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INDIA AFTER THE REFORMS

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List of Tables

1. GNP of the world's largest economies at purchasing power parity, 1992

2. India's trade with major trading areas, 1992

3. India's share in world exports, selected commodities and years, 1970-1992

4. Debt servicing capacity of principal Asian borrowing countries, 1990

5. Balance of payments, 1987-88 to 1994

6. Tariff structure, 1990-96

7. Profitability of banks, 1991-92 and 1993-94

8. Developments in the capital market, 1991-1994

9. Financial transactions of all governments as a proportion of GDP, 1990-91 to 1994-95

10. Inflow of foreign direct investment under the new regime, 1991-94

11. India's share in world output of some consumer goods, 1982 and 1992

12. India's share in world output of some intermediate goods, 1982 and 1992

13. India's share in the world output of some agricultural goods, 1979-81 and 1993

Abbreviations

BIFR	Bureau of Industrial Finance and Reconstruction
BJP	Bharatiya Janata Party
CRR	Cash Reserve Ratio
FIPB	Foreign Investment Promotion Board
GDP	Gross Domestic Product
GNP	Gross National Product
JD	Janata Dal
PPP	Purchasing Power Parity
SEBI	Securities and Exchange Board of India
SIA	Secretariat for Industrial Approvals
SLR	Statutory Liquidity Ratio

Contents

I. INDIA IN THE WORLD ECONOMY 1

II. SECTORAL DEVELOPMENTS 8

III. A BALANCE SHEET OF REFORMS 34

IV. THE PROSPECTS 38

I. INDIA IN THE WORLD ECONOMY

1. A Comparison of National Outputs

Total production of goods and services (GNP) of India, if compared at current prices and exchange rates, is less than that of Korea or Brazil, a third to a quarter of the GNP of France, Britain or Italy, and a twentieth of that of the USA (Table 1). But this comparison is misleading, since prices in India are between a third and a sixth of prices in industrial countries. This is characteristic of countries with low labour costs. The labour costs are reflected in low prices of goods that are not traded, such as services; and import and export restrictions as well as transport costs sustain the differences in prices of tradables.

If a correction is made for the price differences, the output of the Indian economy is about as large as that of France and Italy, and somewhat larger than that of Britain, Russia or Brazil. The US economy produces about six times as much as India; Japan and China, over twice as much; and Germany, 1.7 times as much. Thus India is one of the half-a-dozen largest economies of the world in terms of absolute volume of production and size of the market.

Of the economies portrayed in Table 1, China and Korea have grown faster than all others; Japan has grown faster than other industrial economies. India's growth rate of 5.2 per cent over 1980-92 was higher than that of Japan, and about twice that of other industrial economies and Brazil. If the 1980-92 growth rates continued into the future, the annual increase in India's output would be exceeded only by the USA, Japan and China.

Table 1

GNP of the world's largest economies at purchasing power parity, 1992								
	Population (million)	Price level	GNP/capita ($ 1000) Mkt. price	PPP	GNP ($ trillion) Mkt. Price	PPP	Annual GNP growth 1980-92 (%)	Annual GNP increment ($ billion)
USA	255	1.01	23.2	23.1	5.9	5.9	2.7	159.3
Japan	125	1.40	28.2	20.1	2.9	2.5	4.1	102.5
China	1162	0.25	0.5	1.9	0.5	2.2	9.1	200.2
Germany	81	1.01	21.8	20.6	1.9	1.7	2.6	44.2
France	57	1.12	23.0	19.2	1.3	1.1	2.2	24.2
India	868	0.26	0.3	1.2	0.3	1.1	5.2	57.2
Italy	58	1.15	20.5	17.7	1.2	1.0	2.4	24.0
UK	58	1.06	17.8	16.7	1.0	1.0	2.7	27.0
Russia	149	0.40	2.5	6.2	0.4	0.9	(-0.5)	
Brazil	154	0.53	2.8	5.2	0.4	0.8	2.2	17.6
Korea	44	0.76	6.8	9.0	0.3	0.4	9.4	37.6

Source: Tata Services Limited (1994): Department of Economics and Statistics. *Statistical Outline of India 1994-95*, Bombay 1994. Population, p. 217, Table 227; per capita GNP, p. 236, Table 245. Figures of per capita GNP at 1992 purchasing power parity are originally from the World Bank. GNP growth rates are from International Monetary Fund (1994): *International Financial Statistics Year book 1994*, Washington DC. Relative prices (i.e., ratios of PPP GNPs to GNPs converted at current exchange rates) are calculated with GNPs at current 1992 prices.

Table 2

India's trade with major trading areas, 1992								
Exports ($ million)	Share in world exports	Distribution of India's imports (per cent)	India's share of area exports		India's Share of area imports	Distribution of India's exports (per cent)	Share in world imports	Imports ($ million)
1470	39.9	31.0	0.50	EC	0.37	27.5	39.6	1524
447	12.1	8.9	0.47	USA	0.67	17.9	14.4	553
340	9.2	7.0	0.48	Japan	0.79	9.0	6.1	233
120	3.3	1.5	0.30	Hong Kong	0.56	3.3	3.2	123
86	2.3	0.7	0.20	China	0.20	0.8	2.1	82
75	2.0	2.0	0.63	Korea	0.53	2.1	2.1	81
51	1.4	5.2	2.39	S. Arabia	1.02	1.9	1.0	38
50	1.4	1.5	0.68	Singapore	0.56	2.1	2.0	76
41	1.1	2.0	1.15	Malaysia	0.80	1.6	1.0	40
36	1.0	0.7	0.45	Brazil	0.05	0.1	0.6	23
34	0.9	0.2	0.16	Indonesia	0.57	0.8	0.7	28
32	0.9	0.3	0.23	Thailand	0.18	0.4	1.1	41
30	0.8	0.0	0.00	S. Africa	0.03	0.0	0.6	22
25	0.7	4.6	4.37	UAR	4.05	3.9	0.5	20
850	23.1	34.4	1.01	Others	0.62	28.9	25.0	962
3687	100.0	100.0	0.64	Total	0.54	100.0	100.0	3846

Source: Calculated from International Monetary Fund (1993) : *Direction of Trade Statistics Year Book 1993*, Washington DC. International Monetary Fund (1994) : *International Financial Statistics Year Book 1994*, Washington DC. Tata Services Limited (1994) : Department of Economics and Statistics : *Statistical Outline of India 1994-95*, Bombay.

2. Low Trade Dependence

India's exports are less than 7 per cent of its GNP and imports less than 8 per cent of its national expenditure even when these are measured in current prices. The USA and Japan have the lowest trade rations amongst industrial countries; India's are4 even lower. If production is measured in terms of purchasing power parity (i.e. at uniform prices for all countries) as in Table 1, then India's trade ratios are even lower- at best about 2 per cent. Even those of China, which like India has domestic prices, are twice as high; the USA's, 3 ½ times, Japan's, 6 ½ times, and other countries' trade ratios are even higher. Thus amongst major countries, India is the least dependent on foreign trade.

Equally, the world is less dependent on India as a market or a source of supply than on many smaller countries. India buys 0.6 per cent of the world's exports and supplies 0.5 per cent of imports. Countries with a lower GNP such as Brazil, Malaysia, Indonesia, and South Africa have a much larger share of the world's exports and import than India. India's trade ties are stronger with a few neighboring countries such as UAE, Saudi Arabia, Singapore and Malaysia; but its share of even these countries' trade is small. India's low share in other countries' trade means that they have less at stake in what happens to the Indian economy. Economics news of India figures less in international media, and news of accidents, catastrophes and unrest figures more. This is one reason why India has a low profile and a poor image in the world: it matters less to the world than many smaller countries.

India's trade ratios are low because of the stringent trade restrictions India imposed from the mid-1950s onwards. They consisted of exchange control, import duties and quantitative import restrictions.

Table 3

India's share in world exports, selected commodities and year,1970-1992						
	1970	1975	1980	1985	1990	1992
Tea	33.4	31.3	27.7	26.2	21.7	10.5
Spices	20.5	13.3	14.5	19.3	7.7	6.4
Leather	13.4	12.3	10	7.9	4.5	3.4
Cotton fabrics	6.8	5.1	5.3	4.8	3.5	2.8
Iron ore	6.7	5.4	6.3	7.8	7.2	9.4
Synthetic fabrics	4.8	2.4	0.5	0.2	0.7	0.5
Tobacco	2.5	3.2	4.4	3	0.8	0.4
Precious stones	2.2	2.2	3.1	9.6	8.7	10.1
Coffee	1	1.3	2.1	1.9	4	2.1
Sugar	1	4.8	0.3	0	0	0.6
Iron and steel	0.9	0.3	0.1	0.1	0.3	0.4
Other fabrics	0.8	0.9	6.4	4.8	2.3	2.2
Leather goods	0.6	1	6.3	16.4	11.7	6.7
Rice	0.6	0.6	3.7	5.6	6.8	3.4
Dyes	0.5	0.6	0.8	0.8	1.2	1
Pharmaceuticals	0.4	0.4	0.8	0.8	1.2	0.3
Animal feed	0	0	1.6	1.5	2.2	2.5
Garments	0	0	1.8	2.3	2.3	2.4

Source: Ministry of Finance (1995): Economic Survey 1994-95, New Delhi, pp. 97-99, Table 7.5.

Quantitative restrictions in particular were imposed so as to give unconditional protection to domestic producers however high their costs. The cost-raising effect of import constraints was heightened by the fact that a system of approvals for industrial production, expansion and diversification minimized domestic competition. Thus high-cost industries were built up which could not export and which preferred to import, and imports tended to outrun exports. The persistent weakness of the balance of trade was used to justify ever tighter import restrictions. Import restrictions protected domestic industry, but raised its costs and made it internationally uncompetitive. Inefficient upstream industries such as steel and petrochemicals raised the costs of downstream industries such as engineering and chemicals, and made them uncompetitive too.

The effect of this trade regime can be seen in Table 3. In 1970 India had a significant share in the world exports of tea, spices, leather, fabrics and tobacco. In all these products it suffered a major loss of market share in the next twenty years. In leather this was due to an active policy of encouraging exports of finished products; in other goods, however, there was straight loss of market share. India increased its market share in precious stones, rice, animal feed and garments; but only in gems was the

ensuing market share significant. Even in products where India did not steadily lose market share, there were large year-to-year variations; for instance, in coffee, sugar, steel and garments. In some of these goods, priority given by the government to supplying the domestic market led it to operate arbitrary export restrictions; hence India came to be known as an unreliable exporter. In other goods exports were unprofitable or only marginally profitable, and were pushed by subsidies; variations in subsidies and the hassles involved in getting them destabilized exports.

3. From Undertrading to Overborrowing

The rise in oil prices in the 1970s led to large balance-of-payments surpluses in oil-producing countries which were recycled and lent to a number of developing countries such as Brazil. Most of them became over indebted: few major developing countries remained good lending risks in the 1980s. Having borrowed little in the 1970s, India was one of the few developing countries which remained a good credit risk. Hence it was offered and took loans on a large scale in the 1980s. Still, at the end of the 1980s its ratio of debt to GDP was modest by international standards. But since its export ratio was so low, the debt service ratio mounted precipitately (Table 4). Thus in 1990, Indonesia, Malaysia and Thailand had higher debt in relation to their GNPs than India. But their export ratios were much higher. Hence Indonesia could sustain a debt-to GNP ratio which was over twice as high as India's; Malaysia and Thailand had higher debt-to-GNP ratios and lower debt service-to- exports ratios than India.

The structure of international fund flows also changed radically from the late 1980s. Supply of private capital grew much faster than that of capital provided by international and government agencies. Private lenders were once unwilling to lend to developing countries which they considered too risky; the business was left to the International Monetary Fund and the World Bank whose size and status gave them greater influence on borrowing countries' policies. But East Asian countries significantly reduced lender's risk by maintaining strong export performance and by borrowing short. The supply of short-term funds grew more rapidly than that of long-term funds. Long loans are normally used for long-term fixed investment; short loans are more often used for

Table 4

Debt servicing capacity of principal Asian borrowing countries, 1990							
		India	Indonesia	Malaysia	Thailand	China	Korea
GNP	$ billion	291.9	100.9	40.9	84.6	338.3	251.9
Debt	$ billion	82.0	66.7	16.1	28.2	52.6	35.0
Debt service	$ billion	6.2	8.5	3.4	4.3	5.9	7.4
Interest payments	$ billion	3.7	2.5	1.1	1.4	2.5	1.2
Repayments	$ billion	2.1	4.1	2.3	3.0	3.3	5.7
Exports - goods and services	$ billion	25.6	29.9	34.5	31.3	60.5	77.4
Current account balance	$ billion	-10.0	-3.0	-0.9	-7.3	12.0	-2.2
Debt/GNP	per cent	28.1	66.1	39.4	33.3	15.6	13.9
Exports/GNP	per cent	8.8	29.6	84.4	37.0	17.9	30.7
Debt service/debt	per cent	7.6	12.7	21.1	15.2	11.1	21.1
Interest/debt	per cent	4.5	4.7	6.6	4.8	4.8	3.4
Repayments/debt	per cent	2.5	6.2	14.5	10.6	6.3	16.2
Debt service/exports	per cent	24.2	28.4	9.9	13.7	9.7	9.6
Current deficit/exports	per cent	-39.0	-10.0	-2.6	-23.3	19.8	-2.8

Source : All figures from World Bank (1994): *World Bank Debt Tables : External Finance for Developing countries,* Vol. 2, country tables, Washington DC.

inventory finance, asset leasing, and production support. Shorter terms give both the creditor and the debtor greater flexibility in fund management. Inflows of international short-term funds have created competition for the domestic banking systems of borrowing countries, opened up opportunities of interest arbitrage, and provided flexible finance for export-related production. All the east and Southeast Asian countries in Table 3 - China, Korea, Malaysia, Thailand and Indonesia - took advantage of shorter terms; India did too, but to a lesser extent. But shorter terms imply a greater annual repayment burden. Hence short-term lenders are highly sensitive to the borrowing country's balance of payments: signs of payments difficulties can switch off the supply of shorter-term funds very quickly; and since more of shorter loans are repaid every year, net inflows can easily become outflows. This is what happened to India (Table 5).

Between 1987-88 and 1989-90 India ran a large deficit on current account; imports outran exports, and borrowings to finance the deficit led to mounting interest payments. The deficit was not entirely covered by capital imports, and foreign exchange reserves were run down. In 1990 India began to borrow from the International Monetary Fund; still reserves in March 1991 were down to $ 2.2 billion from $ 3.4 billion a year earlier. The signs of a balance of payments crisis were loud and clear. Non-resident Indians began to withdraw their deposits from Indian banks, and foreign banks refused to renew the short-term loans that became due. The minority government that was in power could not muster enough support in Parliament to pass a budget. The country plunged into a crisis; by June the reserves had fallen to $ 1.1 billion, and foreign exchange was being rationed from one day to the next by the Reserve Bank of India (the central bank).

Table 5

Balance of payments, 1987-88 to 1994 ($ billion)								
	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994
	April - March							Apr-Sep
Year-end exchange reserves	5.6	4.2	3.4	2.2	5.6	6.4	15.1	18.9
Overall balance	-0.2	-0.1	-0.1	2.5	-2.8	0.6	-8.7	-4.5
Use of reserves	0.7	1.0	0.7	1.3	-3.6	-0.7	-8.9	-3.3
Transactions with IMF	-0.9	-1.1	-0.9	1.2	0.8	1.3	0.2	-1.1
Balance on capital account	5.0	8.1	7.0	7.2	4.0	3.0	9.0	4.9
Government				1.0	1.8	1.0	1.0	-0.4
Non-government				3.9	1.9	2.2	5.9	2.8
Other flows				2.3	0.3	-0.2	2.1	2.4
Balance on current account	-4.9	-8.0	-6.8	-9.7	-1.2	-3.5	-0.3	-0.4
Balance of trade	-7.2	-9.4	-7.5	-9.4	-2.8	-4.4	-1.3	-1.5
Exports	*12.6*	*14.3*	*17.0*	*18.5*	*18.3*	*18.9*	*22.7*	*11.9*
Imports	*19.8*	*23.6*	*24.4*	*27.9*	*21.1*	*23.2*	*24.0*	*13.4*
Net invisibles	2.3	1.4	0.6	-0.2	1.6	0.8	1.0	1.1
Nonfactor services	*0.5*	*0.7*	*0.7*	*1.0*	*1.2*	*1.1*	*0.8*	
Investment income	*-1.3*	*-2.5*	*-2.9*	*-3.8*	*-3.8*	*-3.4*	*-4.0*	
Private transfers	*2.7*	*2.7*	*2.3*	*2.1*	*3.8*	*2.8*	*3.8*	
Official grants	*0.4*	*0.5*	*0.5*	*0.5*	*0.5*	*0.4*	*0.4*	

Source : All figures from Ministry of Finance *(1994): Economic Survey 1993-94*, New Delhi, pp. 77 f., Table 6.2; Ministry of Finance (1995): *Economic Survey 1994-95*, New Delhi, p. 87, Table 5.2; pp. 79 f., Table 6.2.

In these circumstances a general election was held in May 1991, and a new government took office in June. Starting immediately, this government carried out policy reforms over the next four years, of which the most important are described below.

II. SECTORAL DEVELOPMENTS

1. Foreign Trade

The currency was devalued. The official exchange rate against the D-Mark was raised from Rs 11.44 to Rs 14.63 in June 1991 and Rs 15.60 in March 1992. At that point a foreign exchange market was created to finance non-official imports, in which exports were allowed sell 40 per cent of their exchanges in the market; the rest continued to be appropriated by the government at the official exchange rate. In March 1993 the dual market was abolished; all current transactions were financed by exchange bought and sold in the market. The unified market exchange rate settled at Rs 18.17 to the D-Mark. Since then Reserve Bank of India has effectively pegged the rupee to the US dollar. So it has depreciated somewhat further against the D-Mark.

Together with these change in exchange rate regulation, exchange control was relaxed. Now exchange control on current transactions is decentralized and is administered by banks; only capital movements require Reserve Bank’s approval. Exchange control on trade transactions has been removed; they are now regulated only by tariffs and the remaining import controls.

The detailed import licensing regulations were replaced in June 1991 by a single negative list; all goods not on the list were presumed not to require licences. In this way, all industrial inputs and capital goods were freed from import controls. More goods have been removed from the negative list in the past four years. Now the only o\important gods that remain subject to import controls are agricultural goods and consumer goods. Some consumer durables are importable by exporters against special import licences issued to then. Except for these goods, the only policy affecting imports is tariff policy. Tariffs were extremely high till 1991. Since then, they have been brought down in the budgets presented every February, by reducing the maximum tariff as well as individual tariff rates within the peak. The tariff structure has evolved as in table 6.

The peak tariff was brought down from 300 per cent in 1991 to 110 per cent in 1992, 85 per cent in 1993, 65 per cent in 1994 and 50 per cent in 1995. With the fall the peak tariff, the range has been compressed. The number of tariff rates been particularly reduced in respect of intermediate goods and capital goods. Most Indian agricultural prices are lower than international prices, and domestic prices of both agricultural and industrial goods are often below tariff-inclusive import prices. The tariff range has been reduced by bringing down agricultural tariffs faster-although imports of many agricultural goods are still subject to import licensing and hence not constrained by tariffs. Consumer goods are subject to import licensing and hence not normally imported, and the duties on them are relatively high. In practice, imports of those goods on which tariffs are brought down more rise faster; hence the import-weighted tariff comes down more than the unweighted average. This is particularly true of intermediates. It is also true of agricultural goods because imports are allowed for political reasons for instance because they are mass consumption goods or important industrial intermediates such as sugar, cotton or edible oil; for the same reason, import duties on such goods are kept low or waived.

Table 6

Tariff structure, 1990-96						
	All imports	Intermediate goods	Minerals	Agricultural goods	Capital goods	Consumer goods
			Simple average			
1990-91	128	133		106	109	142
1992-93	94	104		59	86	92
1993-94	71	77	71	39	58	76
1994-95	55	59	48	31	42	59
1995-96	42	45	37	26	35	43
			Standard deviation			
1990-91	41	42		48	32	33
1992-93	34	25		49	26	42
1993-94	30	22	24	39	24	36
1994-95	25	17	25	30	20	22
1995-96	21	15	18	21	13	21
			Import-weighted average			
1990-91	87	117		70	97	164
1992-93	64	55		30	76	144
1993-94	47	40	33	25	50	33
1994-95	33	31	31	17	38	48
1995-96	27	24	30	15	30	39

Source : World Bank (1995): *India : Country Economic Memorandum. Recent Economic Developments: Achievements and Challenges,* Washington DC, p.31, Table 1.18.

The changes in the import regime have reduced the cost of imports; but even more, they have made importing a great deal easier by cutting out red tape and removing the need to get licences in advance. Under import licensing, lead times of 6-9 months in importing were not uncommon; now they are measured in weeks. As a result, industry can respond much faster to domestic shortages or to export opportunities. Although tariffs have been reduced, the absolute level of protection has not declined. The cost of D-Mark in terms of the rupee has risen by 70 per cent since 1991. At this level of devaluation, a post-devaluation tariff of 25 per cent would raise the domestic price of imports to the same level as a pre-devaluation tariff of 110 per cent. In other words, an import duty of 110 per cent could have been brought down to 25 per cent without reducing the protection to a hypothetical domestic industry which required no imports; import-dependent industries could have borne even larger tariff reductions without suffering any reduction in protection. Most tariffs have come down much less than this; thus the net level of protection to most industries has increased since 1991. It was reinforced in the past two years by the rise in international raw material prices.

Exporters can import inputs duty-free in advance on the basis of export orders received, but for that they still need to get licences and to give bank guarantees that if they do not export, they would pay duty. They thus need to get advance import licences, obtain a bank guarantee and give them to the licensing authorities, and get the guarantee revoked when exports are made. Hence advance licensing for exporters continues to beriddled with red tape, and the delays are often so long that advance licences for imports which should go into the exports are actually received after the exports are made.

The incomplete liberalization of foreign trade has caused distortions. For instance, the industrial growth rate has risen from 0.6 per cent in 1991-92 to 2.3 per cent in 1992-93, 4.1 per cent in 1993-94 and 8.3 per cent in 1994-95; in the current year (1995-96) it may exceed 9 per cent. This accelerated growth is spearheaded by consumer durables, and especially vehicles, whose imports are still banned. Demand is fed by credit, and shortages cannot be relieved by imports. Thus excess demand is driving industrial production into areas which may well be internationally uncompetitive. Similarly, India has had a surplus of cotton whose trade is controlled; exports are not normally allowed owing to the strength of the textile industry lobby. On the strength of the cheap domestic cotton, textile exports were built up. In 1994, however, the cotton surplus disappeared as industrial demand outstripped supply. Import licensing was abolished and imports freely allowed, but this was no help to the textile industry since domestic cotton prices were no higher than import prices. In sugar, too, there are periodic surpluses and shortages which have to be relieved by opening up exports or imports. But because of import and export controls India is an occasional and unreliable trader in these products, and its domestic imbalances are widely publicized before trade is eventually opened up, so import prices are driven up and export prices are driven down. All controls bring forth lobbies, and there are lobbies which resist removal of the remaining controls. The disadvantages of the remaining controls are being recognized, but further liberalization is slow. Nevertheless, the relaxation achieved is sufficient to sustain faster industrial growth for some years.

2. Finance

The financial structure has been biased towards fixed interest funds and against equity for two reasons; first, government companies, which accounted for 60 per cent of corporate capital, were not allowed to issue equity to private shareholders, and the governments lent them money rather than increase their equity in the belief that the enterprises would thereby be forced to earn enough to service the debt; and second, the central government exercised control on the issue price of new equity, and underpriced it, so even privately owned companies, which could raise equity, avoided doing so and preferred borrowing money. The market for equity was narrow, and for debt it did not exist. Ordinary banks were not allowed to invest in shares either. Instead, the government created intermediary institutions which intercepted personal savings and invested in debt and equity. The larger banks were nationalized in 1969, and the remaining private banks did not grow for fear of nationalization. Insurance companies were nationalized in the 1950s. Thus government-owned financial intermediaries dominated the market for deposits, long-term debt as well as equity.

The high ratio of debt to equity made industry - both private and public - vulnerable to variations in profitability; firms easily stumbled into liquidity crises and bankruptcy. If a government company got into financial trouble, the government would either lend it more money or force one of the government-owned financial intermediaries - banks or long-term financial institutions- to give it further loans. If a private company went bankrupt, the Industrial Disputes Act required it to seek government permission to close down, which was almost never given. So the company would go into a limbo; it would neither be liquidated, nor could it continue business. In 1981 the government set up a Bureau of Industrial Finance and Reconstruction (BIFR) which was to act as a liquidation court. The BIFR tried to force the creditors - especially government banks and financial institutions - to write off part of the debt, reduce the interest

burden, and give fresh loans to keep the bankrupt companies afloat. The creditors did so reluctantly and often reneged on their promises to the BIFR When it became clear that the company could not be revived, it would be sent to an ordinary court for liquidation. So in most cases the BIFR only duplicated the role of courts and delayed liquidation proceedings, which are slow anyway. In the meanwhile, both the owners' and the creditors' funds were locked up for years. Thus it was impossible for a company that got into trouble to close down.

After they were nationalized, banks and insurance companies were moulded into the government structure. Their salaries were brought in line with government salaries (which, since they were low at the top, created a powerful incentive to corruption). Recruitment was placed in the hands of separate boards, which conducted examinations and forced the banks to accept the candidates so chosen. Promotion from the ranks was largely by seniority, and three-quarters of the promotions were reserved for internal staff and hence dominated by trade unions. Promotions to top management positions were made by the finance ministry, with considerable scope for political interference. Managers thus appointed had generally very short terms before transfer or retirement, often less than two years. In management they were shackled by rules and by pressures from the bureaucracy and the unions. So there was little they could do; and generally there was little they wanted to do beyond keeping everyone happy - politicians, bureaucrats, and staff. All could be kept happy only at the expense of profits.

However, profits were eroded by forced credit and interest cross-subsidies. Banks were forced to give 40 per cent of their loans to "priority" borrowers - farmers, small firms, craftsmen, and other politically favoured groups. They could equally be forced to favour a borrower by a telephone call from the finance ministry or a visit from a local politician; and borrowers who got loans as political favours saw no reason to repay or service them. As earlier mentioned, many firms went bankrupt because they had over borrowed; they too ceased to service their debt. In this way, the burden of bad debts on the banks went on increasing, and a number of banks went technically bankrupt. To prevent further financial erosion, the Reserve Bank supervised the banks ever more closely, required voluminous information, staged periodic inspections, and issued detailed instructions. The instructions were not necessarily followed, and as the information system broke down, it was impossible to know how far they were obeyed. Thus by 1991 the banking system had become highly centralized, and its management verged on the chaotic.

The costs of systemic inefficiency and bad debts had to be met either by the government or by the public. The losses of the public enterprises were met out of the budget; and the budgetary deficit was met by issue of money or by compulsory loans from the banks. By 1991, 63.5 per cent of banks' deposits were taken away by the governments - 15 per cent in the form of the cash reserve ratio (CRR) and 38.5 per cent in the form of the statutory liquidity ratio (SLR). The cash reserve ratio forced banks to keep idle cash; the statutory liquidity ratio was used to make the banks buy loans of the central and the state governments. These loans bore rates of interest below the banks' costs; besides, the banks made losses on cheap loans to privileged borrowers. The Reserve Bank regulated Interest rates so as to compensate the banks for these losses; it kept interest rates on public deposits low, and the lending rates for unprivileged borrowers high, to give banks high enough spreads.

These high spreads created opportunities for other institutions to arbitrage: for instance, instead of paying high interest to banks, companies could borrow directly from the public. The structure could survive only if such opportunities were curbed. Thus the Reserve Bank also fixed interest rates that could be paid by companies on public deposits, and rates that could be paid on debentures. In the 1980s, a large number of leasing companies came up to exploit the interest spread; the rates they could pay also came to be controlled. Thus the losses of the entire financial system were borne out of high profit margins ensured by interest regulations; in effect, private savers, who received low interest, and industry, which paid high interest, subsidized the banks, privileged borrowers, and defaulters.

Beginning in 1991, the government has tried to repair this system in three ways: it has tried to speed up liquidation of bankrupt enterprises and to prevent them from getting more funds from the financial system; it has recapitalized government banks and reduced interest cross-subsidies; and it has removed price control on equity issues and sought instead to regulate the equity market.

Bankrupt enterprises can be government-owned or private. Till 1991, bankrupt public enterprises were not recognized as such at all. It was assumed that since governments owned could not go bankrupt, the firms they owned could not go bankrupt either. This position created a strong incentive amongst unsuccessful government firms to go ever deeper into debt. The competition to borrow turned into a vicious circle of indebtedness. If government companies could not repay debts to private parties, they would eventually stop getting credit from those parties. But if they could not pay other government companies, the latter could still be forced by the government to continue to lend. This is how state electricity boards came to owe billion of rupees to Coal India Limited, the monopoly producer of coal, to National Thermal Power Corporation, National Power Transmission Corporation, and Bharat Heavy Electricals Limited, all central government companies supplying the power producers. After 1991, the central government stopped its enterprises from giving unlimited credit to other government enterprises , and sent 52 public enterprises (out of 111 loss-making ones) to the BIFR; following its lead, state governments sent another 66. The BIFR refused to take on 22, constructed revival packages for 11, recommended liquidation of 7, and 5 cases got involved in litigation over jurisdiction of the BIFR references to signify that even public enterprises would be closed down if the were unprofitable. The message has not been convincing enough, for the number of loss-making central government enterprises rose from 111 in 1990-91 to 117 in 1993-94, and their losses from Rs 31 billion to Rs 53 billion. But at least the financing of losing enterprises by the financial system has been stopped.

The BIFR itself was an ineffective and dilatory organization. A committee appointed by the finance ministry in 1992 strongly criticized its performance, and proposed that reference of bankrupt firms to the BIFR should be made voluntary. This frightened it into greater efficiency. In its first five years (1982-87), the BIFR took an average of 160 days before it held even the first hearing on a case, and 700 days to decide a case. These delays were brought down to 63 days and 187 days respectively in 1994.

3. Banking

Banks' finances have been strengthened in three ways: they have been recapitalized; a machinery has been created for them to recover their bad debts; and the interest rate structure has been changed to reduce cross-subsidies. At the same time, the government has tried to intensify competition by licensing new banks and liberalizing the entry and expansion of foreign banks.

The Reserve Bank asked all banks to achieve the Basel norms of capital adequacy by 1996: basically, they had to have unimpaired capital to cover 8 per cent of their risk-weighted assets. They also had to make full provision for bad debts, which would mean that they had to recognize the resulting losses. A number of government banks did not have the capital. Those amongst them that were profitable were allowed to borrow or issue shares in the capital market. The rest were given government bonds, which would give them interest for ten years and then replenish their cash. To help banks realize bad debts, five debt recovery tribunals were set up to speed up recovery. To prevent defaulters from using the judicial system to pay their debts, it was decreed that if they appealed against an adverse decision of a tribunal, they had first to deposit 75 per cent of their dues.

The interest rate structure, which in 1990 had over 20 different rates, has been simplified. Now there are two ceilings on deposit rates: 11 per cent on deposits over 46 days and 4.5 per cent on savings deposits withdrawable without notice. There are concessional interest rates of 12 and 13.5 per cent on small advances and 13-15 per cent on export credit; other bank lending rates are no longer controlled. Export credit is refinanced by Reserve Bank; so only small loans now get a small cross-subsidy. The state governments continue to receive a cross-subsidy since they pay less on their securities than commercial advances. But the statutory liquidity ratio, which is the instrument of compulsory lending to the governments, has been brought down from 38.5 per cent in 1991 to 25-29 per cent. The central government has ceased to take recourse to the SLR, and has reduced the access of long- term financial institutions belonging to it; thus the SLR is now being used largely to finance state governments' deficits. Most of them are not creditworthy and can get loans only through this mechanism which compels banks to lend to them.

Six new banks have begun business, and six more have been licensed. Some belong to the public long-term financial institutions, which have very large financial dealings with the investing public, and hence expect to have much captive business. Hitherto, however, the new banks have confined themselves largely to wholesale banking, which needs less access to prime urban property for retail branches and yields higher margins.

Table 7 shows banks' financial results and the effects of the early reforms on them. Foreign banks accounted for 6 per cent and private banks for another 4 per cent of working funds; the remaining 90 per cent of the funds were with government banks. State Bank of India, which as Imperial Bank of India before independence had a monopoly of government business, accounts for over a quarter of the deposits. The cost of deposits was close to

Table 7

Profitability of banks, 1991-92 and 1993-94									
	Income				Expenditure				Profits
	Funds	Interest	Other	Total	Interest	Operations	Provisions	Total	
	Accounts 1991-92 (Rs. billion)								
State Bank of India	1151	118	17	134	74	29	29	132	2
Other public banks	1866	190	20	210	136	50	18	205	6
Private banks	119	12	1	13	7	4	1	12	1
Foreign banks	251	28	8	37	18	6	9	34	3
	3387	347	45	394	235	88	58	382	12
	Accounts 1993-94 (Rs. billion)								
State Bank of India	1409	119	20	139	81	38	17	136	4
Other public banks	3535	302	45	347	219	94	78	391	-42
Private banks	230	21	3	24	14	6	3	22	2
Foreign banks	334	38	7	46	19	9	7	35	11
	5508	480	75	556	334	146	105	584	-25
	As proportion of working funds 1991-92 (per cent)								
State Bank of India	100.0	10.3	1.5	11.6	6.4	2.5	2.5	11.5	0.2
Other public banks	100.0	10.2	1.1	11.3	7.3	2.7	1.0	11.0	0.3
Private banks	100.0	10.1	0.8	10.9	5.9	3.4	0.8	10.1	0.8
Foreign banks	100.0	11.3	3.4	14.6	7.4	2.3	3.7	13.3	1.3
	100.0	10.2	1.3	11.6	6.9	2.6	1.7	11.3	0.4
	As proportion of working funds 1993-94 (per cent)								
State Bank of India	100.0	8.4	1.4	9.9	5.7	2.7	1.2	9.7	0.3
Other public banks	100.0	8.5	1.3	9.8	6.2	2.6	2.2	11.1	-1.3
Private banks	100.0	9.1	1.3	10.4	6.1	2.6	1.3	9.6	0.9
Foreign banks	100.0	11.5	2.2	13.7	5.8	2.6	2.1	10.5	3.3
	100.0	8.7	1.4	10.1	6.1	2.7	1.9	10.6	-0.5
	As proportion of income 1993-94 (per cent)								
State Bank of India		85.6	14.4	100.0	58.3	27.3	12.2	97.8	2.9
Other public banks		87.0	13.0	100.0	63.2	27.0	22.6	112.8	12.8
Private banks		87.5	12.5	100.0	58.3	25.0	12.5	91.7	8.3
Foreign banks		83.8	16.2	100.0	42.3	19.3	15.0	76.6	23.8
		86.4	13.6	100.0	60.0	26.3	18.9	105.1	-4.9

Source : Ministry of Finance (1994): *Economic Survey 1993-94,* New Delhi, p. 42, Table 3.6; Ministry of Finance (1995): *Economic Survey 1994-95,* New Delhi, p. 48, Table 3.5.

the minimum - 5-6 per cent in 1993-94 - for all banks; they clearly did not take much money on term deposits. The banks' operational costs were also very similar. Their return on funds was modest compared to the regulated interest rates they charged borrowers then, which were 12 per cent on small loans and 15 per cent on larger loans. Clearly, concessional interest rates, low rates on government securities and funds locked up in bad debts caused much erosion of potential income - less so in the case of foreign banks because of better fund management. Foreign banks also earned far more from non-fund business, where their superior service gave them an edge. With expenses comparable to other banks, these higher earnings gave them much higher profitability. In 1993-94, the government banks together did not earn enough to make the provisions required by the Reserve Bank for bad debts, and so made a loss. Once the provisioning is finished, government banks are expected to break even, and some would undoubtedly be profitable.

4. Capital Market

The Indian capital market before 1992 was well developed; there were a large number of companies - the largest number in any national stock market in the world - and active stock exchanges. The principal stock exchange in Bombay handled 70 per cent of the transactions, and about 30 companies accounted for most of the trading. However, there were a large number of small companies whose stocks were little traded, and the floating stock of most companies was limited. This situation was due both to the character of Indian enterprise and government regulation. Indian business is largely family-based. Industrial empires were set up by patriarchs who were helped by sons and close relatives, and who passed on the companies to their children. Such a system of management can be combined with corporate enterprise only if outsiders can be prevented from buying up a controlling share in a company's equity. A safeguard is embodied in Indian company law: a company can refuse to register share

transfers if they can lead to a loss of management control. More recently, takeover regulations have also been enacted which make takeovers difficult.

But apart from these legal safeguards, the Indian industrialists were helped by certain features of government control over the capital market. First, the government controlled capital issues. A company which wanted to make a public issue of shares or fixed-interest debentures had to seek the government's permission. The approving authority, the Controller of Capital Issues, used certain formulae to determine the issue price of shares which were based on the company's past performance. The formulae led to under pricing of shares, especially of shares of companies with bright prospects. They therefore involved a subsidy from the company to those who were allotted new issues, and raised the cost of equity capital. Hence companies avoided issuing shares, and the supply of equities was reduced. At the same time, an allottee of a public issue could sell his allotted shares and make an immediate profit. So demand for new issues exceeded supply. The Controller of Capital Issues made rules to ration out the scarce new issues: basically, no applicant could be given more than a certain, small number of shares. Many got more shares than the maximum by making multiple applications; but the system of rationing shares also created a numerous class of small shareholders who made small applications and made speculative profits by selling off their allotments. The government gave a tax concession on investment in new issues; this also encouraged the buying of newly issued shares.

The small shareholders had no influence on the management of the companies, and little interest in it. But there was another class of shareholders who also profited from the under pricing of shares, namely government long-term financial institutions. They gathered up public savings through mutual funds and tax-saving schemes, and invested in new issues. Over the years, they came to own a high proportion of equity stock; all of them together would own anywhere between 30 and 70 per cent of the total equity of a company. They followed a policy of supporting the existing management as long as it did not make serious mistakes - often even after it did. Their shareholdings made it easier to control a company. Someone who controlled a company had only to hold enough shares to give him a majority with the support of the financial institutions - essentially, the difference between 50 per cent and the financial institutions' share if it was below 50 per cent, and any small number of shares if the financial institutions held a majority of shares. Businessmen also parked the shares of a company in trusts and in other companies of the group. In this way they could control the company with a very small personal stake.

Since such a large proportion of the shares was held by financial institutions, businessmen, and their supporters who seldom bought and sold shares, the floating stock in most shares was very small. Prices were volatile, and capital gains and losses loomed large in the returns on investment. The volatility was increased by tax rates and resulting company practices. Interest was taxable in the hands of the receiver but could be written off as cost by the company that paid it; dividends were doubly taxable as profits of a company before distribution and as income in the hands of the receiver; capital gains were taxable in the hands of the receiver at a lower rate than other income, and if a company issued bonus shares, they were not taxable at all when received by the shareholder and taxable at the reduced rate on capital gains if he sold them. Hence instead of paying out dividends, companies retained profits, and issued bonus shares every few years. This involved no payment to the shareholder; it only

required transfer of accumulated profits from a reserve account to the equity share account. The timing of the issue of bonus shares was uncertain and added to the speculative quality of returns on equity.

In 1992 the government did two things: it abolished the Controller of Capital Issues and transferred regulation of the capital market from the finance ministry in Delhi to the Securities and Exchange Board of India (SEBI), an official regulatory body in Bombay. And it abolished control on the pricing of new issues. Immediately the issue prices rose closer to market prices, and issuing of shares became more attractive for companies. In the next two years, the number of issues doubled, and the capital raised rose fourfold (Table 8). This was also when the first effects of industrial delicensing were being felt. Companies could no longer rely on the government to restrain their competitors; the only answer to competition was growth. Capital was essential to growth. Improved access to the capital market came just in time to fill this need, and helped in intensifying competition.

In 199 1-92 long-term loans given by government financial institutions to companies were almost four times the value of public issues; two years later public issues raised almost as much capital as term loans. Thus companies improved their equity-debt ratios and reduced their dependence on government lending institutions. Larger companies, which had good access to the term lenders and used to borrow heavily, began to take greater recourse to public

Table 8

Developments in the capital market, 1991-94

	1992-94	1992-93	1993-94	1993 (April - December)	1994 (April - December)
Market capitalization (Rs billion)					
April		2780	1751		3649
December		1050	3050		4000
Average daily turnover (Rs million)					
April		6720	1730		1960
December		1870	4380		4230
Average price-earnings ratio					
April		49	25		46
December		29	40		39
Number of new issues	*512*	*1034*	*1143*	*753*	*1032*
Initial public issues		546	773	466	813
Rights issues		488	370	287	219
Capital raised (Rs million)	*55.6*	*167.5*	*219.8*	*162.8*	*113.8*
Initial public issues		107.5	130.6	98	72.4
Rights issues		60	89.2	65.8	41.4
Average issue (Rs million)	*108.6*	*162.0*	*192.3*	*216.2*	*110.3*
Initial public issues		196.9	169.0	210.3	89.1
Rights issues		123.0	241.1	229.3	189.0
Foreign investment (Rs billion)	*0.2*	*2.9*	*109.5*		*98.5*
Investment in India	0.0	0.0	52.2	37.5	
Offshore funds	0.2	0.2	11.4		6.9
Euro-issues	0.0	2.7	45.9	54.1	
Institutional term loans	*155.9*	*222.7*	*256.3*	*187.9*	*233.5*

Source: Ministry of Finance (1994): *Economic Survey 1993-94*, New Delhi, p. 47, Table 3.10; p. 55, Table 3.13. Ministry of Finance(1995): *Economic Survey 1994-95*, New Delhi, p. 55, Table 3.10; p. 64, Table 3.15; p. 66, Table 3.16.

29

issues. However, the flood of new issues weighed down the market; whenever prices in the secondary market began to rise, new issues stopped the rally.

In 1992 the government also opened a window to foreign portfolio investment. The finance ministry began to approve issues of shares and bonds by Indian companies in the Luxembourg market. At the same time, respectable foreign financial institutions were allowed entry to the Indian capital market after registration with the Securities

and Exchange Board of India (SEBI). The Indian procedures for share transfers are cumbersome and labour- intensive; they have placed a limit on inward investment into the Indian markets. But about 50 Indian companies, especially large ones, made issues in Luxembourg. Though small by international standards, the capital that came in was large in relation to the daily turnover in the markets. It counteracted the depressive tendency arising from the new issues, and caused a boom in share prices which reached a peak in September 1994.

5. Government Finances

India has two levels of government, the centre and the states. Whose powers of taxation and spheres of action are defined in the constitution; the third - city and village administrations - is weak and generally under the control of state governments. Broadly, the centre levies taxes on incomes, production and foreign trade, whilst the states tax domestic trade. In practice, commodity taxes are levied by both; the centre calls them excise duties, and the states call them sales taxes. Agricultural income can be taxed only by the states; none of them do. The centre transfers money to the states in three ways. First, finance commissions appointed once every five years decide the proportion of revenue from different central taxes that must be given to the states, and recommends formulae for sharing the transfers so as to favour poorer states. Second, the planning commission coordinates central and state expenditures on investment and social services, and in doing so, makes the central government transfer money for state governments to spend on agreed programmes. Finally, the centre also gives states occasional grants to meet calamities or just as favours to state governments.

All the governments together take about a fifth of GDP in taxes, spend about a third, and run a deficit of 10-12 per cent of GDP. Most of the deficit is financed by borrowings through banks and financial institutions. In 1993 the central government stopped taking recourse to this compulsory borrowing, and preferred voluntary sales of securities instead (though banks were their main buyers); but the states continue to depend on borrowings from banks under the statutory liquidity ratio. The uncovered deficit which directly adds to the money supply was running at over 2 per cent in the late l980s but has been cut to less than 1 per cent of GDP in recent years. Thus the government has kept down the inflationary impact of deficits by compulsory borrowing through predominantly government-owned banks and financial institutions. But it has also thereby reduced the savings available for investment in production and trade. At the same time, government investment has been going down as a proportion of GDP.

The financial system deteriorated over the 1970s and 1980s: the excess of expenditure over revenue increased, and the share of investment in government expenditure fell. Since 1991 the central government has tried to curb these adverse trends. It has not had much success. Its objective of reducing the fiscal deficit conflicted with its desire to reduce tax rates; and the central government does not have much influence on the state governments. The overall budgetary balance has changed little since the reforms. But the tax structure of the central government has changed considerably (Table 9).

Table 9

Financial transactions of all governments as proportion of GDP, 1990-91 to 1994-95 (per cent)					
	1990-91	1991-92	1992-93	1993-94	1994-95
Development expenditure	19.8	19.3	19.1	19.2	18.5
Defence expenditure	2	1.9	1.7	1.9	1.8
Interest payments	6.2	5.7	5.8	6.3	6.7
Tax collection costs	0.4	0.4	0.4	0.4	0.4
Police	1.2	1.2	1.3	1.3	1.2
Other expenditure	3.4	3.8	3.7	4.0	3.8
Total expenditure	**33**	**32.4**	**32**	**33.2**	**32.4**
Personal & corporation taxes	2.3	2.7	2.8	2.9	2.9
Central excise duties	5.2	5.2	5.0	4.6	4.3
Central customs duties	4.4	4.1	3.9	3.2	2.9
State sales taxes	3.9	4.0	3.9	4.0	4.0
Public enterprise surpluses	2.4	2.4	3.0	3.6	3.4
Other non-tax revenue	2.4	3.3	3.2	3.2	3.6
Total revenue	**20.7**	**21.7**	**21.8**	**21.5**	**21.1**
Domestic borrowings	9.4	8.5	7.5	9.6	9.8
Foreign grants and loans	0.8	1	0.9	0.7	0.6
Issue of money	2.1	1.1	1.8	1.5	0.9
Total deficit	**12.3**	**10.6**	**10.2**	**11.7**	**11.3**

Source: Ministry of Finance (1995): *Economic Survey 1994-95*, New Delhi, P. 15, Table 2.1; P. 23, Table 2.8; pp. 41 f., Table 2.2.

The reduction in tariffs we earlier reviewed means that tariffs now yield less revenue as a proportion of GDP than they did four years ago. Central excise duties have also been reduced. Earlier, high rates of excise and customs duty were accompanied by extensive exemptions for favoured taxpayers. With the reduction of duties, many exemptions have been abolished, and tax discrimination reduced. The share of income and corporation taxes in GDP has increased significantly. This is in spite of a reduction in tax rates: the peak personal income tax rate has been reduced from 56 per cent in 1990-91 to 40 percent, and the corporate tax rate from 50.4 per cent to 46 percent. Taxable incomes, especially corporate profits, have risen rapidly, and revenue has risen despite rate cuts. Thus dependence on indirect taxes, especially on import duties, has declined appreciably. The contribution of public enterprises to government budgets has also improved. Thus the structure of revenue has been significantly improved - away from taxes on production and imports, and towards higher public enterprise profits, personal taxes and corporate taxes.

The structure of expenditure shows one major change for the worse: the proportion of interest in expenditure has risen inexorably. As the central government has ceased to take recourse to compulsory borrowings from the banks, it has had to persuade them to buy its loans, which it has done by raising interest rates. In 1993-95, capital inflows

augmented money supply; in an effort to curb the inflationary pressures arising from them, the Reserve Bank has pushed up interest rates. Finally, the devaluations of 1991 and 1992, together with additional borrowings abroad, have raised the interest cost of foreign debt. In this way, interest has taken an increasing share of the centre's revenue, rising from 34 per cent of revenue in 1989-90 to 53 per cent in 1994-95. Interest liabilities limit the government's ability to increase development expenditure. And as interest payments grow, an increasing proportion of the central government's real expenditure is being financed by borrowing; just to run the normal business of the government, it has to borrow.

As interest rates have risen, so have state governments' interest dues to the centre. The centre's new loans to the states have not kept pace; in an effort to restrain its own expenditure, the centre has capped its loans to the states. The result is that whereas in 1990-91, the centre made net transfers to the states of Rs. 47 billion, in 1994- 95 it is estimated to have received net transfers of Rs.16 billion from the states.

6. Industry

Till 1991 the government enforced a kind of caste system amongst firms. The highest caste was that of government-owned firms. Certain industries - mainly steel, metals, energy and defence - were reserved for them. In other industries they were given preference. The next highest caste was that of small firms (i.e. firms with fixed investment below a certain limit, which is raised every few years on account of inflation). Over 1,000 products were reserved for them; in addition they paid lower excise taxes, and qualified (together with other privileged borrowers such as agriculture) for a 40 per cent quota of bank credit. The third caste was that of cooperatives. These received generous government loans - so generous that many could not service them; if they could not, they were taken over by the government. Thus in many states cooperatives were little different from government-owned firms. In general they were unimportant except in the sugar industry. The fourth caste was that of large privately owned firms, which were divided into three sub castes; firms belonging to certain industrial groups such as the Tatas and the Birlas, foreign firms - defined as those with a foreign share in equity exceeding 40 percent - and the rest. Of the three, group firms and foreign firms were especially discriminated against.

The discrimination was exercised through two major laws: the Industrial Development Regulation Act of 1951 under which every large firm required a licence if it wanted to produce anything, to increase capacity or to produce a new product; and the Foreign Exchange Regulation Act of 1973 under which foreign firms required permission for many actions. Both acts spawned a jungle of detailed regulations. They were used to enforce the industrial caste system through thousands of case-by-case decisions. The decisions would be taken with greater or less delay or not taken at all. In their taking there was scope for bargaining or horse-trading. Foreign firms, which had the choice of opting out, did so; there was little inflow of foreign investment, and many foreign firms were sold to Indian interests in the 1970s and 1980s. Indian firms, which did not have the choice, worked out ways of living with and manipulating the control mechanism. The final result was chaotic and riddled with politics. But its major effect was to reduce competition, favour inefficiency, and increase the unpredictability in business environment. The industrial licensing controls were also extensively evaded, largely by setting up firms which were small enough not to

require licences. Small firms had the additional advantage of paying lower wages and being free from legal restrictions on firm closure and dismissal of workers. Thus small firms won large market shares in many industries.

The complicated control structure has been dismantled and modified. The numerous and piecemeal changes are difficult to summarize. The three types of firms that are most affected are large private firms, foreign firms, and government firms.

The arena of operation of large private firms has been enormously extended. Industrial licensing has been abolished in all except 15 industries, of which only sugar is important. Industries reserved for the government have been reduced to coal, oil, railways, nuclear energy and materials, and defence. Even in these industries some private investment is being selectively allowed. The over 1,000 products reserved for small firms remain intact, but few of them are important. Thus large private firms can invest freely in most of industry, and can invest in some more - e.g., oil, power and telecommunications - subject to regulation. This also means that the protection against competition afforded by the old industrial licensing mechanism is gone, and that the only defence against competition lies in growth and innovation. Thus a frantic race for growth has developed amongst the large firms.

Many foreign firms have been drawn into India as partners by these Indian firms in search of growth and competitive advantage. Deregulation has also stimulated the interest of Indians resident abroad, who have increased investment in India. They also often act as partners or fronts for foreign firms. For foreign firms on their own, both the definition and the regulatory mechanism have been modified. Foreign firms can take 24 per cent equity of an Indian firm or 20 per cent equity of an Indian bank without government approval. They are now allowed to set up or own companies with a foreign shareholding of 51 per cent in a number of specified “priority” industries. These are mostly capital-goods and technology-intensive industries. In these the foreign investor does not have to get approval; he just has to file a statement with the Reserve Bank of India. All other foreign investment proposals must be sent to one of two government institutions. One is the Secretariat for Industrial Approvals (SIA), which dates back to the old days. The other, Foreign Investment Promotion Board (FIPB), has hitherto been much quicker and more positive. It is essentially a body with which a foreign investor can bargain: by promising a high export ratio he can get permission to set up a majority-owned company in almost any industry. It usually decides within a month. Multinationals in consumer goods, such as Coca Cola and Walt Disney, have entered India through FIPB approval. Till recently FIPB was housed in the Prime Minister’s office and chaired by his Principal Secretary. Hence it was very powerful, and it used its power to give a strongly welcoming message to foreign investors. Now it has been transferred to the industry ministry, and as the general elections approach (they must be held by May 1996), FIPB has been seen to become less forthcoming. But it still continues to promote rather than stop investment.

Table 10

Inflow of foreign direct investment under the new regime, 1991-1994 ($ million)					
	1991-92	1992-93	1993-94	1994 Apr-Dec	**1991-94**
Priority industries		42	89	81	**212**
Nonresident Indians	63	61	217	295	**636**
With SIA/FIPB approval	87	238	315	380	**1020**
	150	**341**	**621**	**756**	**1868**

Source : Ministry of Finance (1995) : *Economic Survey* 1994-95, New Delhi p. 90, Table 5.3.

Thus unless the investment is in the narrow field of "priority" industries and the foreign investor is satisfied with a 51 per cent share of equity, investment of more than 24 per cent of the equity capital of an Indian company by a foreign company still requires government approval. That approval may involve a price, such as exports. But as long as the investment is in an industry which no longer requires industrial licensing, the foreign company is free to invest and grow as it likes once it has entered the Indian market.

The investment attracted by this new regime is modest as shown by Table 10. Only $200 million was invested in the priority industries where no government approval is required. $ 1 billion was invested with government approval. $ 600 million was invested through nonresident Indians, some of whom may have been front men for foreign investors. Developing countries attracted $ 228 billion of foreign direct investment in 1991-94; India attracted less than 1 per cent of it. Against actual investment of $ 1.8 billion, approval was given to investments worth $ 7.2 billion. Thus larger investment flows may be in the pipeline. But there are pipelines to other countries as well.

As discrimination against disfavored sectors - foreign investors and large firms - has been dismantled, the privileges of the favoured sectors - government enterprises, small firms and cooperatives - have become less valuable. Public enterprises are susceptible to private competition in almost all civilian industries, although the competition in some areas - for instance, electricity, telephones, railways, bus transport or nonferrous metals - is only potential or nascent. The government has also tried to sell off a minority of the shares in many public enterprises - although the buyers have chiefly been government-owned financial institutions, and the change in ownership is thus only cosmetic. Nevertheless, public enterprises face competition not only in the product markets, but more important, in the labour markets, which affect their fortunes more radically. In industries where private competitors have made a substantial entry, they have often lured away executives from government firms. Since salaries in public enterprises are kept in line with the salaries of civil servants in the government, they cannot be raised to match private competition. The result is sudden, large depletion of managerial manpower in some public enterprises. This exodus has led to concern in government and its enterprises. The government has appointed a pay commission to review public sector salaries; the commission has been approached by bureaucrats' associations with proposals to raise public sector salaries five- or six fold. At the same time, public enterprises which cannot meet competition and are making losses can hardly support a case for salary increases. The government is determined not to give up ownership of public enterprises. Even if it were ready to

do so, they would fetch a poor price. More important than privatization would be creation of autonomous managements which would take their own decisions about executive salaries amongst other things, and establishment of financial responsibility whereby loss-malcing enterprises would not receive budgetary support. On these wider reforms the government has not progressed.

As earlier described, small firms had three major types of privileges: over 1,000 products were reserved for manufacture by small firms, 40 per cent of bank credit was reserved for "priority" sectors of which small industry and agriculture were the leading ones, and both the central and the state governments gave tax concessions to small firms. Formally there has been no diminution in these privileges; but their value has declined. Sixty-four per cent of small firms did not produce any reserved products at all; 233 of the 1076 reserved products were not being produced by small firms at all. Sixty-eight products accounted for over 80 per cent of the small-scale production of reserved products, and in 21 of those products, small firms were competing with large firms anyway: the reservation was ineffective. Thus reservation makes little difference to small firms. Reserved credit continues to be available, although small firms must compete for it with other privileged borrowers. But reserved credit does not necessarily involve an interest subsidy, which is given on small loans; as a small firm's credit requirement grows, it would have to pay the same interest as large firms. And the interest subsidy itself has gone down as interest rates have been deregulated and interest rate differentials have declined. Concessions in excise duties have declined as a result of two changes. Excise duties have been reduced; and the definition of small firms entitled to duty concession or exemption has been narrowed. Further, the central government has extended the application of the modified value-added tax to new industries. In these industries, a buyer gets credit for the excise paid by his supplier; so the fact that a small supplier may not have paid excise is no advantage to him - his large competitor would also be selling in effect at a price net of excise.

We shall now review the prospects of some individual industries; for each industry, we shall look at the growth achieved between 1982 and 1992 and compare it with global growth for some major industries. We also look at industry market structures in the process. It emerges that while past growth rates do not seem particularly difficult to reach in the future, far greater growth opportunities may lie in greater firm specialization and

Table 11

India's share in world output of some consumer goods, 1982 and 1992

	India's output	Units	India's share of world output		increase	Annual rate of change 1982-92	
	1992		1992	1982	1982-92	World	India
			per cent				
Sugar	13113	000t	12.6	9.6	43.6	0.8	3.0
Biscuit	639	000t	7.9	2.3	40.0	1.4	12.5
Wheat flour	4771	000t	2.3	1.3	15.0	0.7	5.9
Beer	2204	000hl	0.2	0.2	0.2	1.2	1.1
Soap	1558	000t	21.2	5.1	146.2	1.0	13.7
Washing powder	247	000t	1.6	1.4	2.3	2.5	3.8
Leather footwear	201	m pairs	4.7	1.9	37.2	0.7	8.6
Rubber footwear	28	m pairs	1.7	2.2	20.4	-0.2	-2.5
Razor blades	3329	m	32.6	26.4	42.5	4.1	5.9
Bicycles	7219	000	8.5	7.2	13.8	1.9	3.3
Scooters etc	1637	000	14.1	2.7		-1.5	12.9
Cars	193	000	0.6	0.2	2.1	2.0	13.3
Refrigerators	1124	000	2.3	0.9	7.3	2.1	10.1
Watches	9.5	m	1.1	1.2	1.1	5.1	4.8
Radios	470	000	0.4	1.1	10.2	-0.7	-9.5
Television sets	1190	000	1.0	0.1	2.6	3.3	20.7

Source : United Nations (1993) : *Industrial Statistics Year Book 1993*, Vol II, Commodity Production Statistics, New York.

consolidation of production, for many Indian firms are in a number of unrelated products, and many markets are full of firms producing on a small scale.

Tables 11 and 12 depict India's share in the world output of some consumer goods and intermediate goods. The figures are not all equally accurate. The world figures, compiled by the UN Statistical Office, rely on national responses. Some countries do not respond or respond with inaccurate figures; these inaccuracies are reflected in the global figures, and although we have excluded figures which were obviously inaccurate, the remaining figures are not perfect. The same applies to Indian figures. Generally they exclude the output of small firms; this can lead to gross underestimation of output, as well as of growth of output where the share of small firms is growing. A case in point is radios. Millions of radios and cassette players are manufactured in India by small manufacturers who do not enter any statistics; official statistics seriously underestimate output.

India's low per capita income implies low per capita consumption, especially of goods other than necessities; but the total demand can still be substantial owing to the large population. Besides, demand for consumer goods depends on their income-elasticity and the growth of incomes. The income-elasticity of non-necessities tends to be high at low incomes; and GDP has been growing about twice as fast in India in the 1980s as in industrial countries. Hence the absolute demand for at least some goods is substantial. Table 11 lists a number of consumer goods whose demand in industrial countries has been saturated, such as sugar, biscuits, soap, footwear, and bicycles; for these goods India accounted for a high proportion of the global increase in demand in 1982-92. This also implies that for such goods, the proportion of global consumption accounted for by India has been rising. In fact, that is true of every consumer good listed in Table 11 except rubber footwear, watches and radios where Indian figures are probably seriously underestimated owing to the output of small firms (a large proportion of the demand for watches is probably met by smuggling). Alcoholic

drinks (and tobacco) are regarded as milch cows by Indian finance ministers, and have been taxed far beyond the point where they would yield maximum revenue; hence the low output of beer. The consumption of all goods except these has grown faster, in most cases much faster, in India than in the world. Table 12 shows the same features in intermediate goods - Indian output has been rising faster than world output, and hence the share of India in world output has been rising. Table 13, encompassing agricultural goods, includes basic necessities such as food products where India accounts for a high proportion of world output.

India is the world's largest producer of refined **sugar**. Demand for sugar in industrial countries is saturated; in India, on the other hand, sugar is a popular consumer product, with tea, in sweets, and eaten unrefined. The governments have favoured farmers' cooperatives with cheap capital loans which are seldom repaid. If they are not repaid, a state government can take over a cooperative mill. Thus cooperatives have become playthings of rural politicians in some areas, and of bureaucrats elsewhere. But the availability of cheap loans has hitherto ensured rapid growth regardless of profitability. The sugar industry is one of the few that remain under industrial licensing and price control; the two together ensure that plants are too small and irrationally located, and there is much siphoning-off of profits. The discrimination in favour of cooperatives has killed off most corporate mills, which were important till the 1950s. Those private mills that survive have diversified into other industries, such as cement, engineering, alcohol, ferroalloys and chemicals. The largest corporate sugar producer is Bajaj Hindustan with 1993-94 sales of Rs. 2.1 billion, of which sugar accounted for Rs. 1.6 billion. Shriram Industrial Enterprises, the next largest producer, had total sales of Rs. 6.8 billion of which Rs. 1.5 billion came from sugar, Rs. 2.7 billion from butter-substitute, and the rest from engineering and chemicals. The sugar industry has a broad domestic base. Domestic consumption will continue to grow; but this huge industry has not exploited export markets because of controls on imports and exports. The licensing regime has also created too many small, inefficient and mislocated plants. If the industry were opened up to competition and international trade, it could become an exporter and grow much faster.

Biscuits and confectionery have many small firms; corporate enterprises account for only 21 per cent of the estimated output of biscuits, and 47 per cent of the output of confectionery. Britannia Industries in biscuits, and Nestlé and Cadbury in confectionery, are large companies with national distribution networks. After industrial delicensing in 1991, other foreign firms, including Smith Kline Beecham and Procter and Gamble have tried to enter the industry, but have not won significant market shares. Biscuits are the kind of poor man's luxury which could grow rapidly if supply conditions were favourable. Greater integration of the industry, through growth of currently small local enterprises to larger size and the spread of foreign food product companies, could accelerate growth.

Although most of the 90 million tons of wheat and coarse grains produced are milled before consumption, **flour milling** is still unorganized. Many households buy grains and get them milled by a neighborhood miller. Larger flour mills are still unincorporated businesses which sell their products in the local wholesale markets. Branded flours and rice are in their infancy. NEPC Agro Foods, the largest flour mill, had 1993-94 flour sales of only Rs. 282 million. The industry will continue to grow on the basis of domestic wheat output and market, but could achieve greater

efficiency and growth if large, modern mills could emerge. Their emergence requires decontrol of wheat. The same applies to the processing and milling of other grains - rice, coarse grains and pulses.

The high taxation of **alcoholic drinks** has led to a nexus between liquor barons, politicians and tax authorities; thus the manufacture of beer and alcoholic drinks is dominated by a few large industrial groups, each with a number of companies and plants spread over the country. Liquor excises are levied by the state governments and are generally proportional to volume rather than alcohol; so beer and wines tend to be expensive, and most of the consumption is of hard liquors, especially whisky and rum. There is a large market in local brews about which little is known. The leading producers are the Chhabria group, whose flagship company is Shaw Wallace, the Vijay Mallya group, which owns United Breweries, and the Mohan group, whose major company is Mohan Meakin. The prospects of growth in this industry continue to be uncertain as long as the nexus between politicians and industrialists persists. But if the taxes were reduced, the industry could grow much faster at the expense of illicit and country liquor.

Soap and detergent, an important industry in India, was dominated by Hindustan Lever, a Lever subsidiary, whose growth was constrained by industrial licensing. Licensing also helped the growth of Nirma, a pioneering firm which got detergent cheaply manufactured in small workshops, escaped licensing regulations by not building a large factory, and took a substantial market share. With the removal of licensing in 1991, competition intensified. Hindustan Lever took over Tata Chemicals, the next biggest soap manufacturer. Godrej Soaps the third biggest manufacturer, formed a joint venture with Procter and Gamble. Nirma has held out till now, but must face the problem of growing to keep up with the emerging giants in the industry. Nirma's institutional innovation gave this industry a great push in the 1970s and 1980s: competition intensified, and costs were brought down. This phase has now ended; the next phase may see less change and more dominance of multinational firms.

The **footwear** industry has had three loosely connected components. One is a large number of small manufacturers either manufacturing on custom or selling in the local market. Then there are large shoe manufacturers, of which Bata India is the largest. With the most extensive distribution network, Bata has been the major manufacturer of expensive shoes, and survived through the licensing regime. The third is leather goods exporters. Indian leather is good for shoe uppers, but not for heels and soles in which synthetic materials have largely replaced leather anyway. Hence there have been a large number of shoe upper manufacturers. Till 1990 they were exporting to the USSR. With its collapse they have begun to export elsewhere or to sell within the country. After delicensing, the finances of Bata India have distinctly worsened; new producers from the third group have cut into its market. A structural change is going on in this market; competition is intensifying and new. Competition is emerging for Bata. This would accelerate growth providing leather supplier continues to grow. The government has tried to favour the leather industry by restricting leather exports. This helps as long as the domestic leather industry cannot use up the domestic outturn of hides. But once it needs to grow beyond that point, the policy of restricting trade in leather will prove counterproductive. It would be far better to open up both imports

and exports of hides and leather, so that the industry becomes a value-addition industry using raw materials from all over the world.

In absence of shavers, it is not surprising that the Indian market for **razor blades** is substantial. It is largely controlled by an unquoted private firm belonging to the Malhotra family. The largest quoted company, Indian Shaving Products, in which Gillette has a share, has a market share of 15 per cent. Although the growth of the industry is impressive, it would grow even faster if the monopoly were broken. Competition, whether from new domestic firms or from multinationals, is required.

Bicycles, being a poor man's vehicle, are produced on a large scale in India. There are three major manufacturers: Hero Cycles, Atlas Cycles, and Tube Investments. Hero and Atlas came up in the 1960s from scratch and built up extremely low-cost production based on high labour productivity; they sent the previously established cycle manufacturers, Raleigh and BSA, into bankruptcy. But now they have matured, demand growth has slowed down, and the industry has stabilized. Despite its enormous size, the industry has not exploited the export market, for which, however, it would need to diversify and improve its products. There is a lucrative market for bicycles and exercycles in the richer countries; to exploit it, however, the industry needs infusion of foreign know-how and capital.

Bicycles have yielded to **scooters, motor cycles, and mopeds,** which is one of the foremost growth industries; it is still growing rapidly in India while the demand in the rest of the world is stagnant. The industry is dominated by Bajaj Auto, one of India's most successful firms. Bajaj originally got its technology from Lambretta; at the end of the 1960s it broke loose and began to export. Lambretta stopped it in the American and European markets by means of lawsuits alleging breach of patent, and set up a joint venture in India, LML Ltd, to compete with Bajaj. LML has taken a 19 per cent share in the scooter market, but failed to challenge Bajaj, which meanwhile has diversified into motor cycles, where its main competitors are Hero Honda, a joint venture of Hero the bicycle manufacturers with Honda, and Escorts; and into mopeds, where it competes with Majestic Auto, another Hero affiliate, TVS Suzuki, and Kinetic Engineering. The industry produces a product that is very well suited to the Indian market, and has intense domestic competition. So it should continue to grow; but it could grow even faster if it could exploit the international market.

The **car** industry was moribund till the late 1970s. It was under licensing, and cars were under price control till 1975: the government bought a large proportion of the output, and kept the prices low to suit itself. Sanjay Gandhi, Mrs. Gandhi's younger son, tried to manufacture a car as a virtually backyard operation. He was killed in an air crash in 1979. The government bought up his operation, brought in Suzuki as an equal partner, and set up a modern factory which dominates the industry today with a 66 per cent market share. Of the two older manufacturers, Premier Automobiles tried for years to upgrade production with limited capital, but has now finally teamed up with Peugeot to produce the 306 model. Telco, a truck manufacturer in which Daimler Benz has long had a minority share, has in recent years been manufacturing a heavy estate car in limited numbers; now it has teamed up with Daimler Benz to produce Mercedes E-series cars. Mahindra and Mahindra, a tractor and jeep manufacturer, proposes to manufacture Ford Escort cars in a joint venture. Finally, DCM, a small and unsuccessful manufacturer of minivans, has begun to make Daewoo cars. Thus

the car industry is poised to see a sudden influx of competition, which should accelerate growth. The substantial tax cuts on cars last year should also help.

Refrigerators are a useful consumer durable in a tropical country. GE Appliances bought into Godrej, the largest manufacturer with a 37 per cent market share, in 1993. At the other end are newcomers such as BPL and Videocon, both manufacturers of television sets and audio-video equipment who have diversified into refrigerators, and IFB-Bosch; all these have small market shares, but have a more up-to-date product range. In between is Kelvinator, the second biggest manufacturer, which is supposed to be in trouble and looking for a foreign partner. The industry has been dominated by Godrej and Kelvinator and has grown on the basis of rather outdated products. But the new firms, while still small, have introduced improved products; with their competition, the industry's growth may be accelerated.

Watches cannot be legally imported, being a consumer good, but are extensively smuggled in; so also watch movements. The largest manufacturer used to be Hindustan Machine Tools, a central government company which diversified into watches in the 1970s. But since delicensing it has been displaced by Titan, a Tata company with good design and marketing which has taken a market share of 41 per cent. The other manufacturers are small in comparison. Watchmaking is a labour-intensive industry, and skill has been

Table 12

India's share in world output of some intermediate goods, 1982 and 1992

	India's output		India's share of world output		increase	Annual rate of change 1982-92	
	1992		1992	1982	1982-92	World	India
			per cent				
Buses	26	000	5.3	4.2	82.0	3.4	21.6
Trucks	120	000	1.1	0.8	3.1	2.1	6.4
Transformers	32410	MVA	6.3	42.2	2.7	22.0	4.1
Aluminium	504	000t	2.5	1.3	8.1	1.6	7.3
Cement	50	mt	4.4	2.6	10.1	2.2	6.7
Printing paper	1150	000t	1.6	1.6	1.6	4.5	4.5
Kraft paper	551	000t	0.6	0.4	0.8	3.3	5.8
Other paper	950	000t	0.7	0.5	1.1	2.8	5.4
Newsprint	289	000t	0.9	0.4	2.6	2.1	9.2
Motor vehicle tyres	8.6	m	1.0	0.8	1.6	2.3	4.1
Two-wheeler tyres	30	m	14.0	13.8	25.0	0.2	0.3
Noncellusic filament	263	000t	5.1	1.5	18.1	2.0	12.8
Noncellusic fibre	177	000t	2.3	0.8	6.6	2.6	12.3
Cellulosic filament	59	000t	8.7	5.1		-2.9	1.6
Cellulosic fibre	156	000t	8.1	2.6		-0.3	9.4
PTA	50	000t	2.3	1.6	4.9	1.9	5.0
Xylenes	164	000t	1.5		4.2	3.8	
Caustic soda	1016	000t	2.8	2.0	6.0	1.8	4.6
Soda ash	1500	000t	5.0	2.4	17.1	1.6	8.0
Sulphuric acid	3889	000t	3.2	2.0		0.0	4.1

Source : United Nations (1993) *Industrial Statistics Year Book 1993* Vol II, Commodity Production Statistics, New York.

taken out of it by the advent of quartz clock movements. So it has an enormous scope in India and could grow much faster if the protection, which only helps smugglers, was removed.

For many years during the licensing era, the government favoured small firms in the manufacture of **television sets**. Their costs were high, quality was poor, and marketing non-existent; this limited their spread. Many of the small firms survive; some have grown. But five companies have emerged in the forefront. Videocon leads,

closely followed by BPL. Phillips (India), Mirc Electronics, and Kalyani Sharp follow some way behind. All three buy sets from small producers and market them. The small, scattered firms are inefficient, but their wage costs are low. The new structure of small manufacturers and large marketing firms is very promising, and could accelerate the growth of the industry.

The separate figures for **buses and trucks** in Table 12 are misleading; the same manufacturers make both in most countries. But even if we take the two together, India is a rapidly growing market for heavy vehicles. The large area of the country generates a high demand for land transport; as the growth of railways is hampered by poor finances resulting from low, politically biased fares, the demand for trucks continues to grow. Bus transport is also popular in a poor country. Much of bus transport is in state government ownership: it is subsidized, and generates heavy demand for vehicles. Most of it is met by two industry leaders: Telco and Ashok Leyland. Telco, which originally received technology from Mercedes Benz in the l950s, has built on the technological base, designed vehicles for India's rugged conditions and rough usage, and gone on to diversify into smaller vehicles - first light commercial vehicles and now cars. Ashok Leyland, originally an affiliate of British Leyland, is now a part of the Italian Iveco group; it is particularly strong in buses. There are a number of manufacturers of light commercial vehicles, but the only significant one apart from Telco is Bajaj Tempo, which continues to manufacture an old German model van. Intense competition and the presence of some of the best Indian firms ensure that this industry will continue to grow, diversifying into smaller vehicles and cars. But its growth would be even faster if bus transports were reorganized and the loss-making, inefficient state government enterprises were privatized or the industry was opened up to private competition.

The **electricity** supply industries are largely owned by state governments. In the licensing era, they were made to buy large transformers from Bharat Heavy Electricals Limited (BHEL), a central government-owned manufacturer of heavy power generators and transformers, and small ones from small manufacturers. This pattern continues to this day; the state electricity boards are in poor financial shape, and no new manufacturers have jumped in to meet their requirements. But a number of companies manufacturing a variety of electrical equipment also make transformers. The more important amongst them are Crompton Greaves, GEC Aisthom, Bharat Bij lee, ECE Industries and Kirloskar Electric Co. This industry should continue to grow with the electricity supply industy.

The **aluminum** industry is dominated by two firms set up in the 1950s, producing almost half of the output between them. Hindalco, a Birla company, has based its success on a power plant - the most efficiently run in India. Indian Aluminum Company is an affiliate of Alcan. India has considerable deposits of bauxite, which belong to the central government by law. It promoted two companies of its own - Bharat Aluminum and National Aluminum - on the basis of cheap bauxite deposits, which have market shares of 18 and 10 per cent respectively. The rest are much smaller, and none of them is an integrated manufacturer. At the present international prices, Indian aluminum producers are making high profits and reopening facilities that were closed down earlier. The industry is likely to do no worse in the future.

With large deposits of limestone and coal, India is potentially competitive in **cement.** But the combination of licensing and price control till the late 1980s allocated new capacity to inefficient government plants and rewarded high-cost plants by reimbursing their costs. It also restricted entry, and ensured the dominance of Associated Cement Company (ACC), a Tata company whose market share exceeded 45 percent. In 1988 price control was removed, and the industry was delicensed. There was an influx of new entrants; today the industry is much less concentrated, and companies from many other industries - e.g., jute, textiles, building, engineering, paper, fertilizers etc. - have gone into cement. Companies belonging to the Aditya Birla group are now particularly strong in cement: Birla Jute, Century Textiles, Grasim Industries, and Indian Rayon between them have a market share of 16 per cent. ACC's market share has fallen to 14 per cent. Cement Corporation of India, a central government company, has a market share of 5 per cent. Competition has greatly intensified in this industry in recent years; it would continue to grow at least as fast as in the past. Its growth would be even faster if it was allowed to import coal at low duty.

The governments are the largest buyer of **paper** for textbooks and school books. To keep costs down, paper was kept under price control for a long time, and control was used to favour small, inefficient firms and firms which used raw materials other than wood pulp - e.g., sugar cane biogases. As a result, there are a large number of small firms, each producing less than 10,000 tons a year. Only ten firms produce more than 50,000 tons a year, accounting for a third of the output. Three - Ballarpur Industries, Orient Paper Industries and Hindustan Paper Corporation (which is owned by the central government) - produced over 100,000 tons each; ITC Bhadrachalam Paperboards, Andhra Pradesh Paper, and West Coast Paper produced 70-90,000 tons each. The industry is uncompetitive and inefficient, and not geared for rapid growth. But this year the government has considerably lowered import duties. Import competition could well lead to improvements in industrial structure and growth prospects.

Newsprint is produced by central and state government companies except for the small Aurangabad Paper Mills; the idea was to control the press by making it dependent on the government for supplies. Government ownership of newsprint producers was reinforced by direct allocation of newsprint, which favoured a multitude of small newspapers. Three manufacturers - Hindustan Newsprint, Nepa and Hindustan Paper Corporation - are owned by the central government, and two - Mysore Paper Mills and Tamilnadu Newsprint and Paper - are owned by state governments. Even after the industry was delicensed in 1991, newspapers were forced to buy newsprint from government paper mills in a certain proportion to their imports. That restriction has just been removed since global newsprint prices have gone up and the government thinks that its mills will be able to survive without a captive demand. With its removal, imports are likely to rise. The present newsprint producers can survive by importing pulp and diversifying, but the growth of the industry is unlikely to accelerate.

There are a large number of **tyre** manufacturers, but most of them make tyres for two-wheelers, mainly scooters. The largest tyre manufacturers are MRF, CEAT, Apollo, JK and Modi Rubber, accounting for two-thirds of the production between them. Production of cycle tyres is far more concentrated; Govind Rubber and Dewan

Rubber between them account for most of the production. The industry's growth, tied to automotive industries, is bound to accelerate. The recent freeing of rubber imports, if it continues, will help.

Synthetic fibres have attracted many producers, but certain industrial groups have specialized in them. The foremost is Reliance Industries, which produces 29 per cent of polyester filament, and which is integrated forward into fabrics and backward into PTA and LAB. India's largest company, it has recently spread its wings into oil exploration, refining and imports, and power. The next largest is Grasim Industries of the Aditya Birla group, which produces 87 per cent of viscose staple fibre, as well as fabrics, caustic soda, cement etc; Indian Rayon and Industries of the same group is into viscose filament, fabric, cement, and carbon black. The third is the group of the BK Birla companies, Century Textiles, Century Enka and Kesoram Industries which, between them, produce nylon, viscose rayon, polyester, cement, and paper. JK Synthetics is another company spread into nylon, polyester, and acrylic fibre as well as cement. There are a number of other small companies and groups in fibres. This industry has been held back by high excise duties, and by the presence of many small, inefficient units during the licensing era. The high taxes also

Table 13

India's share in world output of some agricultural goods, 1979-81 and 1993.

	India's output		India's share of world output		increase	Annual rate of change 1979-81/1993	
	1993		1979-81	1993	1979-81/1993	World	India
Cereals	201	mt	10.6	8.8	19.8	1.4	2.9
Wheat	57	mt	10.1	7.9	17.5	2.0	3.9
Rice	111	mt	21.0	18.8	27.7	2.2	3.1
Coarse grains	34	mt	4.2	3.9	7.6	0.6	1.1
Roots and tubers	22	mt	3.7	3.1	9.8	0.7	2.2
Potatoes	16	mt	5.5	3.5	34.2	0.5	4.1
Pulses	13	mt	22.8	25.8	15.6	2.7	1.7
Groundnuts	7	mt	28.4	32.4	16.8	2.3	1.3
Soybeans	5	mt	4.1	0.4	16.6	2.0	21.5
Rapeseed	5	mt	18.6	16.5	20.1	6.7	7.7
Coconuts	8	mt	17.7	12.0	42.1	1.7	4.8
Vegetables	60	mt	12.9	11.7	16.9	1,9	2.7
Fruit	32	mt	8.6	6.8	16.3	1.6	3.5
Cow's milk	31	mt	6.7	3.2	51.8	0.6	6.5
Buffalo milk	30	mt	63.6	63.2	64.0	4.3	4.3
Meat	3	mt	2.5	2.3	3.3	2.0	2.7
Eggs	1516	000t	3.7	2.1	7.1	3.1	7.8
Cashewnuts	150	000t	31.3	35.6		0.6	-0.4
Coffee	169	000t	2.9	2.4	8.3	0.7	2.3
Tea	758	000t	28.7	30.0	25.6	2.7	2.4
Tobacco	581	000t	7.0	8.3	4.5	3.1	1.8
Cotton lint	3760	000t	22.4	18.3	46.0	1.2	2.8
Rubber	440	000t	7.9	3.8	16.6	3.0	8.9

Source : Food and Agriculture Organizations (1994) : *Production Year Book,* 47, 1993. Rome.

encouraged smuggling. With substantial reductions in excise duties in the past three years, synthetic fibres are at last becoming competitive with cotton. Smuggling is also declining. Once they do so, their production should grow much faster.

Caustic soda production is also spread amongst a large number of producers. Some are specialist chemical manufacturers, but most are users of caustic soda in textile or paper industry or have diversified in caustic soda without any reason. The largest producer, Standard Industries with 18.8 per cent market share, is basically a textile producer; so is the third producer with 7.7 per cent market share, Grasim Industries, which we encountered in the previous paragraph, and Ballarpur Industries with a 7.6 per cent market share, which is primarily a paper manufacturer. Only the second

producer, Gujarat Alkalies and Chemicals with a 9 per cent market share, is a specialist caustic soda producer. This industry should continue to grow with its user industries; consolidation of its structure could accelerate growth.

Soda ash, on the other hand, is a much more concentrated industry. Soda ash is made from salt, for which the western Gujarat coast is the best location. Tata Chemicals, situated there, accounts for 45 per cent of production; Gujarat Heavy Chemicals, and VXL India, close by, account for 26 per cent and 14 per cent respectively. With its low costs of salt production, India is potentially a competitive producer of soda ash. The industry should continue to grow at least as fast as in the past.

Sulphuric acid is easy to produce from sulphur. It is used to pickle phosphate rock and make phosphatic fertilizer; many phosphatic fertilizer producers make it as a by-product and sell it. It is also obtained as a by-product in the refining of copper and zinc out of suiphurous ores; hence nonferrous metal producers also often market sulphuric acid. Thus the largest producer with a 17.5 per cent market share, Dharamsi Morarji Chemical Co., is the second biggest phosphatic fertilizer manufacturer. The second biggest, Hindustan Zinc and the fifth biggest, Hindustan Copper, are nonferrous metal manufacturers. The third biggest is Nirma, the manufacturer of soaps and detergents, and the fourth is Salvigor Laboratories. India is unfavourably placed to produce either phosphatic fertilizers or nonferrous metals. With import liberalization the output of phosphatic fertilizers may well decline; nonferrous metals are being increasingly produced from imported scrap. Hence the output of sulphuric acid may keep up with demand, but is unlikely to grow very rapidly.

7. Agriculture

Historically, the principal foods in India have been cereals, pulses, and vegetables. Consumption of meat and fish has been very low. Milk and milk products are prized, but their consumption has been low. India’s large population and high population density have from time to time fed fears that it would not be able to feed itself. But for the last three decades, its agricultural growth has outstripped population growth, and food output has at least kept pace with population. As Table 13 shows, India’s share of world output of all major food products has increased. Within food products there has been a change in composition. **Coarse grains**, considered poor man’s food, have lost ground, and been replaced by **wheat** and **rice**. The output of **milk** and **eggs** (and, by implication, **poultry**) has shown a particularly rapid increase; fruit production has also risen. Increases in the output of other food products are not equally spectacular, but have outstripped population growth. Thus there has been a significant qualitative improvement in diet. Progress in commercial crops had been less pronounced, but noticeable.

The green revolution is now over 20 years old, so the continuing increase in the production of **wheat and rice** is not due so much to technological change as to increased fertilizer use, and more intensive exploitation of irrigation. There are no signs of exhaustion of this process, and output can continue to increase at past rates. In the last three years the government has built up uncomfortably large foodgrain stocks of almost 40 million tons. This may be due to official price support: prices may have been pushed up and consumption restrained. Or it may signify a slackening in the growth of foodgrain demand; following coarse grains, the income elasticity of

demand for wheat and rice may also be on decline. If this happens, a number of possibilities will open up. One is diversion of land from wheat and rice to other crops; in particular, if demand shifts as in other countries to meat and milk products, there could be diversion to animal feedstuffs. There could be a shift to other crops such as sugar cane and cotton. This is particularly likely if agricultural price support policy continues to keep prices high and restrict domestic demand for foodgrains. Another is exports. India produces over a tenth of the world's wheat and over a fifth of its rice; but it trades very little in either because of policy: imports have been limited to keep India self-sufficient, and exports have been controlled to ensure that there are no domestic shortages. India's output of wheat exceeds a half of the world trade in wheat; amongst India's neighbours in East as well as West Asia are substantial importers of wheat, including Iran, Malaysia, Indonesia, Philippines, Taiwan, China, Japan and Korea. World imports of rice are less than 15 per cent of India's output. India exports limited quantities of high-quality rice. Its market share could -be considerably increased without a significant reduction in domestic supply. To become a substantial and steady exporter, however, India would have to revise its agricultural policies: especially price support, which generally raises foodgrain prices and makes exports uncompetitive, credit restrictions on foodgrain storage, centralized procurement and distribution which, apart from being enormously inefficient, make foodgrain processing and trading uneconomic for the private sector, and the Essential Commodities Act which makes it illegal to store more than minute quantities of foodgrains and hence makes trading hazardous. These policies have discouraged investment in foodgrain processing, and kept processing technologies so backward that they form a barrier to exports.

Following a policy of self-sufficiency, India has protected **oilseeds** so much that domestic prices of edible oils are 50-100 per cent higher than import prices. The price difference was used to its advantage by the government: it gave its own agencies exclusive permission to import, and they resold imported oil below market prices, but still at an enormous profit. There was considerable resistance within the government to the dismantling of this regime. But finally this year, import restrictions on edible oils have been relaxed; they are now importable at 30 per cent duty. Meanwhile, a profitable export trade in oilcakes, used for animal feed, was built up, cross-subsidized by the high domestic prices realized for oils. If imports bring down edible oil prices, oilseed production may decline, and with it, oilcake exports. The effect would be greater on expensive oilseeds such as groundnut, and less on cheaper oilseeds such as soybeans.

Milk production has been boosted by breeding improvements; but probably more important is the introduction of tractors in certain areas, which has reduced draft animal requirements and released fodder for milch animals. Till the 1970s, milk used to be in short supply in cities. They were supplied by local official monopolies, and the prices were kept low, which aggravated the shortages. But in the 1 980s, a sudden acceleration of growth in milk supply eased the shortages and made supplies available to private distributors. Slowly, the monopoly of the governments and their proteges has been dismantled, and private distributors and processors have been allowed. Growing supplies of milk have in particular increased supply of **butter-substitutes.** Food product companies have also begun to enter the markets for ice cream, butter-substitute, and milk powder. The process is still precarious, but looks irreversible. Rapid growth in milk production should continue. As a surplus of draft animals and of

feedstuffs emerged, meat production picked up **meat** has been exported in small quantities to the Middle East. The growing supply of feedstuffs has also supported the growth of poultry, which is the favoured form of meat. Although **fish** exports have grown considerably, its domestic consumption is still very low. Most of India's population, living inland, does not like fish. Meat production should continue to rise on the basis of strong growth in supply as well as demand.

In the 1970s and 1980s, exports of **tea, coffee**, and **tobacco** went increasingly to the Soviet Union. It paid more than world market prices; so exports to the rest of the world suffered. After the breakup of the Soviet Union, these products have sought other markets with varying results. In tea, better qualities have found a good market abroad; their relative prices have gone up. Low qualities accounting for the bulk of the production continue to be in difficulty despite a fall in their price. In coffee, the collapse of the Soviet market coincided with the breakup of the International Coffee Agreement, and a growing world shortage and rising prices which rose to a peak last year on account of Brazilian crop failures. Riding on the back of this boom, coffee exports have risen rapidly to exceed tea exports last year. Under pressure from exporters, the government has also relaxed controls on the coffee market which cross-subsidized domestic consumers at the expense of exports, and given up compulsory auctions which prevented direct contact between producers and markets abroad. The regime is in the process of crumbling; if it is abolished, coffee exports and production should receive a significant boost.

A number of hybrid varieties of **cotton** were developed by Indian scientists in the 1960s which supported rapid growth in output and quality improvement. By the late 1970s India had a cotton surplus and could have emerged as a major cotton exporter. But under the influence of the textile industry, the government maintained export restrictions on cotton and kept domestic prices low. This domestic surplus of cotton supported a rapid growth of exports of yarn and garments after the 1991 devaluation. By 1994, however, the cotton surplus was exhausted, and domestic prices rose sharply. Imports were liberalized; but that was little help since world cotton prices were higher. It is unlikely that the textile lobby's influence on policy will decline. Cotton would probably continue to be discriminated against, and the growth of its output is likely to suffer as a result.

India was traditionally an importer of **rubber.** As with oilseeds, imports were restricted and taxed to encourage domestic production; now India produces its entire rubber requirements. Generally prices have been much above international prices, and the rubber lobby has been too strong to allow import liberalization. But last year, a domestic rubber shortage forced imports. In the meanwhile international prices also rose until they were above domestic prices; so import liberalization had no effect, and did not create a political backlash. For that reason import liberalization may survive. India is unlikely to become a rubber exporter, but rubber output should continue to grow to meet domestic requirements.

III. A BALANCE SHEET OF REFORMS

What is the outcome of the economic reforms? How far have they advanced India towards becoming a stable, dynamic economy? How much more needs to be done? These questions can be answered at three levels. We may ask whether:

(a) a lasting improvement in the economy's past performance can be expected with what has been done,

(b) whether the fundamental constraints on the economy's performance have been relaxed, and

(c) how far the policies are from those that would get the best performance from the economy.

1. Durability

Four policy changes have made it particularly likely that there will be a lasting improvement in economic performance. One is *introduction of domestic competition* by abolition of most of industrial licensing. This has raised the sights of Indian companies: deprived of protection against competition they earlier got from industrial licensing and import controls, they need to grow to survive competition; this need to grow has given them dynamism. Next, the need to grow is now backed by resources to grow. *Deregulation of the capital market* has made it easier and cheaper for companies to raise equity capital. Similarly, *licensing of new banks* has introduced competition into the banking industry, and will lead to easier access to bank loans. Finally, *import liberalization* has improved access to foreign goods, reduced potential for inflation, relaxed domestic capacity restraints, and introduced some competition from abroad. These changes together have improved the prospects for non-inflationary industrial growth. As we showed in the previous section, these macroeconomic factors favouring faster growth are backed by better prospects in most major industries. The only industry which could materially hold up growth is *electric power*. But here too there has been no deterioration in conditions; and now that the states have to compete to attract industry, they will be under pressure to ensure adequate growth of power production. India's GDP grew at 5 ½ per cent a year in the 1980s; it should grow at this rate at least in the coming decade.

2. Constraint Management

The fundamental constraints on the growth of the economy have been import capacity and domestic inflation; the two are interconnected since inflation tends to raise imports and worsen the import bottleneck. Under the previous policy regime, high import barriers raised costs and made exports uncompetitive, thus worsening the balance of payments bottleneck; import restrictions also prevented excess demand from spilling over into imports, and led to inflation, which harmed export competitiveness.

The reforms have done more to improve balance of payments management than to moderate inflation. Substantial *removal of import licensing* has reduced delays in the

import of industrial inputs, although consumer and agricultural goods continue to be under import control. *Tariff reduction* has also been significant and will continue. Thus when domestic inflation gathers pace, supplies from abroad will come in more easily to dampen it; the chronic tendency for inflation to improve the real exchange rate and make exports uncompetitive has been weakened. But the improvement is partial. Consumer and agricultural goods still remain subject to discretionary constraints; in effect, their imports are banned until the government recognizes the need for them, which is usually too late and too little. Besides, import liberalization converts the internal constraint of inflation into an external balance of payments constraint. Now that the exchange rate is no longer officially determined, it is likely that exchange rate policy will be more flexible, and that in the event of strain on the balance of payments, the currency will be allowed to depreciate. If that happens, the ill- effects of domestic inflation on export competitiveness will be avoided. But the timing of devaluations is never perfect, and short- term losses of competitiveness are always possible.

But the factors which make the Indian economy mildly but chronically inflationary still persist. *Government deficits* remain undiminished at about 12 per cent of the GDP. As long as they continue at this high level, a high proportion of domestic savings must continue to be absorbed in financing them; and insofar as those savings cannot be easily commandeered, there will be a persistent tendency to monetize the deficits. *No market for government debt* has been developed outside the banks and governmental financial institutions, so the capital market remains incapable of absorbing the increase in debt that would be required to finance government deficits, and increases in reserve money would continue to be necessary to finance the deficits. In trying to sell a growing volume of securities in an undeveloped market, the government has pushed up interest rates in the past three years. Interest payments have absorbed an increasing proportion of government revenue, and government borrowings on the present scale cannot continue without causing a budgetary crisis; the present trend is unsustainable. This is one area where further reforms are essential to ensure long-term stability. *Agricultural price support policies* operated to benefit farmers continue to push up prices, and *price controls on energy products* are used to cross- subsidize inefficient at the cost of efficient producers and cause continuous inflation in energy prices.

3. Looking Further Ahead

Thus further reduction of import barriers, removal of price controls and price support mechanisms, and improvement of fiscal balance are the most urgent priorities. But more extensive reforms can be designed which would make the economy more robust and dynamic. After the liberalization, *regulation of foreign investment* now consists of disconnected relics of old controls, consisting of a fairly liberal regime in the so-called priority industries whose rationale is obscure, discretionary controls on other foreign direct investment, and a liberal regime for foreign portfolio investment which is, however, nullified by the inefficient organization of the capital market. The distinction made in policy between direct investment and portfolio investment does not have much meaning; policy should be concerned, not so much with foreign investment as such, but with its effect on actual and potential competition. An antimonopoly policy would make more sense than control of foreign investment.

The position of *government enterprises* has worsened because they have been subjected to private competition without being given the freedom to react to it. They need to be able to decide their financial structure; this would mean freedom to issue equity, and hence the possibility that the governments would lose ownership of the enterprises as they grow. Financial autonomy must mean abolition of subsidies; if the enterprises are to have an incentive to perform, the government must cease to underwrite their losses. The enterprises are also losing qualified staff to competing private enterprises, and being left with unemployables. To compete effectively, they need to be able to decide their salary structure independently of government salaries.

Support of small firms also consists of fragments of old promotional measures - tax incentives, cheap, reserved credit, exclusion of large firms from production of over 1, 000 products etc. Small industry promotion has served to keep firms small and led large firms to disguise themselves as or otherwise exploit small firms. The present system of small industry promotion needs to be replaced by more selective promotion of new enterprises.

Agricultural investment has been heavily subsidized. Irrigation and other public works supply their services almost free and cannot even be maintained from the revenue they earn; private investment in mechanization, land improvement etc has been financed from cheap loans disbursed by special official institutions, seldom repaid. The current arrangements for financing agricultural investment cannot lead to adequate growth of agricultural investment, and need to be replaced by more viable institutions.

Law relating to closure and retrenchment has long been known to be unsatisfactory. Closure of firms or retrenchment of labour requires permission from state governments which is seldom given. The result is that many firms close down, but cannot be liquidated; workers are thus thrown out of their jobs anyway, and creditors and investors cannot recover their dues from the firms. Evidently, these problems affect only firms on their way to bankruptcy, and those are only a few. But labour laws add to the difficulties of firms in decline and make it impossible for creditors and owners to disentangle their assets; this does discourage investment. In labour relations, the accent needs to shift from preventing retrenchment to ensuring adequate compensation; and in liquidation, procedures need to be speeded up.

The law relating to land ownership is similarly in need of reforms. A ceiling of 1,000 square meters was introduced on ownership of urban property in the 1960s. This has led to clandestine ownership of larger areas of land and corruption; more important, it has made large-scale, integrated property developments virtually impossible without government involvement or connivance. A law requiring government permission for land transactions exceeding Rs. 1 million has similarly led to corruption and undervaluation. The resulting distortions of the urban land market are the cause of the persistent shortages of office and commercial space and the high costs of land in Indian cities. A freer, less controlled land market needs to be created by means of the repeal of the urban land ceiling, reduction of taxes on land transfers and stamp duties, and reduced government interference in the land market. Agricultural land reforms in the 1950s led to similar concealment and corruption in rural land transactions; here too, the laws need to be simplified to create a market in agricultural land.

Investment in infrastructure is constrained by unviable government enterprises. Notably in railways, power, and telecommunications the government has tried to attract private capital; but the new arrangements have worked poorly. In railways, private investment in rolling stock is invited without giving the investor a voice in managing his investment; hence no investment has been forthcoming. Railways, currently run as a department of the central government, need to be decentralized, so that private investment can go into smaller, independent local systems. In power, private investment has been invited on attractive terms; but the state governments which manage the electricity systems are seen to be too arbitrary and unstable, and do not have the credibility required to do business. Electricity distribution needs to be decentralized, and competition amongst generators needs to be introduced, so that electricity supply would grow at least cost. In telecommunications, a number of errors and false starts over four years have finally led to a stage where real private competition may soon be introduced. But the keenness of the government telecommunications department to maximize its own revenue is likely to ensure that the tariffs will remain high and the spread of services limited. A more competitive institutional structure would reduce costs and facilitate faster absorption of new technologies.

Beyond this, there is scope for a more comprehensive *reform of the governments* in India. The structure of government has changed very little since independence: India functions as a federal democracy with administrative procedures little changed from those of the colonial British government. But whilst the procedures remain the same, the practices have changed considerably. The bureaucracies have been vastly expanded, and their control structures have been weakened. The quality of intake into the senior bureaucracy has gone down. The same trends are seen in the judiciary: the load of pending cases has mounted, the control of higher over lower judiciary has weakened, the quality of intake into the judiciary has gone down, and with it, the quality of justice. Politics now attracts less able and less professional people, and the quality of legislation has gone down as the quantity has gone up. For three decades the governments, particularly the state governments, functioned as employment agencies; they expanded while their standards of work declined and services deteriorated. Although that phase has ended and controls op recruitment are stricter now, conversion of the present governments into a service industry requires broad-based changes in organization, salaries, incentives, conditions of employment, parliamentary practice, and judiciary procedure.

IV. THE PROSPECTS

Although the reforms that have been done are likely to lead to a decisive improvement in India's economic performance, it is necessary to ask: how durable are these reforms? Might they be reversed? What are the chances of further reforms? Is the agenda of reforms laid out in the previous section likely to be implemented? The answer must depend on future political developments, and cannot be predicted with any precision. But some guesses can be made.

1. Shifting Centre of Gravity

Indian politics is obviously in a state of flux. The Congress party, which has ruled at the centre for all except four out of the 48 years since independence, is losing strength. There is no clear successor. Thus questions arise about the likely colour of future ruling parties, and about their stability.

Although the long rule of the Congress had given India a semblance of stability, the Congress has been much less dominant in the states. The Congress was the party that struggled for independence from British rule; hence it was the only popular party at the time of independence in 1947. But the first non-Congress state government - a communist one - was elected in Kerala in 1956. After Nehru, the first Prime Minister, died in 1964, there was a power .struggle in the Congress which his daughter, Indira Gandhi, won, but only at the cost of a split in the party. The economic crisis caused by the rise in oil prices in 1974 shook the government. Indira Gandhi retained power only by abolishing democracy and declaring an emergency in 1975. When, in 1977, she lifted the emergency and held elections, the newly formed opposition party, Janata Dal (JD), won power at the centre as well as in most states. The Janata Dal broke up from intrigues orchestrated by Indira Gandhi in 1979, she came back to power, and the Congress held on in Delhi for ten years. Then again the Congress lost power in 1989. Disunity in the Janata Dal, again fomented by Rajiv Gandhi who had by then succeeded Indira Gandhi, his mother, as Congress leader, led to the fall of the JD government in 1991. The Congress then came back to power with a minority, and slowly broke up minor opposition parties and gathered support to emerge with a majority. Even now the Congress does not have the numerical strength in Parliament to pass crucial legislation - for instance, to get parliament's sanction for the commitments made in the Uruguay round. Most of the major states are being ruled by parties other than the Congress. Thus India is a polyarchy; it is ruled by a number of parties, and has so been ruled for many years. It has, in this sense, been unstable, and can hardly become more unstable in the future.

But this multiparty rule has not paralyzed the government. The constitution divides functions clearly between the centre and the states. It gives the centre certain powers which it does not have to share with the states; so a party at the centre can continue to govern as long as it commands a majority in Parliament. So the real question is: would some party or parties continue to command a majority in Parliament? There have been short periods of instability, for instance in 1989-91, where the division of seats in Parliament made it difficult for any party to form government; can such instability become more frequent or endemic?

This question is particularly difficult to answer at this juncture, when non-Congress parties have won most of the eight state elections held earlier this year and are therefore poised to repeat their success in the national elections which are due by May 1996 at the latest. In a situation of such uncertainty, it is usual for parties to form alliances; the alliances will strongly affect the outcome. So the outcome is unpredictable, but the chances are high that the Congress will not return with a majority. It may still form the government with the help of some minor parties as it did in 1991; or a coalition of non-Congress parties may come to power.

Whatever the outcome, the absence of a single strong party at the centre, together with a multiplicity of parties ruling various states, makes the environment unfavourable to radical change, whether in the direction of reforms or away from them. There are too many checks and balances in the federal democratic constitution to permit basic change, which is why the Indian reforms have been less sudden or radical than in other developing countries. But the forces that work against such changes also work against the reversal of what has been done. So the reforms that have been done are likely to survive. The political centre of gravity is moving towards the right in India; if the Congress is thrown out of power, the most likely alternative is a government dominated by the rightist Hindu party, the Bharatiya Janata Party (BJP). This party has recently shown signs of taking over the xenophobic slogans that the Congress sported till the late 1980s. This may have something to do with the industrialists, many of whom support the BJP. But as a party of traders and industrialists, the BJP has always been against detailed regulation by the government. Hence the possibility of its coming to power does not threaten the deregulation that has taken place. Further, a variety of parties ruling in the states means that there would be lack of support for strengthening the powers of the centre. So reforms in the direction of further deregulation are particularly favoured by the emerging constellation. Besides, now that the central powers of industrial and import licensing are largely given up, the states have to compete for industry. This is conducive to reform of state governments. Thus whilst radical reforms of the sort mentioned in the previous section do not have very bright chances, what has been done will stay, and improvements in the states are perfectly likely.

2. Conclusion

There is little doubt that amongst the largest economies listed in Table 1, India will show the second highest growth rate after China, and will also achieve the third or fourth largest absolute increase in market size after the US, China, and perhaps Germany for the next few years. It is also highly likely that the high growth will last: macroeconomic conditions have been created which would enable the government to prevent interruptions in growth. Access to the Indian market has been improved by import liberalization as well as by relaxation of the restraints on foreign investment. India has a constitutional structure and a legal framework which slows down policy changes; but it also prevents drastic changes in the policy framework and arbitrary discrimination against foreign investors or traders. The political colour of the Indian governments at the centre and in the states is variable as it should be in a democracy; but underlying this political instability is a certain stability of structure arising from the working of the constitution and the rule of law. As the economic climate in India becomes more positive, its legal stability will begin to reinforce its advantage as a partner in trade and production.