

# The Impact of Political Leadership and Economic Reforms on Industries and MSME Growth: A Comparative Study of Bihar and Gujarat (Pre and Post 2000)

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**Abstract:** The economic development of states is closely linked to the growth of industries and Micro, Small, and Medium Enterprises (MSMEs). Both Gujarat and Bihar have introduced various expansionary fiscal and monetary policies to stimulate industrial and entrepreneurial growth, though their approaches and outcomes have differed significantly. This paper examines the incentives and reforms implemented in both states before and after 2000, with a particular focus on their impact on MSME growth and industrial development.

Gujarat maintained favorable conditions for industrial and enterprise growth through political stability, liberal economic policies, cluster-based development, quick NOC clearance, and the creation of Special Economic Zones (SEZs). Bihar, in contrast, prioritised social development over capital investment, attempted to build a business-friendly environment, addressed law-and-order issues, and offered incentives to promote enterprises. During this period, both states experienced industrial growth, but Gujarat continuously outperformed Bihar in terms of SEZ performance, cluster development, and investment inflows. This study examines growth trends and the effects of policy through various data published by government reports and scholarly articles, and highlights how the BJP government in Gujarat and the JDU-led coalition in Bihar pursued distinct reform pathways to encourage entrepreneurship.

**Keywords:** MSME, Industrial Policy, Economic Reforms, Political Leadership, SEZ, GDP, Employment Generation, Structural Transformation.

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## 1. INTRODUCTION

Simon Kuznets, in his 1971 Nobel Prize lecture, noted that one of the key features of modern economic growth is the structural "*shift away from agriculture to non-agricultural pursuits and, recently, away from industry to services; a change in the scale of productive units, and a related shift from personal enterprise to impersonal organization of economic firms*" (Kuznets, 1971). This observation forms a foundational lens through which the industrial trajectories of both Gujarat and Bihar can be examined.

As per structural transformation theory, nations shift their focus from agriculture to manufacturing and service sectors. Gujarat exemplifies this transition: currently, agriculture contributes approximately 20% of its GDP, the secondary or manufacturing sector contributes 45%, and the service sector accounts for 35%. Bihar, however, shows an uneven trajectory the manufacturing sector contributes a mere 15%, agriculture contributes 26%, and the service sector constitutes 59% of GDP. This 30-percentage-point gap in manufacturing contribution between the two states underscores how divergent structural transformations lead to vastly different developmental outcomes.

This article examines the pre and post-2000 scenario of industries and enterprises in both states, with a particular focus on the period following the emergence of BJP and its allied parties in power. In 2001, Narendra Modi became Chief Minister

of Gujarat, while the JDU-led NDA coalition came to power in Bihar in 2005 under Nitish Kumar. Both governments espoused capitalist-oriented economic ideologies, though they implemented reforms with different intensities and outcomes. Prior to these administrations, India's Congress-led governments had pursued a license-raj framework that focused on state capitalism with limited space for private enterprise.

## 2. HYPOTHESIS

This study is grounded in the following hypothesis:

*H1: Political leadership quality and the ideological orientation of the ruling government have a significant and measurable impact on the growth of industries and MSMEs in Indian states.*

*H2: States that adopted liberal, investment friendly, and enterprise-supportive economic policies post 2000 witnessed significantly higher MSME growth in terms of sectoral distribution, investment generation, and employment creation compared to states with weaker or delayed reforms.*

*H3: Despite policy reforms, structural disadvantages including bifurcation-related losses, infrastructure deficits, and historical policy inequities continue to constrain Bihar's industrial and MSME growth relative to Gujarat.*

## 3. OBJECTIVES OF THE STUDY

The study aims to achieve the following objectives:

- To analyse the industrial and MSME policies of Gujarat and Bihar before and after 2000.
- To examine the sectoral distribution of MSMEs in both states in the pre and post 2001 periods.
- To assess the trends in investment and employment generation by MSMEs in both states before and after 2001.
- To compare the Compound Annual Growth Rate (CAGR) of investment and employment in MSMEs across both states.
- To identify the structural and political factors that have shaped differential industrial outcomes in Gujarat and Bihar.

## 4. RESEARCH METHODOLOGY

### 4.1 Research Design

This study adopts a comparative, descriptive, and analytical research design. It employs a mixed methodology incorporating qualitative analysis of policy documents and quantitative analysis of secondary data on MSME growth indicators. The study uses a longitudinal framework, examining trends across three time periods: 1980-2000, 2000-2005, and post-2005.

### 4.2 Data Sources

The study relies entirely on secondary data sourced from the following:

- Government of India reports on MSME development and industrial growth.
- State government annual reports and policy documents of Gujarat and Bihar.
- Publications by the Ministry of MSME, Government of India.
- Peer-reviewed academic articles, including works by Dholakia and Dholakia (2015), Hirway et al. (2014), and others.
- Reports from SEBI, GIDC, and Magadh Stock Exchange Ltd. (MSEL).
- Data compiled from the Economic Survey of Bihar and Gujarat.

### 4.3 Variables Studied

The study focuses on three key output variables for MSMEs in both states:

- Sectoral distribution of MSMEs (pre and post 2001).
- Investment generation by MSMEs (pre and post 2001).
- Employment generation in MSMEs (pre and post 2001).

Additionally, the CAGR 0 for both investment and employment generation is computed to provide a standardised growth comparison across the two states and the two time periods.

#### 4.4 Scope and Limitations

The study focuses on the states of Gujarat and Bihar for the period 1980 to 2015. The primary limitation of this study is reliance on secondary data, which may not capture informal sector employment or unregistered MSME activity. Literature review is excluded from this paper as it is being prepared separately by the author.

### 5. SCHEMES AND POLICIES: PRE AND POST 2003

#### 5.1 Gujarat: Pre-2000 Policy Environment

In Gujarat, new industrial units were entitled to incentives and subsidies when they were small or located in backward talukas. In the early 1990s, it was mandatory for beneficiary units to employ a minimum of 100 permanent workers, of whom local workers were required to constitute at least 80% of total workers and 50% or more of managerial and supervisory staff. Over the decade, these conditions were progressively relaxed. The pre-2000 policy largely focused on interest subsidies and incentives for small and tiny manufacturing sectors.

#### 5.2 Gujarat: Post-2003 Policy Reforms

The policy landscape in Gujarat underwent a decisive transformation in 2003 under Chief Minister Narendra Modi. Three major reforms defined this period:

- Labour reforms: Inspections carried out under the labour department were substantially reduced, thereby decreasing regulatory burden and harassment to industries.
- Environmental clearance: A large number of industries were exempted from obtaining No-Objection Certificates (NOC) from the Pollution Control Board.
- Land acquisition reforms: Relatively easier and quicker possession of land through the urgency clause, simplification of administrative processes, liberal land pricing for unused government land, and efficient land acquisition policy were introduced, attracting entrepreneurs to the state (Dholakia and Dholakia, 2015).

In 2004, the Gujarat Special Economic Zones Act was enacted, making access to land easier and labour laws less restrictive. The 2009 industrial policy was explicitly designed to make Gujarat the most attractive investment destination globally. The Gujarat Industrial Development Corporation (GIDC) began providing land to industrial units on 99-year leases and created additional SEZs. Land acquisition by GIDC rose dramatically from 4,620 hectares during 1990-2001 to 21,308 hectares between 2001 and 2010-11 (Hirway et al., 2014).

#### 5.3 Bihar: Industrial and MSME Policy Framework

Bihar's economic trajectory has been shaped by a set of historical policy disadvantages that created systemic barriers to industrial development:

- The Zamindari System and the Permanent Settlement of 1793.
- Step-motherly treatment by the Central Administration during British Rule and the post-Independence Plan periods.
- The Freight Equalization Policy of 1948, which eliminated Bihar's competitive advantage in mineral-based industries.
- An unwritten policy of non-performance during the 1990-2005 period.

Bihar's economy through the 1980s was largely agricultural. In 1980-81, Bihar's per capita income stood at Rs. 917, which was approximately 60% of the national average. Between 1980-1984-85, Bihar grew at a rate of 5.3% one of the fastest at the time. However, the gap with the national average widened rapidly, and by the turn of the century, Bihar's per capita output was as low as one-third of the national average. The CAGR for per capita income in India from 1980-1998 was approximately 3.2%, while Bihar recorded a meagre 1.1%.

A watershed moment was the bifurcation of Bihar in 2000, leading to the creation of Jharkhand. The industrial share that constituted 24% of GSDP in undivided Bihar fell to just 4% in divided Bihar. Most manufacturing units and power generation capacity were located in southern Bihar and transferred to Jharkhand. The share of industry (excluding

construction) in NSDP dropped from 22.5% to 4.6%, while the service sector's share jumped from 36% to 50% almost overnight. This restructuring left Bihar economically vulnerable with 73% of its remaining area being flood-prone and dependent on agriculture and services.

In 2005, under Nitish Kumar's NDA-JDU government, Bihar initiated a new phase of governance and economic reform. The Magadh Stock Exchange Association (MSEA), formed in 1985 and later reconstituted as Magadh Stock Exchange Ltd. (MSEL) in 2006, was repositioned to mobilise domestic investment. By March 2006, MSEL had 192 members including 17 corporate members, and 66 listed companies with a total market capitalisation of Rs. 35.13 crore.

#### **5.4 Common Schemes Implemented in Both States**

Several centrally-sponsored and state-supported schemes were implemented in both Gujarat and Bihar to promote MSME and industrial development:

- Employment Generation and Credit Support Schemes.
- Development of Khadi, Village, and Coir Industries.
- Technology Upgradation and Quality Certification programmes.
- Marketing Promotion Schemes.
- Infrastructure Development Programme.

## **6. RESULTS AND FINDINGS**

### **6.1 Sectoral Distribution in Both States: Pre and Post 2001**

The sectoral distribution of MSMEs underwent significant changes in both states following the reforms of the early 2000s. In Gujarat, the manufacturing sector particularly petrochemicals and chemicals emerged as dominant, contributing 34% and 15% of industrial output respectively. The cluster-based development approach enabled Gujarat to build geographically concentrated industrial ecosystems, increasing efficiency and output.

Bihar, on the other hand, witnessed a dramatic sectoral shift due to the bifurcation of 2000. The share of industry in NSDP declined from 22.5% to 4.6%, with services rising to dominate the state economy at approximately 59% of GDP currently. The manufacturing sector's contribution remains at merely 15% of GDP significantly below Gujarat's 45% reflecting the structural damage caused by bifurcation and decades of policy neglect.

### **6.2 Investment Generation by MSMEs: Pre and Post 2001**

Gujarat witnessed extraordinary growth in investment, particularly after the 2003 reforms. Fixed capital in Gujarat's industry multiplied by a factor of 3.6 in ten years from Rs. 66,601 crore in 1999-2000 to Rs. 2,40,381 crore in 2009-10. Gujarat represented 17.7% of the fixed capital of India as a whole, positioning it as the leading investment destination nationally, surpassing even Maharashtra and Tamil Nadu between 2009-10 and 2012-13.

However, the investment-to-employment ratio was heavily skewed. While Gujarat's fixed capital represented 17.7% of India's total, it accounted for only 9.8% of factory-level jobs indicating capital-intensive rather than labour-intensive industrial growth. This is in sharp contrast to Tamil Nadu, which with 9.8% of fixed capital generated 16% of factory jobs.

In Bihar, investment generation remained constrained by infrastructure deficits, flood vulnerability, power shortages, and lack of an enabling policy environment for private capital. The reconstituted MSEL was intended to channel investment into productive sectors, but the scale remained modest given the broader institutional limitations.

### **6.3 Employment Generation in MSMEs: Pre and Post 2001**

In Gujarat, despite the surge in industrial investment, employment generation failed to keep pace. The annual growth rate of employment in industry declined from 2.4% during 1999-2000 to 2004-05 to just 0.1% during 2004-05 to 2009-10. Urban employment growth rose only marginally from 4% to 4.9%, and wages lagged behind productivity gains.

A critical reason for this employment stagnation was the crisis in the Small and Medium Enterprises (SME) sector which are typically four times more labour-intensive than large firms. Non-performing assets of Gujarat's SMEs grew by 43.9% in 2013, driven by rising gas and electricity prices and inadequate financial support from local banks. The number of sick

MSME units in Gujarat rose alarmingly from 4,321 in 2010-11 to 20,615 in 2012-13 and 49,382 in 2014-15 (Mishra, 2015). Between 2004 and 2014, approximately 60,000 MSMEs shut down in Gujarat (Singh, 2015), severely damaging employment prospects.

In Bihar, employment generation through MSMEs has historically been constrained by the lack of industrial base. Post-2005, the Nitish Kumar government's focus on law and order improvement, infrastructure investment, and social development programmes created a more stable environment. However, the absence of major industrial clusters, limited power supply, and poor road connectivity continued to restrict MSME-driven employment. Inter-state migration from Bihar to states like Gujarat, Maharashtra, and Delhi remained a significant economic feature, reflecting the gap in local employment opportunities.

#### **6.4 CAGR: Investment, Employment, and Overall MSME Growth**

A comparative CAGR analysis of both states reveals the following broad patterns:

In Gujarat, investment CAGR for the period 1999-2000 to 2009-10 was exceptionally high, driven by SEZ development and large corporate investments. However, employment CAGR for the same period was negligible, falling to approximately 0.1% towards the end of the decade underscoring the capital-intensive nature of Gujarat's post-2003 industrial model.

In Bihar, investment CAGR remained low across all periods, reflecting structural barriers. However, post-2005, certain service-sector indicators and agricultural output showed improvement, and MSME registrations began to rise though from a very low base. The overall MSME growth rate in Bihar has been positive post-2005, driven by government schemes targeting credit access and rural enterprise, but absolute numbers remain far below Gujarat.

#### **6.5 Fiscal and Governance Dimensions**

Gujarat's business-friendly model was not without fiscal costs. To attract large corporations, the Modi government extended significant fiscal exemptions. Several major companies accumulated substantial unpaid tax liabilities reportedly totalling Rs. 12,000 crore owed to the state in 2011. Large SEZ beneficiaries including the Reliance Group, Adani Group, and others received billions in tax exemptions. As a result, Gujarat's fiscal liabilities rose from Rs. 45,301 crore in 2001-02 to Rs. 1,38,978 crore in 2011-12, raising questions about fiscal sustainability relative to growth rates.

Bihar's governance challenges during the 1990-2005 period under successive governments led to a near-collapse of industrial confidence. The law-and-order situation, rampant corruption, and political instability discouraged private investment. The post-2005 Nitish Kumar government addressed these concerns through administrative reforms and emphasis on inclusive development, but fiscal resources remained constrained by low tax collection and high dependence on central transfers.

## **7. CONCLUSION**

This comparative study of Gujarat and Bihar reveals that political leadership and economic policy orientation have a profound influence on the trajectory of industrial and MSME development. Gujarat's sustained political stability, liberal land and labour policies, SEZ framework, and cluster-based development under Modi's leadership from 2001 enabled it to become India's leading investment destination in the early 2000s.

Bihar, constrained by historical inequities including the devastating impact of the Freight Equalization Policy, the Zamindari legacy, and the economic haemorrhage of bifurcation in 2000 entered the reform era from a position of deep structural disadvantage. The post-2005 NDA-JDU government under Nitish Kumar made significant strides in governance and law and order, creating a foundation for economic recovery, but the MSME sector remains underdeveloped relative to Gujarat.

A key paradox that emerges from the Gujarat case is that high investment does not automatically translate into high employment. The capital-intensive nature of Gujarat's industries, combined with the crisis of MSMEs (which are the primary generators of employment), meant that job creation lagged far behind investment growth. This has driven inter-state migration rather than alleviating it.

For Bihar, the path forward lies in targeted infrastructure investment, improved power supply, credit access for MSMEs, and leveraging its demographic dividend through skill development. Reducing inter-state migration and creating sustainable local employment require not just policy reform but also sustained institutional capacity-building.

In sum, while Gujarat offers a model of investment-driven growth, its equity and employment implications caution against uncritical replication. Bihar's reform experience post-2005 offers lessons on the importance of governance quality as a precondition for economic development. Both states, through their contrasting trajectories, illuminate the complex interplay between political leadership, economic reform, and inclusive industrial growth in India's federal context.

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