International Economic Integration and Industrial Development: How Has Openness Worked in the Case of India?

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With the economic policies introduced in 1991 India was turned into a much more open and less regulated economy than before.[1] Centrally placed Indian decision-makers and advisers in the IMF and the World Bank expected that the associated increased openness and international economic integration would promote industrial and aggregate economic growth. Others were less optimistic about the outcome. This paper will briefly review the theoretical positions and present some empirical evidence concerning the period from 1991 to 2000. A third section will look at the challenges India is facing in view of the experiences with more openness in the 1990s.

Can openness substitute for a development strategy?

Views among economists differ considerably as to whether increasing international economic integration and openness to trade will promote economic growth in developing countries. There is general agreement that foreign investment, access to foreign savings, international trade, transfer of technology and know-how, etc., may

[1] I have described and analysed these new economic policies in Degnbol-Martinussen, 1999, and in a forthcoming book (Degnbol-Martinussen, 2001, Part III).

help poor countries to circumvent some of the traditional barriers to rapid growth. The disagreement concerns whether openness and international economic integration will *automatically* promote and sustain industrial growth.

Neo-classical economists tend to argue that openness and economic integration by themselves will promote growth. The underlying hypothesis is that the countries that have grown most rapidly over long periods are the countries with low tariffs, few non-tariff barriers, and no restrictions on capital flows. At a World Bank conference in Paris in 2000, the former head of the WTO, Peter Sutherland, summed up the position by saying that the more open countries are, the more growth they will achieve. He added: "Generally, the options have long ceased to be between striving for self-sufficiency behind protective walls and opening up to the world. The only issues now facing governments of poor nations seeking domestic reform and global economic integration are how far and how soon."[2]

At the same conference, however, other economists strongly criticised this position. One was Joseph Stiglitz, former Chief Economist of the World Bank. Stiglitz argued that trade liberalisation works very differently under different conditions. Liberalisation would normally work well for countries with full employment - but not in countries with large-scale unemployment such as South Africa or India.[3]

Dani Rodrik at the conference (Rodrik, 2000) - as in a recent book (Rodrik, 1999) - presented a more detailed analysis. We may extract some of his main points as representative of what I find is a more convincing position than the one propagated by many neo-classical economists.

According to Rodrik, the benefits noted earlier which might emerge from openness and economic integration are only *potential* benefits. Openness in itself is not a substitute for a national development strategy - it is not an independent source of growth. The countries that have done well are those that have been able to formulate a domestic investment strategy to kick-start growth - and those that have had the appropriate institutions to handle external shocks - not those that have relied only on reduced barriers to trade and capital flows. Another important point made by Rodrik is that increasing exports is not an independent source of growth. Although countries that grow fast tend to experience rising export/GDP ratios, the reverse is not true in general (Rodrik, 1999, p 32ff.). The chain of causality is different and starts with increasing investment and productivity which leads to higher growth that,

[2] Sutherland in his keynote address at the Annual Bank Conference on Development Economics - Europe, Paris 26-28 June, 2000. L. Alan Winters in a paper for the conference argued that there is a good deal of empirical evidence to support the argument that openness stimulates long-run growth and that there is no evidence that it is harmful to growth (Winters, 2000, p 11).

[3] It is interesting to note in passing how Stiglitz with this focus on employment reopened the debate that goes all the way back to Keynes' distinction between two types of economies: Those with full employment barring structural unemployment of a few per cent; and those with large-scale unemployment.

in turn, brings about higher export/GDP ratios.[4]

Along similar lines, Linda Weiss has argued that developing countries need to manage openness and integration into the regional and global economies if they are to realise the potential benefits. This requires comprehensive national development strategies with macro-economic stabilisation policies and continuous adaptation of industrial and trade policies to changing conditions. Weiss has also emphasised that this has proved possible for 'strong' developmental states in the past and that their approaches may be replicated by others, provided they give high priority to building relevant institutional capacities in close co-operation with the domestic private sector (cf. Weiss, 1998; and her contribution to this volume).

We shall not go further into the general debate about the effects of openness and how to manage it. Instead, we shall look at the empirical evidence in the Indian case.

How has openness worked in the case of India?

The indicators chosen for assessing how openness has worked in India's case are: (a) industrial growth and especially growth of manufacturing; (b) export performance (manufacturing exports now account for around 80% of total exports); (c) industrial investment; and (d) foreign investment with special emphasis on foreign direct investment (FDI).

The main reason for focusing on indicates that primarily relate to industry is that growth of agriculture in India is to a large extent dependent on the Monsoon and other climatic conditions and therefore not of great interest here. As agriculture accounts for a significant part of GDP, by implication also aggregate growth rates are not good indicators of the effects of policy changes and increased openness. This all lead us to focus on indicators of industrial development (industry here comprising manufacturing, construction, electricity, gas and water supply). In the third section I will add some comments on the impact upon services and the prospects for benefiting from openness and international economic integration in this sector.

Industrial growth

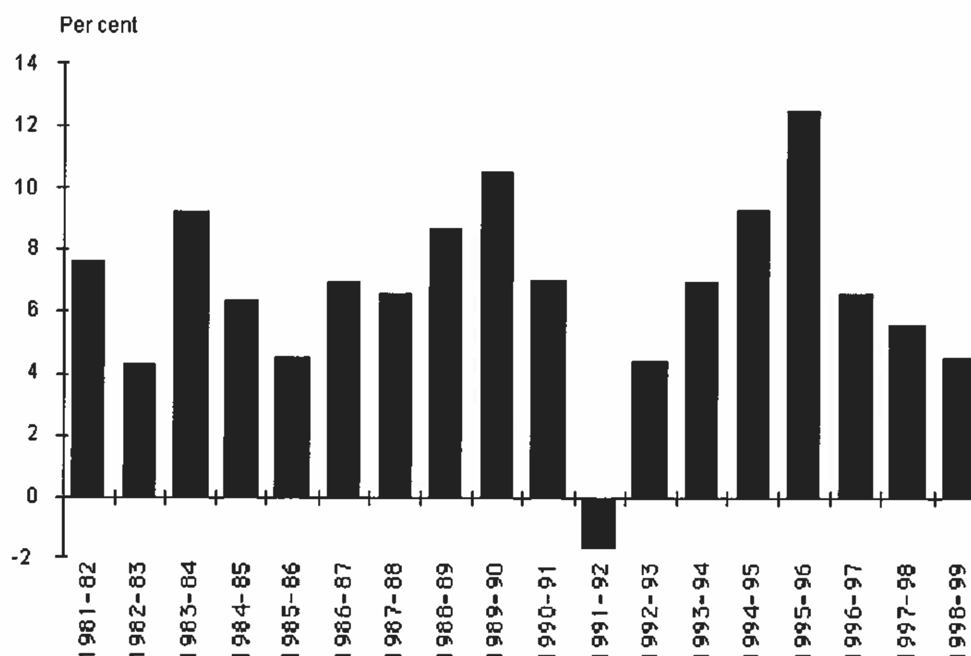
Figure 1 presents annual growth rates for industry since the early 1980s. Indian economists disagree on the interpretation of the growth figures. According to Nagesh Kumar, the average annual rates of growth for the post-reform period has exceeded those of the pre-reform period for the economy as a whole as well as for industry

[4] To substantiate this argument Rodrik has pointed to the fact that 11 out of 25 developing countries with the highest export/GDP ratios had per capita growth of less than one per cent, some even negative growth, during the period 1975-1994 (Rodrik, 1999, Table 2.2, p 35).

(Kumar, 2000, p 13ff.). He has also argued that the trend growth rate for industry, after excluding 1991-92, the year of adjustment, was higher for the period 1992-98 than for the 1980s. S. P. Gupta, on the other hand, reached the conclusion that the level of industrial production in the 1990s remained below the extrapolated trend from the pre-reform period 1980-1990 (Gupta, 1998, p 14). By adding the estimated growth rate for 1999-2000 R. N. Agaraj came to a similar conclusion: the trend growth rate for industry was lower in the 1990s than in the 1980s (Agaraj, 2000, p 2833).

What is important in the present context is that the evidence does not suggest that increased openness in itself brought about industrial growth at a significantly higher level than before the policy reforms in 1991. The opening up of the Indian economy and the other new economic policies probably helped to increase growth rates in the first part of the 1990s but they did not bring about sustained growth at a higher level.

Figure 1: Annual growth rates for industry, 1981-99[5] (at constant prices)



Source: Economic Survey 1999-2000, p S-10.

[5] For the period up to 1993-94 growth rates are based on 1980-81 prices; for the period after on 1993-94 prices.

What if we look at manufacturing separately? Manufacturing registered a growth rate of around 8% per annum during the 1980s. This level of growth has been achieved during only a few years in the 1990s and not after 1997. Growth of manufacturing as well as overall industrial growth have fluctuated significantly over the last decade with a marked tendency to slow down after 1997, indicating that other factors than the new policies have had a strong impact upon industrial development (cf. Economic Division, 1999, p 96).

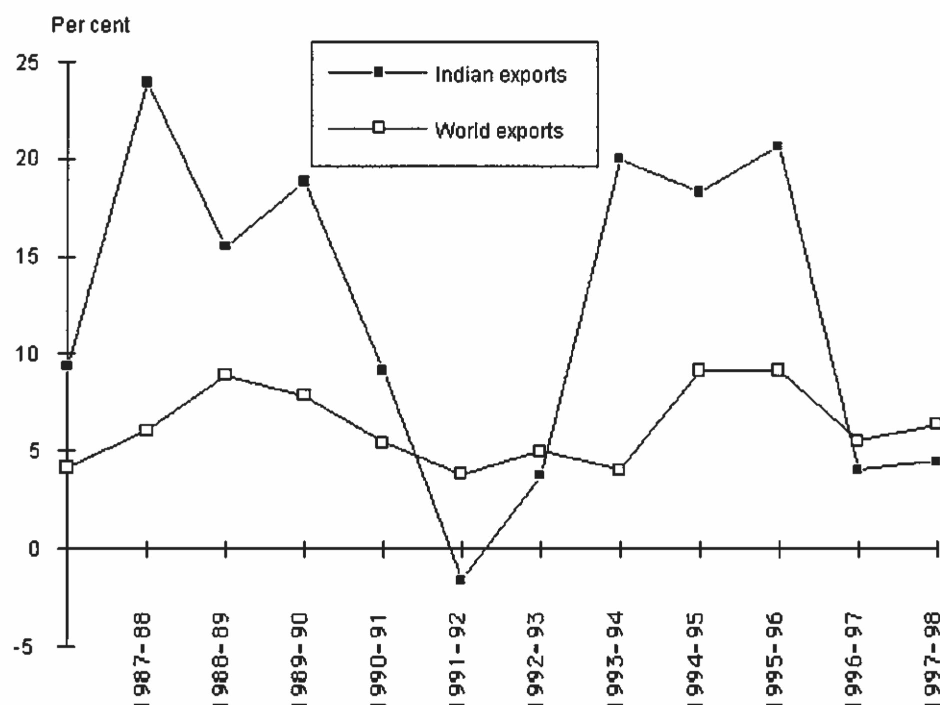
Export performance

In the literature, the role of exports are often overstated. From a national point of view, increasing exports should be seen not as an end in itself, but as a means to finance more imports (Rodrik, 1999, p 32). From a company point of view, sales abroad may be attractive but that need not be the case, especially not in a country with a domestic market as large as India's.

Under prevailing contemporary circumstances, however, it is important for India to increase exports - for at least three major reasons: (a) domestic demand is insufficient to sustain high industrial growth; (b) increasingly, due to liberalisation of imports domestic demand is being met by supply from abroad thus reducing the scope for growth of Indian companies; and (c) import restrictions and other protective measures cannot be used as extensively as in the past - if for no other reason because of India's membership of the WTO. In other words, it is vital for India to increase exports. What has happened since 1991?

As may be inferred from figure 2, there has been considerable growth in Indian exports. Besides, the share of manufacturing exports in total exports has increased, but more so in the 1980s than in the 1990s, and especially before the first round of liberalisation in 1985. The share in 1999-2000 was around 80%, up from around 50% in 1982, but only a modest increase from around 70% in 1991 (Ganesh-Kumar et al., 1999, p 181; Economic Division, 2000, p S-90). Besides, a substantial part of the growth of manufacturing exports, particularly in the 1980s, could be attributed to gems and jewellery with high import content and low value added. For most of the period under review gems and jewellery constituted the largest single item in exports, but the inputs to this part of Indian manufacturing - pearls and precious stones - also constituted the largest item in imports.

Figure 2: Annual growth of exports, India and the world, 1986-98



Source: Gupta, 1998, p 98.

Generally speaking, India's export performance has not been impressive. India's market share in the world has remained at the same level, fluctuating between 0.4% and 0.6% since 1970. It was much higher in the 1950s. Moreover, the growth of Indian exports after 1991 can be attributed to other factors than the new economic policies or increased productivity and international competitiveness. An important factor has been depreciation of the rupee. The real effective exchange rate of the rupee vis-à-vis the currencies of the main trading partners went down from index 100 in 1985 to around 60 in the mid-1990s (Ganesh-Kumar et al., 1999, p 182). Depreciation in real terms made Indian goods cheaper and hence more price competitive. But this was not a reflection of sustainable improvements in the productivity-based competitiveness of Indian enterprises. Further, aggregate growth of world demand as reflected in growth of international trade world-wide has played a role. This has worked both ways: When international trade has grown only modestly, Indian export growth has also gone down - in recent years very significantly. When depreciation of the rupee was brought to a halt and growth in world trade slackened in 1996-97, Indian export growth went down from around

20% to less than 5% as shown in the figure. In Dollar value terms Indian exports recorded a negative growth of almost 4% in 1998-99 (Economic Division, 2000, p 87).

Openness is not to blame for all this. On the other hand, the expectation that increased openness would help India improving its export performance has turned out to be unrealistic.

Openness and increased competition have for some commodities resulted in productivity growth in Indian industry. But based on COMTRADE International Trade Data, India has shown increasing competitive strength in the post-reform period for only 46 commodities out of 404 registered, while loosing competitive strength in 43 commodities, and clearly not competitive at all in a vast majority of commodities (Ganesh-Kumar et al., 1999, p 186).6 India's overall competitiveness has been adversely affected by the failure to diversify the commodity composition of her exports. The commodity concentration has increased with a nine percentage points rise in the share of the top six commodity groups of exports in total exports between 1987-88 and 1998-99 (Kumar, 2000, p 33f.).

To economists who are sceptical about the virtues of openness as a solution in itself this is not at all surprising. They believe that increased investment is the key to accelerate productivity growth - and that diversification of investment is the key to diversify exports towards more technology-intensive products. The main problems, therefore, are that industrial investment has not increased significantly and that investment has not gone into technology-intensive production. We shall confine our observations in this context to looking at the magnitude of industrial investment in the post-reform era and the associated creation of new jobs.

Industrial investment and employment

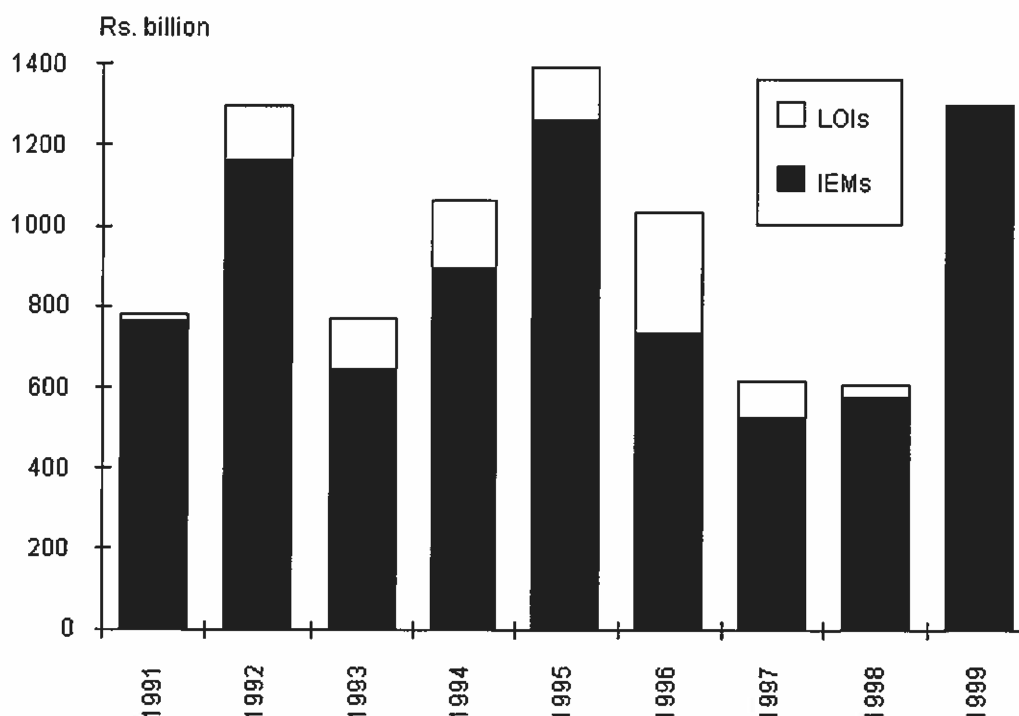
Gross domestic saving in India has been at a higher level in the 1990s than during the pre-reform period - between 22% and 25,5% of GDP since 1991 with a peak in 1995-96. Foreign investment has been offered much better conditions after 1991. Based on this, one would expect industrial investment to come forward in greater quantity. This has not been the case as I have showed elsewhere (Degnbol-Martinussen, 2001, chapter 9). In the publication referred to I have tried to explain why India's new economic policies failed to significantly promote industrial investment and employment creation. The point I want to make in the present context is more simple: Openness in itself has not brought about increasing industrial investment. This substantiates Dani Rodrik's more general argument referred to above.

Industrial investment in India is registered separately for the delicensed and licensed sectors. Investment intentions in the former sector are registered in the form of Industrial Entrepreneurs' Memoranda (IEMs), and those in the (smaller and

[6] The data are freely accessible at www.intracen.org. A review of the most recent data confirm the observations referred to above.

smaller) licensed sector as Letters of Intent (LOIs). The figures below provide overviews of year-wise intentions filed through the two mechanisms, giving information also about the size of the proposed investment and proposed employment.

Figure 3: Proposed industrial investment, 1991-1999 (Rs. billion)

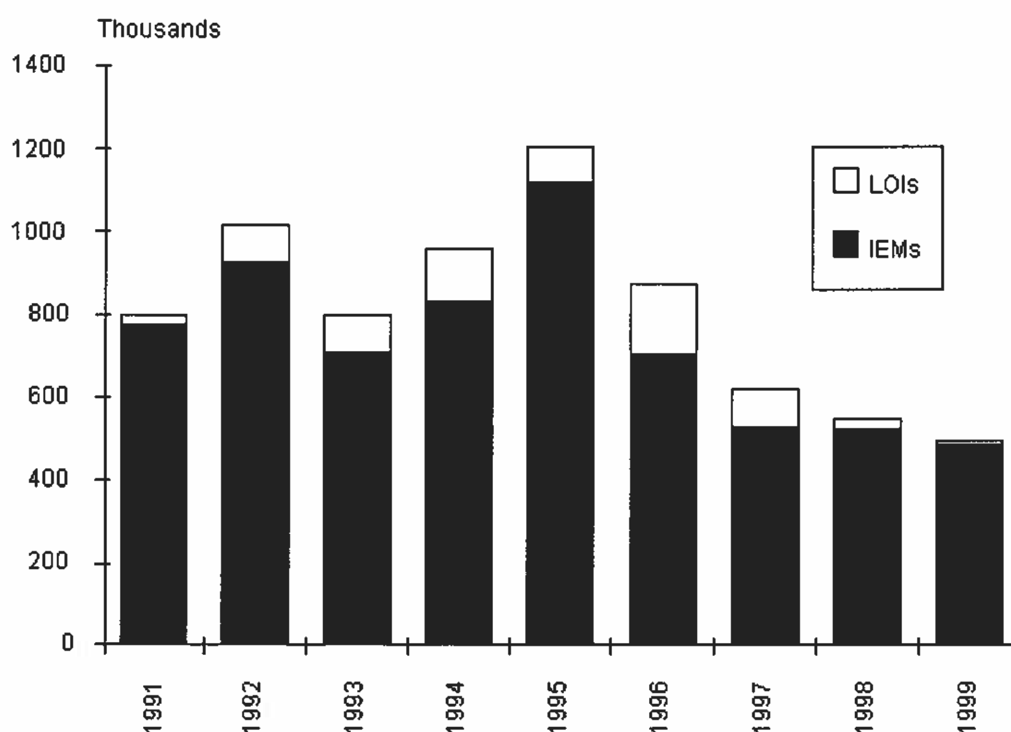


Sources: Economic Division, 1998, p 101; and Secretariat for Industrial Assistance, *SIA Statistics*, October 2000.

Figure 3 indicates a slow-down in total (Indian and foreign) investment intentions after 1995, i.e. a slow-down prior to the onset of the financial crises in the Far East. Proposed investments increased, however, in 1999. Reasons suggested in official documents for the slow-down after the mid-1990s include high costs of borrowing and decline in demand both in India and abroad coupled with build-up of inventories. Based on views expressed by Indian and foreign entrepreneurs I would add disappointment with government agencies for impeding implementation, even in the delicensed sector. It may be noted in this connection that implementation of the IEMs has been slow. By November 1998, commencement of commercial production had been intimated for less than 19% of the investment proposed according to the Secretariat for Industrial Assistance. By the end of 1999, however, this percentage had risen to around 30 signalling some improvement in implementation.

Figure 4 shows the year-wise proposed employment associated with investment in new units or for new articles or for substantial expansions. The pattern is similar to that for proposed investment with a peak in 1995 and a slowing down the following years. Unlike total investment proposed the associated employment remained at a low level. Implementation in terms of employment creation has been even slower than in terms of investment: By the end of 1999, only around 10% of the employment proposed during the period after 1991 had actually been reported to the Secretariat for Industrial Assistance.

Figure 4: Proposed employment, 1991-99 (thousands)



Sources: Economic Division, 1998, p 101; and Secretariat for Industrial Assistance, *SIA Statistics*, November 2000.

The restrictive labour laws and exit legislation in general may have contributed to this low rate of implementation in terms of employment. It seems that several companies have opted for alternative labour recruitment policies, using more labour on casual or daily basis rather than on a regular basis. In this way they have avoided restrictions on retrenchment of workers - and other labour protection legislation.

Foreign investment

Concerning the last indicator chosen, the inflow of foreign investment and particularly the inflow of FDI, the new policies of opening up the Indian economy did bring about very significant increases. One of the main objectives of the new economic policies was to attract more foreign capital and particularly more FDI. Much more foreign capital actually poured into India after the reforms than before and net private capital inflows remained at a significantly higher level. FDI amounted to only around US$ 100 million a year in the late 1980s. The comparable figure for approved FDI in 1997 was more than US$ 15 billion, indeed a very significant increase.

However, the *actual annual inflows* have on average not reached anywhere near the level aimed for by both the Left Front and the BJP-led governments (US$ 10 billion a year). Table 1 presents data on approved FDI as compared with the actual inflow.

The table reveals several interesting patterns. First, the amount of FDI approved increased substantially from 1991 to 1997, then fell to the level of the mid-1990s again. In a longer-term perspective, this represented a very considerable increase in foreign investors' interest in India, clearly brought about by the new open-economy policies introduced after 1991.

Second, actual inflow of FDI showed a similar trend as approved investment for the period 1991-97 and then declined somewhat in 1998 and 1999, but actual inflows have been much lower than the approved amounts. For the period as a whole, actual inflows came to around 35% of total approved investment - as compared with 70-80% in some of the fast-growing East Asian countries. The figure stated for India may even be an exaggeration. The Reserve Bank of India has recently published data that shows a markedly lower actual inflow of FDI than reported by the Secretariat of Industrial Assistance.[7]

[7] This is discussed in an article in Business India, December 11-24, 2000, p 48ff.

Table 1: Foreign direct investment - approved, actual inflow and NRI investment, 1991-99

	Amount of FDI approved (Rs. billion)	Actual inflow of FDI (Rs. billion)	Actual inflow as percent of approved	NRI investment as percent of actual inflow
1991	5.3	3.5	66.0	45.7
1992	38.9	6.8	17.5	22.0
1993	88.6	17.9	20.2	31.3
1994	141.9	32.9	23.2	34.0
1995	320.7	68.2	21.3	28.9
1996	361.5	103.9	28.8	19.8
1997	548.9	164.2	29.9	6.3
1998	308.1	133.2	43.2	2.7
1999	283.6	168.7	59.5	3.6
Total	2,423.9	853.6	35.2	10.4

Source: Secretariat for Industrial Assistance, *SIA Newsletter*, January 1999, various statements; and data provided by the Secretariat in December 2000.

Official statements emphasise that the gap has been reduced in recent years suggesting that "the bottlenecks on the path of implementation of the approved schemes are being removed." (Economic Division, 1998, p 87). There is another more convincing explanation, however: Much of the actual inflow in recent years has been on account of transfer of shares from residents to non-residents under section 29 of the FERA (Foreign Exchange Regulation Act), i.e. mainly parent companies buying more shares in their own subsidiaries.[8] In 1996, this form of FDI accounted for only 3% of total actual FDI, but this share went up to 5.8% in 1997 and 30.5% in 1998. If the purchasing of shares in own subsidiaries is subtracted, the actual FDI in 1998 comes down from 43.2% to 30% of total approved investment.[9] This should then further be seen in relation to the significant decline in approved investment from 1997 to 1998 indicating a lower rate of implementation during the latter year.[10]

Third, the figures for NRI investment show some fluctuation at the beginning of the period studied but a definitely declining trend towards the end of the period. This may be an indication that this external source of FDI was drying up. However, it probably also reflects recent policy changes favouring portfolio investments from NRIs and the offering of Government of India bonds denominated in foreign

[8] Liberalisation led to many affiliates of TNCs, which had enjoyed some autonomy, to be converted or reconverted into subsidiaries of the parent companies who typically increased their equity shares from 40% to 51% when permitted to do so under the new rules.

[9] Based on figures in the same source as used for the table.

[10] Comparing the actual inflow of FDI in 1998 with approved investment in the previous year - even without taking into consideration the buying of shares under the FERA - would show an implementation rate of only 24.3%, lower than the previous two years.

currency.[11] This offer apparently has been perceived as much more attractive than investing productively in India. A very substantial part of the total capital inflow has come in the form of portfolio investment both from NRIs and institutional investors abroad who have been offered attractive rates of interests and other incentives.[12]

The whole approach of the Indian Government may imply serious problems for industrial development. The policy framework in practice encourages portfolio investment over FDI, and the institutional constraints that affect implementation of new projects encourage investment in existing assets, meaning that a significant part of the capital actually flowing into India is used to take over or buying shares in existing undertakings rather than to promote industrial expansion and competition. The focus on attracting rentiers - NRIs especially - to hold portfolio investments in India has not contributed much to real capital formation, merely implied that ownership of existing income-bearing paper assets have changed hands.

Turning to India's performance in attracting foreign investment in a comparative perspective, official statements emphasise that the country's share of the total flow to developing countries has increased during the 1990s (e.g. Economic Division, 1998, p 87f.). This again is an indication that the new economic policies have had an impact as intended. But it is difficult to characterise the outcome as impressive when comparing with other major developing countries in Asia and Latin America.

It seems warranted to conclude that the new policies introducing more openness have helped India attract more foreign investment, but in a comparative perspective the increase of FDI flows has been modest. India's share of total FDI to developing countries rose after 1991 to a peak of 2% in 1995 but, by 1998, it had declined again to 1.4% (Economic Division, 2000, p 102).

Challenges facing India

Based on the evidence presented above, it seems warranted to argue that simply deregulating and opening up to freer trade and investment flows is not likely to be an adequate strategy for India. Liberalisation may have removed important constraints to industrial growth caused by poor macro-economic management, inefficient public sector enterprises, high entry costs, restrictions on FDI, etc. This can lead to the

[11] NRIs, after the imposition of sanctions following the nuclear blasts, were offered Government of India bonds denominated in foreign currency through the State Bank, the aim being to ensure inflow of capital to compensate for the effects of sanctions. The initiative resulted in an inflow of about US$ 4.2 billion - probably far more than could be productively lend.

[12] Amiya Kumar Bagchi, among several other Indian economists, has criticised the new economic policies for being biased in favour of foreign financiers and speculators; cf. Bagchi, 1998. Bagchi has also noted that the Indian stock markets were not prepared for the sudden liberalisation of the capital markets. When official regulation of capital issues by companies was abolished and further liberalisation relating to industrial and financial regulation were expected it started a boom in the stock market (Bagchi, 1998, p 22f.). The share prices of several companies were doubled or trebled within a few months. The boom, however, collapsed around May 1992. It turned out that it had to a large extent been financed by a small group of bull operators with funds made available by a few foreign banks. This was a clear illustration of how important regulatory mechanisms are. Progress has been made in this area but the whole financial system in India remains weak with few opportunities for hedging against fluctuations (cf. also Department of Company Affairs, 1997, p 11).

exploitation of existing comparative advantages such as cheap labour but both theory and evidence suggest that without coherent policies to build new capabilities and guide investment into more skill- and technology-intensive industrial activities it is unlikely that growth can be sustained under present global economic conditions. Moreover, simply opening up to market forces does not address the several structural problems of industrial development that India is facing. This section looks at some of the major challenges which India is facing in relation to industrial development.

WTO rules have introduced restrictions on industrial policies which promote particular sectors, give preference to or provide protection of domestic manufacturers, promote exports, etc. The Indian Government has committed itself to several policy adjustments in these areas. The TRIMs (Trade-Related Investment measures) maintained after the formation of the WTO were to be eliminated by the year 2000. Quantitative restrictions on imports were maintained on balance-of-payments grounds for more than 2,000 products (tariff lines at the eight digit level), but the WTO and major industrialised countries made the Government agree to phase out quantitative restrictions over a period of six years beginning in 1997. Even this commitment was not accepted by the USA who filed a case against India in the WTO. A bilateral agreement was reached by which India should phase out all quantitative restrictions by April 2001 (Economic Division, 2000, p 99).

A bill to amend the Patent Act in line with the agreement on TRIPs (Trade-Related Intellectual Property Rights) was tabled in Parliament in 1998 and passed by the Rajya Sabha (Upper House), but could not be passed by the Lok Sabha. Again under pressure from the WTO and the USA domestic legislation was made to conform with some of the WTO rules through a Presidential Ordinance in January 1999. Similarly, policies have been revised in several other areas all indicating the increasing extent of external influences on Indian policy-making (cf. Economic Division, 1999, p 85). However, the Patent Bill stills awaits the approval of the Lok Sabha.

Compliance with WTO rules need not in a longer-term perspective or across all sectors harm Indian industry. In pharmaceuticals, for instance, it appears that some of the leading Indian companies are rapidly moving from copying Western-developed drugs to taking out patents for their own drugs, thus exploiting the new possibilities of protecting their intellectual property. Moreover, with further steps towards full compliance with the TRIPs agreement several TNCs in pharmaceuticals are likely to expand in the country to take advantage of the cheap but high-quality scientific manpower available for their R&D. But in most other areas of manufacturing, and particularly so in steel, Indian companies in both the private and the public sector are ill prepared for the intensified competition which they are facing after the elimination of quantitative import restrictions and lowering of tariffs (EIU, 2000, p 18f.).[13]

[13] It is interesting to note how differently various observers assess the prospects for Indian industry in the coming years. The Economist Intelligence Unit, in particular, has taken an optimistic view of India's long-term prospects for industrial growth (cf. EIU, 2000, p 8 ff.). Much less optimistic is the assessment made by the Centre for Monitoring the Indian Economy in its overview of the Indian corporate sector (CMIE, 2000).

Unless India can obtain exemption from some of the WTO rules for longer periods than those presently agreed to,[14] the challenge is to work out different types of policies which less directly can boost competitiveness of Indian industry and promote structural changes. Such policies could focus on further reducing fiscal and procedural constraints to exports.[15] They could also focus on infrastructure development, human capital formation, innovation and diffusion of technology, and other important and more basic and long-term determinants of both attractiveness (to investors) and competitiveness. These types of policies are all unconstrained within the framework of the WTO (Bora, et al., 2000). These are also areas, however, which require financial resources beyond the present capacity of the Indian Government and which so far have attracted very little private investment.

A major challenge facing the Indian authorities is in the provision of adequate and reliable levels of economic infrastructure services, including power supply as a particularly critical area. The growing gap between the supply and demand for power is recognised by the Government as a major constraint and cause of loss of output, exports and employment. Other infrastructure constrains relate to road and road transport, ports and telecommunications. New policies have been elaborated to facilitate private entry into these areas of economic infrastructure services with a further view to free scarce public resources to social sectors and anti-poverty programmes. But further progress depends much on access to considerably larger financial resources. It also depends on State governments whose support for reform measures is required, particularly in relation to the State Electricity Boards and the State Public Works Departments.

Another major area of concern for the Government of India is in the provision of social infrastructure services in support of human development, including primary education and health care. These are areas which are particularly vulnerable to fiscal problems at the State level, because they consume the largest proportions of the revenue budget. In a long-term perspective, these basic social services are, however, of utmost importance not only as a means to alleviate poverty but also to promote aggregate growth, as has been demonstrated by the high-performing Far Eastern countries and earlier in the highly-industrialised countries.

Yet another challenge, among several others, is in employment creation and poverty alleviation. The Government has strongly emphasised the need to rely more on labour-intensive sectors and modes of producing, but as pointed out by many critics it is difficult to see how, in practice, the Government can promote such a

[14] When preparing for the 1999 WTO Ministerial Conference in Seattle India, together with 11 other developing countries, signed a document requesting the WTO to consider several revisions in the implementation of the various agreements, including those relating to TRIMs and TRIPs (WTO, 1999). For instance, it was requested that the provisions relating to local-content requirements be revised. Developing countries should be allowed to maintain local content rules to promote industrialisation and ensure balance-of-payments stability. The document has not yet been dealt with by the WTO but it remains an important reference point for India's policies vis-à-vis the Organisation.

[15] It was recognised in the Economic Survey for 1998-99 that exporters face high transaction costs emanating from implementation of various rules and regulations pertaining to obtaining licenses, customs clearances, refund of duties, etc. The Survey added that although progress had been made to simplify rules and regulations, further efforts were needed to smoothen export transactions (Economic Division, 1999, p 95).

pattern of growth. With respect to special poverty alleviation programmes, it is at least as difficult to imagine how such programmes could be financed in a short-term perspective at a larger scale than presently without increasing the public deficits. Therefore, this challenge again points to the need for considerably increasing public resource mobilisation at both Central and State level.

It is evident from the data presented in previous sections that India has not been able to attract a share of international investment anywhere near the proportions corresponding to the size of its industrial sector. Low wages alone are not very important in this context. What matters is labour productivity as compared with wage levels. That does not put India in a strong position as compared with several countries in the Far East and Latin America. Besides, most transnational corporations do not regard India as a cost-effective production centre for their global markets - they are interested primarily in the domestic and still highly protected market. As a corollary, India has not been able to attract much FDI in export-oriented industry.

Mechanisation and automation of production implies that the labour content has dropped both world wide and in India.[16] Some areas of manufacturing such as garments and gem polishing remain very labour intensive. Here India has comparative advantages. But these are not areas with significant long-term growth potential. In a longer-term perspective India can sustain industrial growth only if more capital- and technology intensive production and exports are encouraged. These are the areas with the highest growth potential. India relies almost exclusively on resource-based and low technology manufacturing and exports.

Seen in a wider perspective it may be necessary for the Indian authorities to recognise that the country is not particularly attractive to foreign investors in manufacturing and infrastructure, partly due to basic features of the Indian economy and infrastructure, partly due to the obstacles and distortions created by the institutional set-up for policy implementation as well as the wider institutional setting in the country. Some of these conditions may be altered through state action in conjunction with initiatives from the business community, but at least in the medium term India is not likely to become a great exporter of manufactured products. The restrictions imposed by the membership of the WTO at the same time reduce the scope for state interventions based on India's specific requirements and national priorities.

This has prompted some observes to emphasise the much brighter prospects in services where the labour content is high and where India has comparative advantages, particularly due to the availability of well-qualified and cheap labour in services with a high potential for growth such as software and information technology in general (cf. Aiyar, 1999). Besides, services in these areas are not hamstrung by poor infrastructure as is manufacturing. Also institutional and procedural obstacles appear to play much less of a role in IT-based services. Acquisition of land, environmental clearances, etc., are of minor relevance here.

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[16] In the case of Maruti Udyog, India's largest car company, the labour content in car manufacturing is as low as 2.5% (Aiyar, 1999, p 11).

In support of this argument it may be noted that software exports grew 43% per year during the Eighth Plan (1992-97) and even more after that. Information technology - referred to in India as Infotech - has become increasingly important in terms of both output and exports. Software and hardware sales in the late 1990s approached Rs. 200 billion of which more than half was exported (EIU, 2000, p 18). Sales are expected to increase to Rs. 600 billion in 2001. The software industry employs more than 200,000 people. With further liberalisation of trade in services, which is already part of the WTO agenda, there may be scope for a significant increase in Indian exports.

It is tempting to end the brief review of the challenges and prospects for India's future economic development with this optimistic assessment. However, that would imply focusing on segments of the country's economy which, even in the best possible scenario, would have only a marginal impact on aggregate growth. If India is to sustain growth even at the present level, there is no doubt that the main impetus must come from manufacturing and manufacturing exports.

Concluding remarks

Since 1991, India has become a more open economy, but the country has not been able to reap the potential benefits from increased openness and international economic integration. The several rounds of liberalisations in the 1990s have by themselves had little positive impact upon industrial development and export performance. Openness in itself has not brought about higher rates of industrial growth, better export performance, more industrial investment or the expected significant increase in foreign direct investment. Part of the explanation, undoubtedly, is that the openness introduced with the new policies has not been implemented in practice. The institutional arrangements for policy implementation have changed little, especially at State level, and other necessary preconditions for exploiting the benefits of international economic integration have not been in place (cf. the analyses in Degnbol-Martinussen, 2001).

India's industrial and overall economic development, therefore, depend critically on further reform that extents beyond the declaration of policies and addresses procedural and institutional obstacles. In the context of the major argument presented in this paper it also depends on successful implementation of a national development strategy that facilitate and orchestrate industrial development based on the conditions prevailing in the country. In line with the basic propositions put forward by Dani Rodrik, Linda Weiss and several others what I argue is that India need to add to the opening up of the economy a national investment strategy and a strategy for increasing the institutional capacity to manage both the domestic economy and its integration into the global economy. Indian policy makers are facing tighter constraints in several policy areas as illustrated by the agreements on abolition of quantitative import restriction, tariff reductions and the TRIMs and

TRIPs agreements under the WTO. But this has not rendered the Indian state powerless. Rather, it has put pressure on the state to replace (costly and often ineffective) control-oriented regulations with development-oriented regulations and policies aimed at facilitating and co-ordinating national development efforts.

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