India's Hyderabad Story

By Matthew Rees and Phil Harvey

How poverty was dramatically reduced.

The Indian city of Hyderabad has had a volatile trajectory over the past seventy-five years. In the aftermath of India becoming independent in 1947, the city's ruling prince—a Muslim named Osman Ali Khan—wished to remain independent of the Hindu-majority nation. He held out for a year, but Prime Minister Nehru eventually deployed the country's military to forcibly bring the city under central government rule.

During this period, Khan was said to be the richest person in the world, with a fortune equivalent to more than $60 billion today. He led a life of luxury: In 1934, he chartered an ocean liner to sail to Britain and brought 300 people with him. But he chose to lead a very modest existence once Hyderabad was absorbed into India.

Khan's decision to downplay his wealth was emblematic of his hometown's lot. In the decades after 1947, Hyderabad—which was incorporated into the state of Andhra Pradesh in 1956—was largely indistinguishable from many other large Indian cities. Poverty was widespread and private sector economic activity was virtually non-existent—byproducts of the central government subjecting business to voluminous regulations. The most sought-after jobs were in the public sector. For ambitious locals, the goal was to escape Hyderabad. "There wasn't much opportunity here," says Chebrolu Nagamalleswara, an investor who grew up in Hyderabad and has lived there for most of his adult life.

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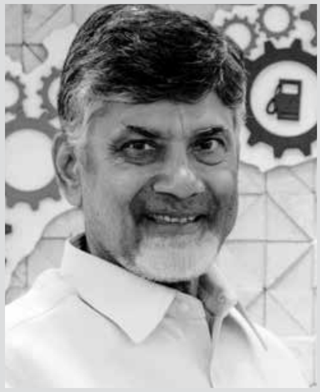
The situation couldn't be more different today. Hyderabad is a magnet for talent from across India and throughout the world. It has been transformed into a technology hub on par with its better-known rival, Bangalore. Plots of land that were once populated by nothing more than rocks are now home to modern office buildings that house hundreds of thousands of people—employed by many of the world's blue-chip companies. (A small sample includes Amazon, Dell, Ericsson, Facebook, General Electric, Google, IBM, Infosys, Microsoft, Oracle, PayPal, Tata, and Wipro.)

Hyderabad's economic gains—among the biggest experienced by any emerging market city in the world over the past two decades—did not happen spontaneously. They were largely made possible by a set of public policy changes that opened the economy to market forces, which enabled capitalist activity to flourish.

The episode showcases the way in which free markets unleash economic opportunity for people across the economic spectrum. But for the poor, the gains have been particularly meaningful. Millions of low-wage workers moved out of poverty as they seized the new opportunities and gained access to the world's goods and services.

The Naidu Effect



Chandrababu Naidu,
former chief minister of Andhra Pradesh

A turning point came in September 1995. That marked the start of Chandrababu Naidu's tenure as chief minister (akin to the governor of a U.S. state) of Andhra Pradesh. Naidu was determined to expand economic opportunity. This involved changing policies but also changing minds.

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A key moment in Hyderabad's development came in 1997. During a 45-minute meeting with Bill Gates, Naidu sold him on the city as a place to do business. The following year, Microsoft opened a software development center in Hyderabad. That helped attract other leading technology companies, as did another development in 1997: Naidu announced that Hyderabad would develop a 160-acre plot of rocky terrain near the city center, with a focus on attracting private-sector companies.

The enclave was officially named Hyderabad Information Technology and Engineering Consultancy City, which yielded a promising acronym: HITEC City.

—M. Rees and P. Harvey

SLOW AND STRUGGLING

"Hyderabad has been going through bad times," opined a *New York Times* reporter in January 1991. Hindu-Muslim riots had recently engulfed the city, leaving more than two hundred people dead. Per capita GDP in Andhra Pradesh was only about 75 percent of the national average, with agriculture accounting for 37 percent of the state's GDP and more than 70 percent of employment. From 1980–1981 to 1996–1997, growth rates for the state's economy and per capita income were less than India's growth rate for the same period.

By the mid-1990s, public spending on welfare programs and subsidies accounted for 27 percent of Andhra Pradesh's total expenditure—the highest share anywhere in India—with an impact that the World Bank politely characterized as "limited." The largesse led to budget deficits, as well as interest payments that consumed 16 percent of the state's revenue. The state's economy had been growing at a progressively slower rate, and the slowdown was projected to continue. That was going to handicap the already-struggling private sector, which in turn would have erected even bigger hurdles for the poor as they sought to improve their living standards.

Hyderabad had begun to see some benefit from the economic liberalization the central government in Delhi began to implement in 1991. While these changes expanded access to imports and opened up exports, they also sent a powerful message that the command-and-control approach to the economy that had dominated India since independence was no longer sacred.

END OF THE FREE RIDE

But changes at the state level were often slow and Andhra Pradesh consistently fell behind most other Indian states. A turning point came in September 1995. That marked the start of Chandrababu Naidu's tenure as chief minister (akin to the governor of a U.S. state) of Andhra Pradesh.

Naidu was determined to expand economic opportunity. This involved changing policies but also changing minds. His biographer, Tejaswini Pagadala, has written that Naidu wanted to effect "a paradigm shift in people's thinking on growth and development." He recognized that continuing to expand the welfare state threatened to plunge states throughout India into bankruptcy. "The free ride was over," as Naidu later wrote.

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Naidu broke with traditional political ploys. To help reduce budgetary pressures, he curtailed subsidies for rice and energy. (The rice program accounted for more than half of the state's total welfare spending, with about 85 percent of the population being covered by the subsidies.) He also traveled throughout the world to sell Hyderabad as a place to do business, emphasizing the business-friendly environment. He was clear about information technology's potential, saying that it was "bound to emerge as a strategic sector, which will both generate wealth and create employment opportunities." One of his aides, in an interview with the *Wall Street Journal,* pointed out that IT was "India's window of opportunity. A country that missed the Industrial Revolution can't afford to miss the knowledge revolution."

Naidu saw government's role as enabling growth, but he understood the risks of having it try to play the role of job creator: "For the first fifty years of this country's independence, governments tried to create this employment themselves and failed quite miserably."

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ENTER MICROSOFT

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On November 22, 1998, Naidu was joined by India's prime minster and other leaders at a ceremony to mark the opening of HITEC City, with two ten-story buildings featuring optic fiber links, satellite connections, and a stable power supply (no small matter in a country infamous for power outages). Before long, the buildings—known as "Cyber Towers"—were populated by a slew of Indian IT firms, as well as GE Capital, Microsoft, Motorola, and Oracle. And Hyderabad's stature rose even higher when Bill Clinton visited the city (and skipped Bangalore), while president, in March 2000.

POLICY CATALYST

In the years that followed, Naidu implemented numerous policies designed to encourage IT firms and biotechnology companies to invest in Hyderabad. This included:

- Exempting the software industry from sales taxes and zoning regulations;
- Allowing women to work night shifts and waiving a regulation that required overtime pay if working more than eight hours in a day;
- Reducing tariffs on power and extending power connections on a priority basis;
- Subsidizing the cost of land, with the equivalent of $400 provided for every job that was created; and
- Accelerating review and approval of industrial projects and simplifying the procedures for inspection and pollution control.

In a country with a notoriously inefficient and corrupt bureaucracy, this last step was particularly important. Known as the Single-Window Act, it "went a long way toward introducing an investor-friendly environment in the state," write Kapoor and Ahluwalia.

Hyderabad's economic gains were largely made possible by a set of public policy changes that opened the economy to market forces.

Indeed, when Indian CEOs were surveyed in 1995 about investment destinations in India, they ranked Andhra Pradesh among the least desirable states. Just four years later, they ranked it third. And by 2002, NASSCOM—the influential India-based trade association primarily representing IT companies—ranked Hyderabad first (among nine Indian cities) as a place to do business in India.

Hyderabad's favorable public policy environment was a catalyst for investment and production. The IT industry boomed. In the second half of the 1990s, the value of software exports from Hyderabad experienced an eighteen-fold increase. From 1992 to 2004–2005, IT exports from Andhra Pradesh achieved an average annual growth rate of 130 percent. That growth has continued. In 2018–2019, IT exports from Telangana (the state in which Hyderabad is now located) totaled $15.7 billion—nearly double the level just five years earlier. (Telangana came into existence in 2014. It was carved out of Andhra Pradesh and acquired 40 percent of the state's population.)

Microsoft is an emblem of Hyderabad's evolution. After opening the software development center in 1998, the company's presence in the city continually grew. Today, Hyderabad is home to Microsoft's largest research and development office outside the United States, which is spread across a lush 54-acre campus. The company's managing director for India for six years, Anil Bhansali, has praised the city as an "excellent destination," citing its "great quality of life" and "easy access to a qualified talent pool." And fittingly, the company's global CEO, Satya Nadella, is a native of Hyderabad.

Employment in Hyderabad's IT sector has also boomed. It was 86,000 in 2004; today it is about 550,000, and it shows no signs of slowing. In August 2019, Amazon inaugurated a new campus on nearly ten acres that employs 15,000 people. And Google is building a 22-story building that is projected to house 13,000 employees.

As the growth rates were rising, infrastructure was being modernized. A new airport opened in 2008 (it now serves numerous international destinations), a ring road circling the city helped relieve congestion, and a subway is under construction. In recognition of the city's progress, it was selected (over Mumbai and Bangalore) as the home to the Indian School of Business, which opened in 2001 with support from leading financiers and partnerships with the business schools at the University of Pennsylvania and Northwestern University. Schools and training centers focused on engineering and IT have also grown in number, from 32 in 1995–1996 to 639 by 2009–2010.

MORE THAN TECHNOLOGY

Emblematic of Hyderabad's rising fortunes, the city has also attracted two iconic consumer-focused companies. In 2018, Ikea, the Swedish furniture and home furnishing behemoth, opened a 400,000-square-foot store there. It directly employs 800 people, with an estimated 1,500 employed indirectly. And it attracted nearly four million visitors in its first year of operation.

A visit one Sunday evening in November 2019 showed it to be buzzing with activity, as families traversed the massive facility, which carries about 7,000 products. While the store appearance and offerings largely mimic what's found in more developed markets—selling everything from bunk beds to stuffed animals—showrooms replicate the distinctive layout of Indian residences, which often house multiple generations of family members. And several offerings cater to Indian tastes, such as forks and spoons being sold as a set, while knives, which are used sparingly in India, are sold individually. The store reportedly sells more children's products than any other Ikea in the world.

Notably, Ikea's decision to open stores in India—more than twenty are planned by 2025—followed the central government's announcement in 2012 that it was liberalizing its foreign direct investment regulations for single-brand retail.

The other iconic company, Procter & Gamble, opened a major manufacturing facility outside Hyderabad in 2014. The facility, which employs about 2,000 people, produces Tide and Pampers. When choosing where to locate it, a key selling point for P&G was the speed and transparency associated with obtaining government permits. A "single window" at the Department of Industry facilitated everything, which was handled online, and every office involved with issuing permits was given a

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deadline of fifteen days. If they failed to act, they could be fined—and the permit would be issued.

P&G wanted to employ women in a variety of roles, but a national law prohibited them from working in factories after 7 p.m. In a sign of how much has changed in tradition-bound India, the company secured an exemption—and didn't have to pay a bribe to get it. Today, women make up 30 percent of the facility's workforce. And given India's well-deserved reputation as a place where construction projects encounter lengthy delays, it's noteworthy that the facility was built in less than two years, a record for any P&G facility throughout the world.

ECONOMIC GROWTH, POVERTY REDUCTION

The surge of corporate investment in Hyderabad and other cities over the past two decades dramatically increased the economic growth rate in Andhra Pradesh. It averaged 3.3 percent from 1982–1994, 4.6 percent from 1994–2004, and 7.4 percent from 2004–2012.

This economic growth triggered a massive decline in the poverty rate. It fell 36 percentage points from 1993–1994 to 2011–2012—the largest decline of any state in India according to government figures. (The rural poverty rate fell from 48 percent to 11 percent and the urban rate fell from 35 percent to 6 percent.) A different measurement, by the Oxford Poverty & Human Development Initiative, showed that the multidimensional poverty rate—encompassing living standards, health, and other factors—declined from 41.6 percent in 2005–2006 to 21 percent in 2016–2017.

While some claim that much of the poverty reduction was a product of increased social spending, Kapoor and Ahluwalia note that "the rise in social spending itself was not possible without the massive [economic] growth." Naidu echoed this idea in a November interview with *The International Economy:* "You have to get wealth creation, so that employment will be generated, then automatically you'll get revenue for the government, so that you can spend some money for welfare and also further development."

Vital to escaping poverty is not welfare spending but the economic growth that stimulates new economic opportunity. As the government regulations began to be swept away, companies flocked to Hyderabad—creating jobs that never existed before and enabling people to move out of sectors with lower levels of growth and productivity, such as agriculture. The people who held those new jobs realized higher disposable incomes, which they used to purchase new products, from computers to cars to houses. This process of unleashing pent-up demand, multiplied hundreds of thousands of times, was fundamental to Hyderabad's economic expansion.

To understand the progress, it's useful to compare the state that was home to Hyderabad until 2014, Andhra Pradesh (population 50 million in 2011), to an even larger state, Uttar Pradesh (200 million), which was less aggressive about liberalizing its economy.

In 1993–1994, Andhra Pradesh's poverty rate was 3.7 percentage points below that of Uttar Pradesh. By 2011–2012, the gap had grown to more than 20 points. Similarly, per capita income in Andhra Pradesh was nearly 1.5 times that of Uttar Pradesh in 1993–1994. By 2011–2012, it was more than 2.25 times higher.

The explanation for the differential between Andhra Pradesh and Uttar Pradesh? According to Kapoor and Ahluwalia, the state government in Andhra Pradesh "took policy measures that allowed it to better exploit the opportunities opened up by the liberalization by the central government." Fundamental to realizing these opportunities was integrating with the global economy. Indian companies found it much easier to export their goods and services, and those of the highest quality came to be in high demand in markets throughout the world.

Similarly, as the rules on imports were liberalized, Indian companies had to improve their offerings in order to stay competitive. That process gave Indian consumers access to more goods at lower prices. These benefits were felt by all consumers, but the poor in particular.

This never-ending contest for customers throughout the world "forces firms to work that much harder to deliver and maintain high quality," writes Arvind Panagariya, a Columbia University economist and author of the magisterial *Free Trade and Prosperity: How Openness Helps Developing Countries Grow Richer and Combat Poverty* (see review on p. 64). "It is simply inconceivable that China's manufacturing industry and India's information technology industry would have achieved the levels of efficiency they did without being subject to competition against the best in the world in their respective fields."

With greater access to imports, new technologies were also available to Indian firms. That access was critically important for the IT industry, and telecom as well.

As the growth rates were rising, infrastructure was being modernized.

"The telecommunications revolution in India during the 2000s would have been impossible without the imports of telecommunications equipment such as cell phones," according to Panagariya.

It's telling that even after Naidu was defeated in 2004, his successor, Y.S. Rajasekhara Reddy, maintained the growth-friendly policies that had been implemented. The momentum has continued. In 2018, Andhra Pradesh (Hyderabad's original state) and Telangana (its current state) were the two easiest Indian states in which to do business, according to a World Bank study.

Hyderabad's growth has been impressive even when compared to other cities in developing countries. A 2018 report by the Brookings Institution ranked three hundred metropolitan areas throughout the world, based on growth in per capita GDP and employment. For 2014–2016, Hyderabad's growth rates in both categories (8.7 percent and 5.4 percent, respectively) ranked 14th—up from 84th when using data beginning in 2000. And Hyderabad's rival, Bangalore, ranked just 46th for the 2014–2016 period.

CAPITALISM AND PROSPERITY

Hyderabad is an emblem of India's progress in reducing poverty over the past thirty years. That progress has enabled hundreds of millions of people throughout the country to lift themselves out of subsistence and move into the middle class. While several different factors contributed to the poverty reduction, Hyderabad's experience shows that the biggest (and most sustainable) gains come from creating a public policy environment that enables individuals and institutions to connect capital with ideas and ambition. In the words of Naidu, "Without private investment and without job creation, you cannot eradicate poverty." That fundamental lesson about the nexus between capitalism and prosperity is a lesson India—and every other country—can never afford to forget. ◆