Industrialisation In India

Jana Hambrock and Sebastian Hauptmann - Socrates

The development of India into a modern industrialised country is a slow but continuing process. Jana Hambrock and Sebastian Hauptmann provide a detailed analysis of the Indian economy, referring to its historical and theoretical context, as well as to its future prospects.

Introduction

To discuss the topic "The Indian approach to industrialisation", this essay is divided into several parts. Firstly, the reasons for, and policies of industrialisation are discussed. The theoretical framework is finished by identifying indicators to be used in the evaluation of the success of such policies. The second section gives a rough overview of the development of industrialisation in India since independence. The third section goes into more detail and provides information about some specific and important areas for industrialisation. The fourth section uses the defined indicators to measure the success of India’s two main approaches to industrialisation and evaluates the results. The fifth section describes the main problems India faces today and in the future. Last but not least, the sixth section informs about current trends in Indian policy.

Theoretical Framework for Industrialisation

Before analysing the Indian approach, we want to introduce the aims of industrialisation, give a rough overview of the industrialisation strategies for Less Developed Countries (LDCs) and identify indicators for the evaluation of the success of industrialisation policies.

Why Industrialisation?

What are the ultimate objectives of economic development? Different governments may have different objectives in mind. Generally, however, they will include a faster growth of national income, alleviation of poverty, and reduction of income inequalities.

But how is industrialisation expected to contribute to these goals? The experience of industrial economies shows a close association between development and industrial expansion. But industry is also thought to provide certain spillovers which would benefit other activities: enhancement of skills, training of managers, dispersion of technology, etc. Moreover, pessimism about the prospects of food and raw materials made the substitution of domestic for imported manufactured goods seem the most promising route to development for many countries.

Industrialisation and foreign trade

Economists and policymakers in the developing countries have long agreed on the role of government in providing infrastructure and maintaining stable macroeconomic policies. But they have disagreed on policies toward trade and industry. The form of government intervention in this area is the distinguishing feature of alternative development strategies.

A convenient and instructive way to approach the complex issues of appropriate trade policies for development is to set these specific policies in the context of a broader

Less Developed Countries strategy of looking outward or inward. Outward-looking development policies encourage not only free trade but also the free movement of capital, workers, enterprises, the multinational enterprise, and an open system of communications. By contrast, inward-looking development policies stress the need for LDCs to evolve their own styles of development and to control their own destiny. Within these two broad philosophical approaches to development, a lively debate has been carried out between the free traders, who advocate outward-looking export promotion strategies of industrialisation, and the protectionists, who are proponents of inward-looking import substitution strategies .

The advocates of import substitution (IS) – the protectionists – believe that LDCs should substitute domestic production of previously imported simple consumer goods and extend this later to a wider range of more sophisticated manufactured items – all behind the protection of high tariffs and quotas on imports. In the long run, IS advocates cite the benefits of greater domestic industrial diversification and the ultimate ability to export previously protected manufactured goods, as economies of scale, low labour costs, and the positive externalities of learning by doing cause domestic prices to become more competitive with world prices.

By contrast, advocates of export promotion (EP) of both primary and manufactured goods cite the efficiency and growth benefits of free trade and competition, the importance of substituting large world markets for narrow domestic markets, the distorting price and cost effects of protection, and the tremendous success of the East Asian export-oriented economies of South Korea, Singapore, and Hong Kong .

The balance of the debate has swung back and forth, with the protectionists predominating in the 1950s and 1960s, and the export promoters gaining the upper hand in the late 1970s and in the 1980s and 1990s, especially among Western and World Bank economists.

Indicators for measuring economic development

Of course, any development policy has to be assessed by measuring the economic development it effects. India’s first Prime Minister Jawaharlal Nehru declared on the eve of the departure of the British, on 14 August 1947, that India’s task in the future included "the ending of poverty and ignorance and disease and inequality of opportunity".

These measures will be used to determine the success of the inward-looking policies he initiated, as well as to compare their success with the success of the reform policies. Therefore, growth of income per capita, alleviation of poverty and reduction of income inequalities are amongst the most important indicators.

To measure advances regarding inequality of opportunity and ignorance, several indicators pertaining to education and health will be used. These are two important public goods to which every individual is entitled; both for their intrinsic importance and for their enhancement of instrumental personal, social and process roles, and also empowerment and distributive roles.

History of Industrialisation in India

This section gives a rough overview of the history of industrialisation in India. Several areas will be discussed in more detail in the following section.

Colonial rule

Under colonial rule, India, as with most other developing countries, followed a non-industrial model. But many Indians believed that progress was retarded by this. It was believed that true economic progress lay in industrialisation; Smith’s and Ricardo’s ideas of international specialisation and mutually advantageous free trade were rejected, at least until India became an exporter of more sophisticated goods.

Industrialisation since Independence

India's first Prime Minister, Jawaharlal Nehru, Premier from 1947 to 1964, saw industrialisation as the key to alleviating poverty. Industrialisation not only promised self-sufficiency for his nation that had just regained political sovereignty, but also offered external economies accruing from technical progress. Believing the potential of agriculture and exports to be limited, Indian governments taxed agriculture by skewing the terms of trade against it and emphasising import substitution, thus giving priority to heavy industry.

Nehru believed a powerful state with a centralised planned economy to be essential if the country was to industrialise rapidly. The Industries (Development and Regulation) Act (IDRA) in 1951 laid the foundations for this administrative control on industrial capacity. But, over time, the licensing requirements became increasingly stringent and were accompanied by a gamut of procedures that required clearance by a number of disparate and uncoordinated ministries.

In order to pursue IS, the Import Trade Control Order of 1955 subjected almost all imports to quantitative restrictions in the form of import licenses. These were supplemented by tariffs at rates that were among the highest in the developing world.

Indian state intervention in industrial development has been extensive. Unlike many East Asian countries, which used state intervention to build strong private sector industries, India opted for state control over key industries. At different times, nationalised industries included chemicals, electric power, steel, transportation, life insurance, portions of the coal and textile industries, and banking. To promote these industries the government not only levied high tariffs and imposed import restrictions, but also subsidised the nationalised firms, directed investment funds to them, and controlled both land use and many prices.

Under Prime Minister Indhira Gandhi (1966-77), two major shifts took place in the role of the state. First, the neglect of agriculture was reversed through state activism in subsidising new seeds and fertilisers, agricultural credit, and rural electrification. The green revolution took off and by the mid-1970s India was self-sufficient in grain. The second shift was the further tightening of state control over every aspect of the economy. Banks were nationalised, trade was increasingly restricted, price controls were imposed on a wide range of products, and foreign investment was squeezed.

In 1973, dealings in foreign exchanges as well as foreign investment came to be regulated by the Foreign Exchange and Regulation Act (FERA). The act virtually shut out the inflow of new technology from abroad in the 1970s and 1980s, particularly when these involved large equity participation.

The Indian system of state planning went far beyond the usual inward-looking industrialisation policies that most developing countries pursued after World War II. The government regulated the most basic business decisions for all firms above a certain size: borrowing, investment, capacity utilisation, pricing and distribution.

The over-restrictive, and often self-defeating nature of the regulatory framework, began to become evident by the late 1960s and early 1970s. Comprehensive planning was increasingly criticised as planned targets were not met and many plans were not even implemented. The lack of success in some dimensions led to a new and more restrictive set of regulations. One example is the attempt to reserve sectors for small industries and to restrict the growth of large firms.

Beginning in the early 1980s, a mild trend towards deregulation started. Economic reforms were introduced, starting to liberalise trade, industrial and financial policies, while subsidies, tax concessions, and the depreciation of the currency improved export incentives. These measures helped GDP growth to accelerate to over 5% per year during the 1980s, compared to 3.5% during the 1970s, and reduced poverty more rapidly. However India's most fundamental structural problems were only partially addressed. Tariffs continued to be among the highest in the world, and quantitative restrictions remained pervasive.

Moreover, a significant government influence continued in the allocation of credit to firms and a discouragement of foreign investment. Relatively inefficient public enterprises, controlling nearly 20% of GDP, remained a drag on economic growth.

The government expanded antipoverty schemes, especially rural employment schemes, but only a small fraction of the rising subsidies actually reached the poor. Competition between political parties drove subsidies up at every election. The resulting fiscal deficits (8.4% of GDP in 1985) contributed to a rising current account deficit. India's foreign exchange reserves were virtually exhausted by mid-1991 when a new government headed by Narasimha Rao came to power.

In July 1991, India launched a second major economic reform program. The government committed itself to promoting a competitive economy that would be open to trade and foreign investment. Measures were introduced to reduce the government's influence in corporate investment decisions. Much of the industrial-licensing system was dismantled, and areas once closed to the private sector were opened up. These included electricity generation, areas of the oil industry, heavy industry, air transport, roads and some telecommunications. Foreign investment was suddenly welcomed.

Greater global integration was encouraged with a significant reduction in the use of import licenses and tariffs (down to 150% from 400%), an elimination of subsidies for exports, and the introduction of a foreign-exchange market. Since April 1992, there has been no need to obtain any license or permit to carry out import-export trade. As of April 1, 1993, trade is completely free, barring only a small list of imports and exports that are either regulated or banned. The WTO estimated an average import tariff of 71% in 1993 which has been reduced to 40% in 1995. With successive additional monetary reforms, the rupee, since 1995, can nearly be considered a fully convertible currency at market rates. India now has a much more open economy.

Special areas of economic policy

After giving a rough overview of the history of industrialisation, this chapter provides more detailed information about the areas of human factors for industrialisation, structure of foreign investment, and the process of privatisation.

Human Factors for industrialisation

A very necessary ingredient for promoting industrialisation and technological change is the investment in human capital. India's current average adult literacy rate is low at 52%. There are large inequalities between males (literacy: 64%) and females (literacy: 39%), between urban and rural areas, and between different social classes. Low levels of female education in India are due to the gender division of labour. Females are expected to spend most of their life in domestic work and child rearing. Secondly, the practice of dowry and the ideology of hypergamous marriage can turn female education into a liability. An educated girl is likely to be more expensive to marry off, thus female education tends to be a threat to the social order. Illiteracy is widespread not only in older groups, but also among young boys and girls, particularly in rural areas.

The remarkable neglect of elementary education in India is all the more striking given the widespread recognition, in the contemporary world, of the importance of basic education for economic development. Primary education in India is not compulsory. However those who receive primary education and make it through secondary school have an excellent chance of getting a high-class University education. India has a huge supply of people with more education than they can use.

Amartya Sen argued that there were deep-seated class biases in the pressures that have determined Indian educational priorities, and that the inequalities in education are, in fact, a reflection of the inequalities of economic and social powers of different groups in India. India’s hierarchical, brahmin-dominated society has been noticeably casual about primary education; resources have been poured into the higher education that benefits the upper class.

The persistence of endemic illiteracy and educational background in India generally limits the freedom and well-being of the Indian masses and has a direct role in the relative deprivation of women in particular. Elementary education is extremely important for a successful integration in the world market and if the process of growth were more ‘participatory’ it could raise the income-earning power of large parts of the nation. Even if India’s high technology industries, such as modern computer software or engineering products had an accelerated growth, the bulk of the Indian population would benefit only marginally.

Foreign Investment Policy Instruments

Since independence, new foreign investment has been rigidly controlled in line with established development thinking. Investment was mostly restricted to industries where it was felt that the acquisition of foreign technology was important, or where the promise of exports was convincing. The FERA was a landmark. In most industries, foreign shareholdings in rupee companies had to be reduced to 40%. The relative importance of foreign ownership in the private corporate sector fell significantly in the next decades. The attitude towards foreign investment began to change in 1985 as a part of Ghandi’s drive for advanced technology. Despite this, looking at 1988 shows how poorly India fared in attracting private foreign investment. Net Private Foreign Investment to India (in million US$) was $280. This is compared to her Asian competitors with figures of $2344 (China), $1093 (Thailand) and $986 (Philippines).

Since the liberalisation in, mid-1991 India has become a magnet for foreign investment. A noteworthy feature is the dramatic speed of approvals, some taking only a week. Automatic approval of projects in 34 industrial sectors is permitted. The constraint that foreign investment should reach only 40% was relaxed to 51%. In certain sectors, such as infrastructure and computer software, the ownership can also be as high as 74%. In some sectors such as transport infrastructure, full foreign ownership is permitted and even encouraged.

Foreign direct investment rose from $170 million in 1991-92 to $1.3 billion in 1994-95. India is targeting foreign direct investment of at least $10 billion annually by the turn of the century. It attracted a total of $2.4 billion in 1996-97 and $3.4 billion in 1997-98. Foreign direct investment is nearly 25 times higher than it was before the economy was liberalised.

The government in New Delhi is continuing to work toward reforming long-standing policies to make the country more "investor friendly"; a move that continues to heighten US interest in the country. A growing number of US companies, motivated by an increasingly favourable investment climate and the country's huge reserves of both human and natural resources, have seriously begun to consider investing there. US investment has been more than 24% of the total investment since 1991. In 1995 approximately $3.5 billion of US foreign investment flowed into India.

The US continues to be the leading investor in India. The US is followed by other more ‘traditional’ investors like the U.K. (6.4%), Israel (5.9%), Mauritius (4.6%), Japan (4.2%) and Germany (4.1%). Most of the investment interest has been in the telecommunications, oil refining, automobile and transportation sectors, with other projects developing in the electronics, software and electrical equipment industries.

Revitalisation of the Indian Private Sector

India has always been a trading nation. Centuries of alien rule and decades of socialism did not stamp out the Indian entrepreneurial spirit. The Statement of Industrial Policy 1991 reduced the list of industries reserved for the public sector from 17 to 6. In 1992/93, 104 out of a total of 237 central public sector enterprises made losses. With few exceptions, the inefficiency of public enterprises, which generate 17% of GDP, has continued to be a serious issue. It is clear that there is a *prima facie* case for privatisation on grounds of efficiency. However, the strength of the case for privatisation varies with the type of industry.

Now exposed to international competition, Indian companies are forming alliances with each other to face the challenges of the future. It is now even possible for Indian firms to merge with other companies. Procter & Gamble merged its operations with Godrej Soaps. Coca Cola acquired Parle, its erstwhile competitor, thus extending the cola wars to new exotic lands. Companies are enjoying the benefits of economies of scale and synergy. As larger and stronger groups emerge, they will have the resources necessary to invest in upgrading technology and will become more competitive.

Evaluation of Industrialisation in India

The indicators named above will be used to evaluate the success of Indian industrialisation policies. A distinction will be made between the period from Independence until 1980, characterised by inward-looking policies such as IS, and the period from 1980 until today, characterised by reforms and the opening up of the Indian economy. The following analysis with indicators compares the achievements of these two periods only. Absolute statements of Indian achievements follow later on.

It must be emphasised that the analysed data conceals sharp disparities within India between development-oriented states and laggards, between women and men, between adults and children, and between city and countryside. Different states have progressed at differing paces and, even within states, different regions have achieved markedly varied results. Even more noticeable than geographic differences in poverty reduction are the inequalities that persist across gender, caste and ethnic groups. Social indicators for women – literacy, for example – are distinctly lower than for men, and the level of scheduled castes and tribes in both economic and social achievements is still well below the national average.

Growth of national income

Growth of national income in GNP per capita in India was about 1.4% in the years from 1960 to 1980. The effects of the reforms of the 1980s are reflected in growth figures: the average GNP per capita growth increased to 3.25%. And with further opening up in the 1990s, the GNP per capita reaches new heights with 3.8% average growth in the period from 1987 to 1997.

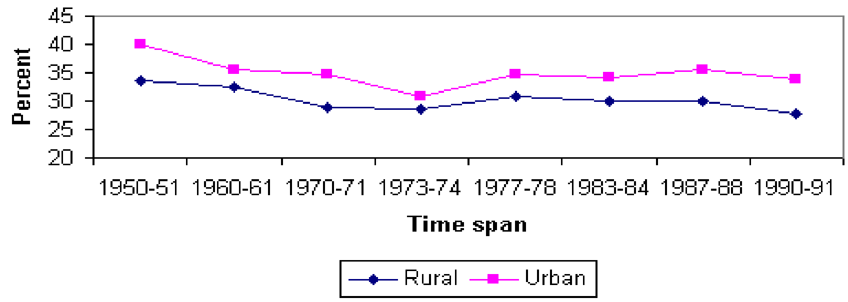
Alleviation of poverty

In the early 1950s, about half of India’s population was living in poverty. Since then, poverty has been declining slowly. The poverty reduction was given new impetus by the reforms: falling from around 55% in 1974 to just under 35% in 1994 by a headcount index. In the 1980s and 1990s, poverty reached historically low levels. Still, because of India’s rapid population growth rate, the relative reduction of poverty has not been sufficient to reduce the absolute number of poor which increased from about 164 million in 1951 to 312 million in 1993-94.

Reduction of income inequalities

The reduction of income inequalities has only made slight advances. The biggest advances were made mostly before the reforms. On the other hand, one of the biggest increases in inequality happened in the late 1970s, and the developments for the late 1980s / early 1990s in Figure 1 look promising. Compared to other low-income economies, the inequality is relatively low.

Figure 1: Gini coefficient of per-capita consumer expenditure



Education

From 1960 to 1977 the reduction of illiteracy was only 11%. From 1978 to 1995, it was 25%, thus much higher. Of course, there are also long-term developments involved here, so that the higher reduction in the second period might be partially due to actions taken in the first period.

Health

Life expectancy, used as an indicator of health, has increased constantly since independence. During the period from 1960 to 1980, it increased from 43 years to 52 years, which is an increase of 21% in 20 years. From 1980 to 1995 it grew to 62 years, which is a 19% increase in only 15 years. This means that the growth of this indicator has increased by a rate of 24% compared to the previous period.

Even clearer is the improvement in the reduction of infant mortality. This was reduced by 25% in the period 1960 to 1995 and a further reduction of 45% took place from 1980 to 1995. This is partially due to better education of mothers, as well as to an improved economic situation of parents.

Summary

Independence - 1980

The system of state planning constrained growth of the private sector by allowing it to expand only with government permission. But despite the massive interventions, economic progress was made during the period following independence. The per capita GDP grew at a respectable rate of 1.4% per annum from the late 1940s into the 1970s. Both famine and poverty were significantly reduced during this period. Nevertheless, most economists argued that the interventions lowered India’s economic growth rates to a level which was not adequate for a country that saved and invested over one-fifth of its GDP. With few major producers of many key industrial products, the concentration of domestic production was very high, inviting monopolistic pricing. Moreover, as the world economy grew and as beneficial opportunities for growth through trade expanded, India paid an increasing price for its economic isolation.

The Indian system of state planning has been described as combining "the worst of socialism and capitalism, by suppressing growth while failing even to deliver the social welfare that communist systems provided".

1980 – mid-1990s

The liberalisation that started in the 1980s and gained further momentum in mid-1991 proved the critics of the old system right.

Per capita GNP reached historically high growth rates; industrial output-growth averaged 8.4% in 1994-95; exports were up by 27%; inflation dropped below 10%; the current account deficit is below 1% of GDP; foreign-exchange reserves are high at $20 billion; and food stocks have hit an all-time high of 37m tonnes.

The long neglected private sector today generates two-thirds of India's GDP. The World Bank describes the change of the state's role from that of principal investor to that of facilitator of entrepreneurship. Thus, over the course of a few years, the old national consensus on socialism has given way to a new consensus on liberalisation.

India – a perspective

It should not be forgotten, that despite all mentioned advances, India is still a low-income, developing country. It has an economy slightly smaller than Belgium's with a GNP per capita of $390. Only about half of its 960 million people can read. Only 14% of the population has access to clean sanitation - a lower proportion than anywhere else except for parts of Sudan and Burkina Faso. According to the World Bank, 63% of India's under-five-year olds are malnourished. The infant mortality rates of two Indian states is above the sub-Saharan average. About 40% of the world's desperately poor live in India.

India's progress in fighting poverty is modest when compared with some of its Asian neighbours. Between 1970 and 1993, the proportion of Indonesia's population living in poverty dropped from 58% to 8% – a greater decline in a shorter period of time. According to the World Bank,

> "*it is through rapid growth that India will be able to reduce poverty and generate the resources to invest in the health and education of its people who will in turn sustain this growth, [as] overall growth accounted for the lion's share of poverty reduction: 80% of the decline in the number of households below the poverty line between 1951 and 1970, and almost 100% since 1970*".

But India, like many developing countries that adopted a philosophy of government intervention with import substitution policies, is finding that economic reform can often be a slow, incremental process. Complications continue. Domestic producers will resist tariff reductions that subject them to increased competition. Government bureaucrats will try to maintain the power and influence they acquired during periods of substantial government involvement in economic decision making. The reforms so far are a positive step but must be extended and accelerated if India is to catch up with the East Asian tigers.

It is not possible to condemn the inward-looking policies as totally wrong. Some advances were made and no one can say what would have happened if India had followed another strategy. In our opinion, the idea that industrialisation was important for India in the 1950s was right, as the share of commodities in world trade is constantly decreasing. However, the view that exports are not important and that India could go its own way was wrong. By protectionism and interventions, India fostered the establishment of industries. India didn't create an efficient private sector but a huge, inefficient public sector, and protectionism lowered the competitiveness of India's economy. Furthermore, the neglect of exports led to the fact that India's share of world trade decreased from 2% in 1950 to 0.5% in 1990.

In our opinion, India should have followed an EP-strategy as the Asian tigers did and shouldn't have created the system of state planning and such a large public sector; both of which led to huge inefficiencies. The success of the recent opening up of the economy illustrates the potential India has. Therefore, India should proceed in this direction to encourage further economic growth.

Still, economic growth alone is not enough. Amartya Sen emphasises that growth must be "high and participatory". But even today, India’s "have-nots are treated virtually as are-nots" due to the caste-system and are neglected. Sen toured India in January 1999 to communicate his message that Indians are woefully underfed, undereducated and sickly, even by the standards of poor countries. The impact remains to be seen. India’s biggest current problems will be covered in the following section.’

India’s current problems regarding industrialisation

After evaluating important indicators for industrialisation and giving a summary of industrialisation since independence, we will now take a more detailed look at some specific areas for future industrial development in India.

Infrastructure

Perhaps the biggest problem for doing business in India is the woeful state of its infrastructure. Consider this: it takes four days for a truck to travel the 900 miles between India’s national capital New Delhi and its commercial capital Bombay. It takes months to get connected to the power supply in any Indian city, and several years to get a telephone connection in large cities.

Poor infrastructure is acting as a drag on the Indian economy, and the Indian government is now attracting private domestic and foreign investment to build the backbone of a modern economy. A recent report estimated that investment in infrastructure would rise from 5.5% of GDP in 1997, to about 7% in 2000/01. This includes massive improvements in telecommunications, power, energy, and transport.

India has recognised the vital role telecommunications play in the growth of the economy. The Indian telecom sector was wholly under government ownership and control until recently and was characterised by under-investment and outdated equipment. There is vast potential for extending these services in India, which has one of the world’s smallest telephone densities of 1.3 per 100 people, compared with the world average of 10 per 100. Advanced communication services such as fax, data transmission, and leased circuits are becoming increasingly common. Foreign collaboration is also being encouraged in cellular phones and paging systems. In the telecommunications sector, estimates for regional investment needs range from $40 billion a year, to as high as $70 billion a year by the end of the century.

The power problems are severe in India with three-hour-a-day power cuts and damaging voltage fluctuations that require companies to generate their own power. Investment in energy is a sound way of increasing manufacturing activity. If all 49 proposed private sector power projects are implemented, these would add a total of 20,000 megawatts to India’s current capacity of 66,000mW. However it should be noted that India’s energy demand is growing at 8-10% a year.

As part of India’s liberalisation efforts, the transportation sector has been opened to private investment. The government is offering incentives to invest $4.7 billion to construct and operate bypass roads, highways, bridges, railways, and ports.

Health and Education

HIV/AIDS is a newly emerging threat to India’s public health. About 3 million people in India may be affected. Malnutrition also continues to impede India’s development. Prejudices against women and girls are reflected in the demographic ratio of 929 females for every 1,000 males.

To support India’s goal of achieving universal primary education, the World Bank is supplementing increased state government expenditure. This has boosted school enrolment, particularly among girls and disadvantaged children, and is improving the quality of instruction and learning achievement.

Amartya Sen reckons that India could enrol all its children in primary school by spending an additional 0.5-1% of GDP. Providing basic health and education is not expensive where labour is cheap. But health and education indicators, while showing some progress, still remain among the world’s lowest.

Public sector

Another big problem is India’s notoriously bloated and inefficient public sector. The World Bank has turned down applications for power loans worth $750 million for projects in some states because of mismanagement in their government. Many electricity boards have become insolvent as a result of providing electricity at extremely subsidised rates and ignoring large-scale thefts of electricity. State governments have been unable or unwilling to take the politically unpalatable decisions needed to make their electricity boards viable.

The most telling evidence of the cost of delaying reform is the sheer effort companies have to expend to cope with the country’s labyrinthine bureaucracy. For example, foreign investors continue to seek permission from the Foreign Investment Promotion Board, even though their plans are covered by the automatic approvals system.

Corruption

An immediate threat to India’s governance is not the tottering coalition governments or the BJP, but corruption. The combination of a state-run economy and weak political institutions created all too many opportunities for crooked politicians and bureaucrats.

Worse still for the business community is that the government itself is the fountain-head of corruption. This is particularly serious in view of the huge importance of the government sector in India’s economy.

Corruption has become ubiquitous at all levels and is accepted by everyone. Many Indian businessmen feel that liberalisation of the economy will have no impact on reducing the corruption that has become so well entrenched. The influx of foreign companies is already unleashing a new wave of even greater corruption. A survey of 183 US firms conducted by the US embassy in 1995 revealed that US investors rated corruption in India as the third worst problem they faced after red tape and a lack of electric power.

The blame for the deluge of corruption in India lies in the lack of transparency in the rules of governance, extremely cumbersome official procedures, excessive and unregulated discretionary power in the hands of politicians and bureaucrats, who are prone to abuse it, and a lax judiciary.

Tax Problems

Tax reforms have been seeking to transform India’s tax system from one with high differential tax rates falling on a narrow base, into one with tax rates at moderate levels falling on a broad base. The 1995 fiscal budget reduced taxes on corporate income, and a major reform of excise taxes has been implemented to make it resemble a value-added tax more closely.

But the government’s income is also constricted by an inefficient taxation system. Rural areas are not taxed because they contain such a large pool of voters and no government has had the political will to change this. Income tax is skilfully dodged.

This leaves the government with excise and customs duties, which represent two thirds of all taxes.

Labour market

India needs greater labour market flexibility to make its companies more competitive and its economy more productive. Politically powerful labour unions have stifled most efforts at serious reform or privatisation of India's largest public sector enterprises, including most banks, all insurance companies, and many major industries, even though privatisation would probably cost the jobs of no more than 1.1% of the urban labour market. India's labour laws hinder efficiency and growth.

Financial sector

India's financial sector still cannot effectively mobilise and mediate capital to respond to economic changes. The resulting high cost of capital makes Indian industry and exports less competitive. In spite of recent improvements, India's equity markets are still too thin and volatile to inspire great confidence on the part of domestic or foreign investors. Bond markets are practically non-existent. Liberalisation of the insurance industry, which would greatly improve the investing of India's substantial savings, now 26% of GDP, has been stymied. India's banking system remains flawed, with the dominant state-owned banks still carrying bad loans amounting to 15 to 25% of their total.

Outlook

The arrival of a BJP-led government in March looked like a setback for freer trade. It took two steps away from trade liberalisation. Firstly, India's anti-dumping procedures were tightened. Secondly, the Finance Minister imposed an extra tariff of 4% in June. However, it is too early to conclude that India is returning to protectionism. The government insists that tariffs were increased to raise revenue, not to protect Indian business.

BJP strategy regarding foreign investment

BJP party leaders seem keen to limit foreign investment in all areas other than infrastructure. They are worried that Indian culture will be eroded by western consumerism such as food habits brought in by Kentucky Fried Chicken or McDonald's. Such sentiments cause alarm.

"Foreign investors are not exactly queuing up to enter India, and this attitude will scare away those who are weighing up the possibilities of doing business here," cautions a top executive with a foreign investment bank in Bombay. In its defence, the BJP says that while it seeks to protect domestic industry and reserve "India for Indians", it does not intend to take back the reforms. But approved and actual foreign direct investment already shrank between January and July 1998. Approvals totalled only $4.7 billion, compared with $7.1 billion in the same period in 1997 and actual inflows slid to $1.6 billion from $1.9 billion.

Furthermore the BJP's decision to conduct five nuclear tests in May 1998 underscored India's reputation for unpredictability and highlighted the vulnerability of infrastructure investment to international and domestic political pressures. The sanctions imposed by the US on India include bans on private banking assistance to the Indian government and pressure on multinational lenders such as the International Monetary Fund to withhold loans. The sanctions hit the Indian economy and Indian companies generally, and were potentially very onerous for foreign developers.

On the other hand, the government recently encouraged foreign direct investment. In July 1998 it put forward a plan allowing foreign companies to take stakes of up to 26%

in Indian insurance companies, having resisted opening the insurance market to foreigners in the past. "Automatic" approval of foreign investment of up to 100% was extended to more sectors of industry.

Recent development of the macroeconomic situation

The macroeconomic situation is also causing concern. After a year of patting itself on the back for escaping the Asian crisis, the Indian government is now sitting up at some spine-chilling signs that the economy hasn’t been unscathed after all.

India’s gross fiscal deficit will rise to 6.6% of GDP from a planned 5.7% in 1998, forcing the government to keep borrowing and pushing up interest rates. But the government’s infighting and inability to push through much-touted economic reform bills raises doubts as to whether it can tackle these problems.

The ballooning trade deficit comes on top of sluggish industrial production, high inflation (a 9% annual rate in the first half of November), and an expanding budget deficit. Currency devaluations in the rest of Asia have made Indian exports even less competitive than they were previously.

The current deficit of $2 billion has been pushed to the highest level since 1991. The rising deficit is financed by foreign-exchange reserves, and is expected to put upward pressure on the rupee .

On the other hand, GDP growth is forecast to move upwards to 6.4% in 1999. This follows a slowdown to 5.1% in 1998 due to a 1.5% decline in agricultural production, slowing exports, and industrial growth. Factor-cost GDP is forecast to expand by an annual average of 6.7% until 2002-2003.

Overall, it remains to be seen how entrenched the reforms are in India in the face of more difficult and troubled economic conditions.

Bibliography

Amar, A. D. (1996) "The business opportunity of the next century: India" in *The Mid–Atlantic Journal of Business*, (December 1996).

Anonymous (1996) "India: Poised for growth", World Trade, October 1996.

Basu, K. & P. Patnaik (1995) in D. Mookherjee *Indian Industry – Policies and Performance*. Oxford University Press: Oxford.

Bouton, M. M. (1998) "India’s problem is not politics" in *Foreign Affairs*, (May/June 1998).

Bristow, D.(1998) "A stake in the road to modernisation" in *Accountancy Int.*, (December 1998).

Daneels, J. (1998) "Slow steps forward" in *Asian Business*, (May 1998).

Gaiha, R. & V. Kulkarni (1998) "Is growth central to poverty alleviation in India?" in *Journal of International Affairs*, (Fall 1998).

Heeks, R. (1996) *India’s software industry*. Sage Publications: New Delhi.

Hess, P. & C. Ross (1997) *Economic Development*. Orlando.

Javalgi, R. G. & V. S.Talluri (1996) "The emerging role of India in international business" in *Business Horizons*, (Sept/Oct 1996).

Joshi,V. & L.M.D. Little (1996) *India's Economic Reforms 1991-2001.* Clarendon: Oxford.

Kumar, S. (1996) "Corruption slows growth" in *Asian Business*, (December 1996).

Lane, P. (1998) "World trade survey: India's hesitation" in *The Economist*, (October 1998).

Nayyar, D. (1997) *Trade & Industrialisation*. Oxford University Press: New Delhi.

Sen, A & J. Drèze (1997) *Indian Development: Selected Regional Perspectives.* Oxford University Press: Oxford.

Sen, A. & J. Drèze (1995) *India: Economic Development and Social Opportunity.* Oxford University Press: Oxford.

Shiraz, S. (1998a) "Jettisoned hopes" in *Far Eastern Economic Review*, (24/9/98).

Shiraz, S. (1998b) "No clear winner" in *Far Eastern Economic Review*, (26/02/98).

Sidhva, S. "No escape" in *Far Eastern Economic Review*, (14/1/99).

The Economist (21/1/1995) "A survey to India" in *The Economist Supplement.*

The Economist (12/8/95) "India's Economic Nationalists"**.**

The Economist (9/1/99) "Asia: Uses and misuses of Amartya Sen".

Todaro, M. P. (1997) *Economic Development*. Longman: London.

World Bank (1982, 1987, 1997b) World Bank Development Report. OUP: New York 1982.

World Bank (1997a) *Country Study: India - Achievements and Challenges in Reducing Poverty*. World Bank: Washington D.C.

World Bank "Country brief India 1998". http://www.worldbank.org.

World Bank "India at a glance 1997". http://www.worldbank.org.

World Bank Book (1994) *Trends in Developing Economies.* World Bank: Washington D.C.