both valuable and rare, and forestalling access to substitutes in order to maintain demand. In other words, rent creation and rent-seeking involve political and social activities that are different from entrepreneurship and innovation. A preponderance of such rent-implicated activities can thus have significant negative impacts on long-term growth.⁴⁰

Scholars have long been interested in the political, social and economic effects of particular economies and societies that are saturated by rentier activity, especially when this saturation is due to the dominance of particular sectors such as oil in national economies. In international economics, 'Dutch disease' refers to the way that price booms in mineral rents can jeopardize other productive activities through appreciations in the real exchange rate.⁴¹ In comparative politics, researchers have emphasized the ways that mineral wealth have impacted regime outcomes and relations between state and society.⁴² There is less research, however, on the nature and impact of rents and rent-seeking in non-rentier states. Neither India and Pakistan has production of oil or mineral rents totaling more than two percent of GDP. And yet, there is

significant rent-implicated economic activity within each economy, with successful participation in certain sectors determined not by entrepreneurial skill and managerial acumen but by political connections or social power.

Political economists have recently noted sharp increases of rent-implicated economic activity in post-liberalization India, in ways that are quite distinct from the nature of rent-seeking activity during import substitution.⁴³ Gandhi and Walton have noted that Indian dollar billionaires are concentrated in certain sectors, such as real estate, telecoms, mineral extraction, and infrastructure, that they classify as ‘rent-thick’ because of “the pervasive role of the state in giving licenses, reputations of illegality, or information on monopolistic practices.”⁴⁴ Sen and Kar analyzed the sources of India’s post-liberalization growth experience, and found that the ‘workhorses’ and ‘magicians’ – competitive firms and sectors in the domestic and export economies that were largely responsible for economic transformation – have since 2002 been losing out to rent-seeking and -extracting firms.⁴⁵ Kohli’s recent reading of India’s political economy as largely ‘pro-business’ rather than ‘pro-market’ implicates some of the largest corporations in India as engaging in rent-seeking and collusion with state governments.⁴⁶

The post-liberalization Pakistani economy has also been subject to significant rent creation and rent-seeking. Pakistan’s governments have led more energetic efforts in privatizing state-owned assets in banking, energy and telecommunications, which has increased the chances of capture by rent-seeking actors.⁴⁷ More broadly, Pakistan’s electoral politics since the 1990s has been characterized as an iterated competition by different groups to capture the rents of the state. Looking at the *potential* for rent creation and rent-seeking comparatively, India and Pakistan seem similar. The nature of the administrative state, the statist system of licenses, permits and quotas, the processes of economic liberalization and the politics of patronage, favors

and opaque election financing are strikingly similar. Further, the related, though much broader, concept of corruption is endemic in both countries. The two countries scored in the same decile in the 2015 Corruption Perception Index, and there have been parallel anti-corruption movements among the frustrated middle classes in both countries.

And yet, India also maintains competitive and innovative sectors and firms, from textiles and garments to pharmaceuticals and biotech to information technology and light engineering, which succeed despite manifold challenges in the acquisition of capital and the management of labor.⁴⁸ If Indian political economy lends itself to rent creation and rent-seeking, it has also been able to preserve and enable islands of production and innovation that can maintain economic development. In Pakistan, similar institutional structures and latent entrepreneurial energies have been smothered by an almost-total pervasiveness of rent creation and rent-seeking that has crowded out more productive investment and thus more tepid growth.

We can see this dynamic at play in aggregate capital investment. Gross fixed capital formation (GFCF) is not an exact indicator of non-rent-based investment, as some rent-implicated activities such as construction count in the category, but it is nonetheless indicative; further, economists have long seen a close association between fixed capital investment and growth.⁴⁹ GFCF as a proportion of GDP in India averaged only three points higher than in Pakistan in the early 1990s; by the early 2000s, that gap was roughly eight points, and by the early 2010s, Pakistan's fixed capital investment was 18 points lower than India's. Yet in 1990, Pakistan had a higher level of manufacturing value-added as a proportion of GDP than India, at 17.4 to 16.2, thus demonstrating Pakistan's innate capacity to engage in productive investment at least at the beginning of the period under examination. Why should we see such a difference in the last twenty-five years, when these economies had similar post-liberalization starting points?

It appears that in Pakistan relative to India in the 1990s and 2000s, there has been a greater *demand* for investments in rent-thick sectors, including utilities, energy companies, construction, real estate, infrastructure and ancillary industries such cement and refining. Increasingly, these sectors have come to dominate investments in the private sector economy, crowding out investment in more potentially productive and internationally competitive sectors, from textiles and garments to pharmaceuticals. Thus the trajectories for individual investment are not necessarily those that led to the greatest long-term growth.

The Pakistani bourgeoisie invest in rent-based activities in indirect ways as well. First, banks and financial companies are a popular – and considered relatively safe – means of gaining investment returns for the middle classes, thus the investment decisions of bankers are tremendously important and lean towards rent-implicated activity. An equity fund manager in Islamabad described their behavior:

Pakistani banks these days offer mutual funds on the basis of a guaranteed return, of 18 or 20 percent. As a result, they are unwilling to lend project capital for new investments, but are happy to invest in short-term working capital [for established companies]. Even after 9/11, when the economy was flush with liquidity, everyone... including the banks, they were looking for short-term investments such as CNG [compressed natural gas] filling stations, with gas provided by the government, rather than manufacturing projects.⁵⁰

Moreover, there is substantial evidence that the financial sector in Pakistan has exhibited clear signals of rent-seeking activity, through manipulating markets and lending to politically connected companies.⁵¹ In India, financial companies have been under criticism for bad loans,

but allegations of corruption and rent-seeking in Pakistani finance are more significant and well-established, given the country's earlier and greater openness to financial markets abroad.⁵²

Second, the Pakistani military plays a large role in the private sector economy, as Ayesha Siddiqa has comprehensively detailed.⁵³ The businesses of four military foundations – with assets totaling \$1.2 billion in 2007 – are popular targets for middle class equity purchases, are especially concentrated in finance and rent-thick sectors – banks, insurance, property, cement – but few, if any, in non-rent-thick enterprises.⁵⁴ Further, military-affiliated organizations own and operate some of the most lucrative real estate in the country, through cantonment boards, Defence Housing Authorities and Navy-owned Bahria Towns in Karachi, Lahore, Islamabad and other cities.⁵⁵ The military has unique coercive capacities and government backing to alienate and aggregate privately owned and government land and to develop it.⁵⁶ Further, other kinds of activity undertaken by the military are similarly concentrated in rent-thick sectors; the infrastructure development projects of the Frontier Works Organization, a military engineering corporation, receives lucrative contracts (with the potential of significant kickbacks) from both federal and provincial governments.⁵⁷

In order to assess whether there are any systematic differences between the behavior of Indian and Pakistani investors with regard to rents, I analyze equity data from the primary securities markets in both countries between 2001 and 2013. I fit models on paid-up equity capital, in millions of Indian rupees, a primary measure for the revealed preferences towards a particular company in terms of investment desirability, based on firm-level data from the Mumbai and Karachi stock exchanges. I use a binary variable, *rent*, to signify investor preference for firms in rent-thick industries such as energy, cement, property and mining and *financial*, to assess the extent to which investors prefer investment in financial sector industries,

such as banking, insurance and financial services. To control for alternative explanations, I use *government* for firms partly or wholly owned by the public sector, including the military, *foreign* for firms partly or wholly owned by or affiliated with foreign entities and *income_assets*, the ratio of total income to the company's assets. I estimate separate models for India and Pakistan using OLS regressions with Huber-White standard errors (in parentheses) and year and state / province fixed effects (Table 1).

Table 1: The Impact of Finance and Rents on Paid-Up Equity Capital in the Bombay and Karachi Stock Exchanges

	Bombay Stock Exchange	S.E.	Karachi Stock Exchange	S.E.
Financial	114.39***	30.71	492.40**	90.74
Rent	1145.77***	88.79	1912.58***	123.21
Government	6264.15***	483.11	3770.76***	173.65
Foreign	59.16***	66.18	743.57***	121.16
Income_assets	-3.29*	1.59	-20.71	11.03
Constant	-156.28***	40.12	-324.32*	135.07
R ²	0.125		0.141	
N	50,439		6,852	

Significance: * - p<.05, ** - p<.01, ***- p<.001. Source: Bombay Stock Exchange; Karachi Stock Exchange.

Most of the variables are significant and in expected directions in both countries. The ratio of income to assets has a negative correlation, but this has a modest effect; doubling income in relation to assets only decreases paid-up equity capital by 3 million Indian rupees, or \$45,000, and this variable is not significant (p=.06) in the Pakistan model. Indian investors' greater preferences for public sector firms might reflect India's less vigorous attempts at privatization, and Pakistani investors' greater preferences for foreign firms might be the result of the legacies of the country's greater openness to foreign investment during the statist period.

Perhaps the most noteworthy significant variables are that of rent-rich and financial companies: both have a much greater effect relative to other companies in Pakistan than in India.

Even though India has a significant revealed preference for financial and rent-implicated investments in relation to other companies, there is a fivefold stronger preference for finance in Pakistan, and rent-implicated investments have double the appeal in Pakistan relative to India, all else equal. The powerful preference for investing in companies in finance and rent-rich sectors over others in Pakistan relative to India is revealing, especially as the factor endowments and industrial profiles of the two countries are relatively similar: manufacturing value-added, as a proportion of GDP, was higher in Pakistan from 1965 until 1997. These differences are also likely to be a key mechanism for explaining differences in growth between the two countries, as investing in companies that create, seek and capture rents as a primary activity may generate profits, but are unlikely to generate the innovation or incentivize gains in productivity that are associated with longer-term growth.

Instability, Violence and Rents

What might lead Pakistanis to hold and act on strong preferences for rent-based economic activity, either directly through investment in rent-implicated enterprises or indirectly through investment in finance, in relation to Indians? The answer is unlikely to be that India has stronger institutions, for two reasons. First, as I have argued above, there is little evidence on the ground that institutions that enable transactions act all that differently in the two countries. Formal institutional structures and informal practices of governance are comparable in the two countries, despite many other differences. Further, a greater preference for finance in Pakistan requires the effective operation of institutions, because finance relies heavily on the state's enforcement of debt contracts. Second, the ambient environments that structure the *potential* for rent-seeking and corruption in India and Pakistan are comparable. The difference between Pakistan and India is

not that the latter's economy is free of rents, but that India manages to enable productive investment alongside rent-based activity, whereas Pakistan does not.

What encourages rent-implicated investment in Pakistan to the near total exclusion of more productive investments? I contend that the palpable sense of instability felt by the Pakistani bourgeoisie, through the greater salience of political violence, has led them to act in particular ways with regard to risk and reward. When faced with perceptions of endemic and existential insecurity, investors are likely to opt for opportunities that are more certain to materialize, that promise returns that are more immediate rather than long-term, and more naturally allow for diversification.

The more implicated in rents an economic activity, the more likely it is to fulfill these criteria. Rent-implicated investments are much more certain to yield stable returns, either because they maintain a scarce supply of goods that are demanded by consumers, such as the production of refined petroleum products that require official licenses, or because they are politically protected, as with a cement factory owned by a military foundation with deep pockets, soft budget constraints and guaranteed government contracts. Such investments are also likely to generate immediate returns, particularly for established firms, and thus can provide a constant stream of revenue rather than having to wait for technology inputs to be adapted, equipment to be purchased, workers to be trained, supply chains to be established and products to be marketed. The Islamabad-based financier quoted earlier outlined these preferences in terms of retail and institutional investors: "it's about uncertainty. Most people who invest in the Pakistani economy do so on the basis of 'blue-chip' companies engaged in certain activities: finance, utilities, cement. Investors want a guaranteed immediate return on investment, like an interest rate. Or

else they go for crazily risky investments that are very short-term.”⁵⁸ Thus, investors like stability, but are willing to gamble, as long as the payoff is immediate.

Lastly, some rent-implicated investments naturally lend themselves to diversification through disaggregated streams of financial return. Investment in utility companies provides dividends on the basis of profits from millions of consumers of gas and electricity. Petroleum and CNG are necessary purchases for every teamster and taxi-driver, let alone every household that owns or leases a car or a scooter. Cement is necessary not just for large, government-funded infrastructure projects but the construction of commercial properties and private residences all over the country, in which most middle-class Pakistanis prefer to hold their stock of wealth. And banks have increasingly opted for consumer finance, through lending money to households for the purchase of consumer durables, vehicles or housing. The same cannot be true of a factory for the manufacture of pharmaceuticals or automotive components: if managers are targeted or workers stay home because of spates of violence in Karachi, no goods are made and no returns are evident. Asset diversification is more salient in conditions of generalized uncertainty and insecurity that characterize Pakistan in the 1990s and 2000s, which have led strategies of investment that steer clear of concentrated longer-term investments that might nevertheless capture produce greater long-term growth.

Violence, Rents and Engagement with the International Economy

There are also more straightforward ways in which perceptions of insecurity and violence can make productive investments much more difficult. Despite manifold difficulties, many capitalists in Pakistan remain committed to industrial production, and either use their own capital or persuade banks to lend to them at higher interest rates.⁵⁹ But they face another set of obstacles in pursuing such activities, particularly at higher value levels. Since the 1980s, industrial

production and even high-end services have been integrated into cross-national chains of production through the out-contracting of components manufacturing. These “global value chains” are organized by multinational corporations, which coordinate production and marketing and often supply required technological inputs and intellectual property licenses for products and components to be manufactured overseas.⁶⁰

India has benefitted a great deal from this cross-border economic integration, as multinationals have sought the country as a manufacturing platform and a key source of business-processing and high-end technology services. In Pakistan, however, the reluctance of representatives of multinationals to even visit the country to assess its possibilities has seriously limited the possibilities for participation in globally integrated production. Ruchir Sharma, a senior investment manager at Morgan Stanley, in a bestselling book on emerging markets with full chapters on India and Brazil, makes only fleeting reference to Pakistan, in a chapter entitled “the Fourth World,” about how his team was told by their security detail where to sit in Karachi hotel lobbies to avoid being caught in an explosion.⁶¹ Yet there is little reason, beyond perception, that Pakistan should be so completely bypassed as a location for international engagement. Economist and commentator Tyler Cowan recently named Pakistan the most overlooked economy in the world, citing significant increases in human development, impressive performance of equities and greater macroeconomic stability.⁶²

Pakistan’s engagement with the international economy over the last two decades has been based on foreign investment and capital flight, rather than international integration that enables production domestically. Pakistani investors have bought real estate in ‘safe havens’ like Dubai at much higher rates than Indians.⁶³ A risk analyst with close family ties to the corporate community in Karachi has indicated that third-generation scions of the city's venerable business

houses are currently attempting to divest from well-established industrial assets and shift their resources to IT services and real estate investment abroad.⁶⁴ This lack of international integration has meant that productive economic activity is difficult to pursue, leading even those investors wishing for greater long-term, value-added activities to fall back on rent-implicated investments. As a result, unlike in India, where there are islands of productive investment amid an economy with much rent-seeking, the vast bulk of Pakistan's economy is oriented towards creating and capturing rents.

Conclusion

Divergence in growth between Pakistan and India, on first glance, seems to accord to our expectations about the economic prospects of the two countries, yet the timing of this divergence complicates any straightforward explanation. What factors could be driving this phenomenon that were not present before 1991 or common between the two cases? This article argues that the shifting nature of violence and thus perceptions of instability in Pakistan in the early 1990s, starting with the eruption of urban conflict in Karachi, has led the bourgeoisie to predominantly shift its investments to rent-thick activities. In India over the last quarter-century, where political violence is less salient to the investing population, there is a greater balance between value-added and rent-thick investments and thus higher growth.

In so doing, the article highlights several aspects of research into the politics of growth in developing countries. First, political violence can have more nuanced impact on growth, though investment decisions, apart from asset destruction and capital flight. The nature of Pakistan's violence, and how it is perceived and acted upon, is quite different from that of Syria or Afghanistan, but perhaps more similar to Turkey in the 1970s or Colombia in the 1980s and 1990s. Further, cases with significant political violence may not suffer from growth

consequences, if this violence is hidden from the population, as with Sri Lanka. Second, it suggests that the perceptions of stability among the bourgeoisie are important for understanding the demand for rent-thick activities, when extant research on rents and growth in developing countries has focused on the supply. Preferences for rent-implicated economic activities may be a significant but heretofore unnoticed factor in the politics of development.

Lastly, this comparative case study emphasizes the possible differences in growth among countries that have quite similar micro-institutional frameworks; this suggests some limitations for the causal links between growth and the institutions that enable transactions. Many countries in the middle-income category have comparable (middling) strength and capacity to enforce contracts and defend property rights as both India and Pakistan, and yet we see significant variations in growth among that universe. This article suggests greater agnosticism as to what might drive growth and stagnation.

Notes

¹ This section necessarily telescopes the political economies of India and Pakistan. For a more detailed comparative overview, see Adnan Naseemullah, *Development after Statism* (Cambridge: Cambridge University Press, 2017), 64-95, 205-229. For excellent accounts of national cases, see Francine Frankel, *India's Political Economy, 1947-2004* (Delhi: Oxford University Press, 2005); Akbar Zaidi, *Issues in Pakistan's Economy* (Karachi: Oxford University Press, 2015).

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