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Chapter 8

External Constraints on Policy-making and Industrial Development in India

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The aim of this chapter is to explore how external factors and forces have impacted upon policy-making and industrial development in India since the late 1980s. The paper deals with two main questions: (a) Have external influences on policy-making in India reduced the scope for pursuing economic policies based on national conditions and priorities? And: (b) How have increased openness and international economic integration affected industrial investment and development in India?

After a brief introduction outlining external pressure on India's policy-making in historical perspective, the article deals with the financial crisis in 1991 and the adoption of radically new economic policies. It then goes on to looking at the shaping of India's economic policies from 1991 to around 1998, the implications for industrial investment and development, and the subsequent adjustments of policies in the context of the developments taken note of and new challenges posed especially by the WTO. A concluding section, in addition to summing up the findings of the paper, suggests some more general observations concerning state autonomy and openness as a development strategy.

External pressure on India's policy-making in historical perspective

Since independence, Indian policy-makers have been under various types of pressure to adjust policies in line with prevailing thinking among donors and lending institutions. Major transnational corporations (TNCs) have also attempted to influence Indian policies in keeping with their basic commercial interests. To what extent foreign pressures have affected Indian policies has varied over the period from 1947 to 1991. There was also some variation from policy area to policy area. In broad outline, however, it may be argued that during the fist three decades after independence, industrial

policies came increasingly to reflect the interests of Indian industrialists as outlined in the so-called Bombay Plan.[28]
The basic legal framework was established already in the early 1950s. This framework provided for extensive government regulation of the private industrial sector. Officially, no discrimination against foreign capital was intended, but along with several other types of state interventions the outcome was a policy framework that favoured the large Indian business houses. Significant expansions of the public industrial sector played a crucial role in this context by, on the one hand, pre-empting opportunities for foreign direct investment, and on the other hand, providing a basis for diversified development of the private industrial sector under Indian control.

For several years foreign companies remained too powerful for the policy framework to become effectively implemented in areas of vital concern to these companies. But by the mid-1970s, Indian industrialists and the state-run public enterprises generally gained the upper hand in terms of influencing both policy formulation and actual implementation. For a few years the situation was characterised by a comparatively low level of extra-societal influences on Indian policy-making. Industrial policies as well as economic policies in general reflected the outcome of bargaining and coalition building among Indian actors, leaving foreign actors only limited scope for influencing the policy-making processes.[29]

Around 1980 external pressure again increased. In 1981, special pressure was exercised by the IMF in the form of conditionalities for providing what was then the largest loan agreement concurred by the Fund in its history. Basically, IMF demanded, in return for a loan of five billion Special Drawing Rights, that India should open up its economy much more to foreign trade and give special privileges to foreign investors. IMF further demanded that the public industrial sector be reduced and that several operational controls over the private sector be abolished. The immediate reaction of the Indian authorities was to comply with the IMF

[28] The Bombay Plan was prepared by six leading Indian industrialists, including J.R.D. Tata and G.D. Birla. It was published already in 1944 and thus constituted an important input to the decision-making processes after independence. It is particularly noteworthy in the present context that the Plan argued in favour of state interventions not merely to develop physical and social infrastructure, power and communication but also to lead and guide the development of the private industrial sector in accordance with Indian national interests. The Plan is noted in the list of references under Thakurdas et al, 1944.

[29] I have dealt with these issues in Degnbol-Martinussen, 2001, Ch. 4, based on my more detailed analyses in Martinussen, 1988.

conditionalities in view of the severe financial crisis they were facing. The reactions within India, however, were very strong both among politicians, business representatives and academics. The Government of West Bengal took the lead in opposing the policy changes and also took the unconventional step of publishing the IMF conditionalities along with several critical articles [Government of West Bengal, 1981]. The Finance Minster of West Bengal ended his introduction to the published documents with the following: 'It is now left to our people and Parliament to reverse the process - and force the Government to annul the loan agreement.' [Ibid.: 11].

The agreement was not formally annulled, but because India soon recovered from the financial crisis that had prompted the government to request for IMF support it became politically impossible to sustain the initiated process of policy changes. Very few policy changes, therefore, were actually brought about in the early 1980s.

During the 1980s, however, pressure on Indian policy-makers continued with the widespread adoption of the neo-classical strategy and the so-called 'Washington consensus' concerning the most appropriate economic policies for developing countries.[30] Neo-classical economists achieved considerable influence on the international development debate in the 1980s, and their recommendations were generally accepted by the IMF and the World Bank, in addition to many bi-lateral donor organisations. Their views, during the same period, came to influence more and more key decision-makers in India, particularly within the Ministry of Finance. As leading business representatives at the same time began questioning the state-led development model and demanded de-regulations and more market-friendly reforms this laid the foundation for coalition building in support of liberalisation. However, apart from some steps towards liberalisation taken by the Rajiv Gandhi government in 1985, Indian policies were not brought in line with neo-classical thinking during the 1980s. It was only when the country faced a severe financial crisis in 1991 that major changes occurred.

Seen in retrospect it is interesting to note that Indian policy-makers were able to build up sufficient capabilities and capacities to adopt and retain state-led industrial development over four decades with a substantial element

[30] As representatives of this neo-classical strategy may be taken Bela Balassa (1982), Ian Little (1982), Jagdish Bhagwati (1982), Deepak Lal (1983) as well as to some extent P. T. Bauer (1984). I have reviewed and discussed their contributions to development thinking in Martinussen, 1997, Ch. 18.

of import substitution, even in the face of persistent external pressure. When it came to implementing the policies and bringing about intended impact in terms of industrial growth and technology upgrading the record was less impressive. TNCs tended to either stay away from India or, when they entered the country, they in practice demanded exceptional treatment and interpretations in their own favour of the established regulatory framework [Martinussen, 1988: Ch. 3]. In a sense, therefore, the big foreign companies were able to influence heavily the actual implementation of India's economic policies.

This changed with the financial crisis in 1991 after which one could generally argue that external circumstances and pressure from international actors came to also affect policy formulation more than before. This could only happen, however, because conditions and power constellations within India had at the same time changed.

The 1991-crisis and the new economic policies

Towards the end of the 1980s, India experienced exceptionally high growth rates for the country. In the fiscal year 1988-89 alone, GDP increased more than ten per cent in real terms.[31] This level of growth, however, could not be sustained, because it was based to a large extent on deficit financing and external commercial borrowing. Serious internal and external macro-economic and fiscal imbalances were therefore building up. These imbalances reached crisis proportions in 1991, when India came close to default in meeting its international payment obligations.

The 1991-crisis in most official statements has been explained with reference to changes in the international context. Such changes undoubtedly did contribute to deepening the crisis as will be argued below, but their impact would have been very different had the Indian Government pursued more prudent economic policies in the 1980s. Deepak Nayyar has convincingly argued that the Indian state became increasingly unable to mediate between conflicting interests and competing demands as a result of the break-down of the Congress Party system and the intensified regionalisation of Indian politics in the 1970s and 1980s [Nayyar, 1998].[32] Increased competition among political elites for votes prompted most of the political parties to pursue populist policies. Governments at both Union and

[31] At 1980-81 prices

[32] For a more comprehensive study of these trends I would particularly recommend Atul Kohli, 1991.

State level substantially increased transfer payments on subsidies in order to please voters.[33] At the same time, government consumption was expanded, driven in part by the competitive politics of populism.

The fiscal regime that evolved during this period essentially implied public borrowing to support expenditure that did not yield any direct returns to the exchequer, nor did it expand the revenue base. To this should be added the increased utilisation of public lending to private companies as political patronage by political and bureaucratic elites. State-led industrialisation based on a broad national consensus, which had been a prominent feature from the mid-1950s to the early 1980s, was thus replaced by conflicting demands on public resources and policies driven by populism and patronage.

The point one may extract from these general observations is that the build-up of both the balance-of-payments crisis and the unmanageable public accounts deficits were basically the results of weak-state economic policies in the 1980s. However, the external debt crisis, in particular, was accentuated by changes in the international context around 1990.

One of the important changes was Iraq's invasion of Kuwait and the ensuing war in the Gulf area. This affected the Indian economy drastically. The largest single source of convertible currency in the years before the war had been remittances from Indians working in the Gulf area. Forced repatriation of several thousand migrant workers reduced these remittances substantially. In addition, the war resulted in considerable increases in the price of India's oil imports. Another important factor was the break-up of the Soviet Union which resulted in a significant decline in Indian exports to this previously very important trading partner.

These external developments added to the imbalances. The best single indicator of the seriousness of the crisis was the fact that the foreign currency reserves dwindled to the equivalent of the costs of only two weeks' import. This forced the Indian Government to take action in collaboration with the IMF and the World Bank.

[33] Pradeep Chhibber reached a similar conclusion: 'In India, the emergence of political competition played an important role in accounting for the increase in government expenditures, especially subsidies, since the mid-1960s.' Chhibber, 1995, p 92.

In July 1991, the new government under the leadership of P. V. Narasimha Rao announced drastic changes in the industrial and foreign trade policies. Since then, further liberalisations have been introduced every year with each new Budget.[34] The changes during the period from 1991 to 1998 included abolition of government licensing in most industrial sectors; removal of most of the regulations restricting the growth of large companies; opening up for the private sector of many areas previously reserved for development by the public sector; removal of numerous regulations pertaining to foreign investment and transnational business collaboration; introduction of various incentives to encourage technology transfers in general and foreign investment in high-priority industries in particular; partly freeing of foreign trade from government interference; and steps to making the rupee fully convertible on the current account (but not the capital account).

The new economic policies marked a fundamental break with the past. They drastically reduced the degree of state regulation in several respects and introduced a much more market-friendly and open-economy policy environment - much in line with the strategy propagated by neo-classical economists. Unlike in 1981, economists strongly influenced by this school of thought held several key positions within government bureaucracy, especially in the Ministry of Finance. Several among these government officials had advocated pro-market and open-economy reforms from the mid-1980s onwards [see, e.g., Jalan, 1991]. With the severe crisis in 1991 this segment of the bureaucratic policy-elite was given an opportunity to reinvigorate the reform process initiated by the Rajiv Gandhi Government in 1985. They were given this opportunity also because of changes within the realm of party politics.[35]

The Rao government presented the new economic policies as an expression of the Congress Party manifesto and as the most rational response to changes in economic conditions within India and abroad.[36]

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[34] The profound policy changes have been extensively documented in Indian journals like *Business India, India Today, Business Today, Economic and Political Weekly*, etc., as well as in dailies like *Economic Times.* The new rules and regulations introduced in 1991 were collected in Nabhi, 1992. Subsequent revisions and amendments may be found in Ministry of Industry, 1996. Continuous updating of information is available from the Secretariat for Industrial Assistance at: http://indmin.nic.in

[35] A more detailed analysis of the adoption of India's new economic policies is presented in Degnbol-Martinussen, 2001, Ch. 7.

[36] The Indian Finance Minister, Manmohan Singh, summed up the reasons for the policy changes in this concise manner: 'There is a growing recognition that while the country did make substantial progress in the

Indian scholars, particularly those adhering to socialist values, have distanced themselves from this official version of rational policy-making based on national priorities. They have argued instead that the change of economic policies in 1991 was brought about chiefly because of pressure from the World Bank and the IMF [e.g., Oommen, 1993]. Others have noted that every step taken by the government was in accordance with the major prescriptions of neo-classical economics, which were also embodied in the IMF reform and crisis-management approach [Dasgupta, 1998: 366 ff.].

Key bureaucratic decision-makers, however, have rejected these interpretations, claiming that the pressure from the Bretton Woods institutions had been there all the time - without India submitting to their conditionalities.[37] Instead, they have argued that the policy changes were prepared already by the mid-1980s, but could not be effected because of opposition from a majority of the members of the Parliament. The main reason why the policy changes could be effected in 1991 was because, at that time, they could be presented primarily as necessary crisis-management instruments. The seriousness of the macro-economic imbalances was so evident that it was widely accepted among politicians that radical steps had to be taken, even though they might undermine the system of political patronage and deviate significantly from earlier policy statements.

The initiative came from the Ministry of Finance and the Ministry of Commerce.[38] Core decisions were taken by the Ministries and Secretaries of these ministries in conjunction with the Cabinet Secretary and with strong political support from the Prime Minister and his Office. Apparently, the Ministry of Industry did not play a major role in the decision-making process, and although consultations took place with business associations

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1980s, its full development potential has not been realized. The world in which our old policies were conceived is now a very different place. Technology is today the main determinant of power and wealth of nations. That technology is with multinational corporations, not the public sector. To get access to modern technology, India has had to change its attitude to direct foreign investment. The old bureaucratic methods of controlling economies through quantitative import restrictions and industrial licensing will simply not work in India now that our economy has grown in depth and width. That is why we are deregulating and opening up to foreign investment.' (*International Herald Tribune*, October 21, 1991).

[37] This is based on several interviews with highly placed government officials, including the Finance Secretary Montek Singh Ahluwalia, other Secretaries and Joint Secretaries and economic advisers, in 1996 and 1998.

[38] The Ministry of Commerce was later amalgamated with the Ministry of Industry, but in the early 1990s they played different roles.

and individual business representatives their direct involvement was rather limited.[39] The acute risk of defaulting on international payments apparently had provided the narrow bureaucratic policy-elite with a considerably higher degree of autonomy than in the preceding years. According to their own interpretation, the IMF and the World Bank were involved in the decision-making process merely as advisers.

Seen in retrospect, the response in 1991 to the financial crisis was to a surprisingly high degree in conformity with standard IMF stabilisation policies and World Bank structural adjustment policies. This was surprising because until then most economic policies in India had reflected the outcome of bargaining and coalition building among Indian actors, implying considerable attention to the specific economic and political conditions obtaining in the country. The new economic policies were not the outcome of such bargaining and coalition building. However, this does not necessarily imply that the policy changes were made chiefly due to pressure from external actors. Rather, the changes could be seen as a response by the bureaucratic policy-elite to changed external circumstances and the conditions prevailing in the Indian economy at that time. The new policies were continued after 1991 with support from large segments of the business community.

The shaping of India's economic policies 1991-98

Initially, there was widespread agreement among both Indian and foreign investors that business opportunities in India improved after 1991. The business community also, in general terms, endorsed India's signing the agreements negotiated during the GATT Uruguay Round as well as the country's membership of the WTO. However, by the mid-1990s an increasing number of Indian business representatives began expressing some concern.

The most influential apex body representing the interests of Indian industry, the Confederation of Indian Industry (CII), around the mid-1990s adopted a very critical attitude to the government's new policies, claiming that they favoured new foreign companies coming to India for the first time as compared with both Indian controlled companies and 'old' TNCs in the country. CII endorsed the demands for 'a level playing field', originally put

[39] This is based on several interviews with business associations and individual business representatives in 1996 and 1998.

forward by some of its leading members, including Rahul Bajaj. The basic position of the CII was that India had moved from too much protection to too little protection, which could eventually result in policy-induced de-industrialisation.

The Associated Chambers of Commerce and Industry (Assocham) in its public statements was less critical and instead preferred to reiterate its preference for free flows of capital and investment. Many of its leading members, however, did not share this attitude. While Ratan Tata as Chairman of the Tata group of companies supported both liberalisation and an open-economy approach to globalisation, some of his own directors were of the opinion that the opening up of the economy had happened too fast and gone too far. The existing companies had not been given sufficient time to adjust, and several regulations continued to prevent them from doing so. They felt that the government was giving so much priority to attract new foreign investment that the whole incentive structure had been biased in favour of foreign investors.

The Federation of Indian Chambers of Commerce and Industry (FICCI) tried to adopt a middle-of-road position welcoming foreign direct investment but expressing some reservations regarding foreign portfolio investments from institutional investors, because this type of investment was deemed too mobile and therefore might destabilise the economy as experienced in some of the East and Southeast Asian countries in 1997-98.

Although the opinions differed from one association to the other it appears that broad agreement emerged among Indian industrialists that the new policy framework had introduced certain biases in favour of foreign companies and new foreign investors.

Based on several interviews and a review of existing rules and regulations, several factors and specific stipulations indeed appear to have created disadvantages for Indian promoters and companies vis-à-vis new foreign investors. Of particular importance was the difference with respect to accessing credit and the costs of capital. Foreign investors could access capital funds abroad at much lower interest rates than Indian promoters could obtain in India. The steep rise in interest rates after liberalisation and the depreciation of the rupee both added to the difficulties of Indian promoters and companies. They had no access to the kind of cheap credit, which the TNCs could easily obtain abroad, and the Indian owners were

unable to prevent several take-overs of Indian assets quite cheaply. Moreover, Indian enterprises faced extra costs due to customs regulations, sales tax in connection with inter-state transfers, and the rules relating to excise duty [cf. Degnbol-Martinussen, 2001: 152].

Since 1993, India has had no formal programme with the IMF, but economic policies in general continued along the same lines, though with very important exceptions: India did not introduce convertibility on the capital account. The Indian Government also did not follow recommendations from the IMF and the World Bank concerning exit policies for fear of provoking strong opposition from the trade unions. For similar reasons privatisation of public sector companies was pursued only in a cautious and selective manner. Moreover, none of the governments of the 1990s seriously attempted to reduce the budget deficit to a level that could be financed sustainable by borrowing, mainly because that would undermine voter support among farmers who benefited from credit, fertiliser and electricity subsidies.

These observations, combined, seem to indicate that although Indian policy-makers were under pressure to adjust to external constraints and circumstances they did so in a selective manner in order not to provoke unmanageable resistance from pressure groups and voters within India.

After joining the WTO, however, Indian policy-makers again faced increasing external pressure to comply with the several regulations contained in the GATT/WTO agreements. Seen in a broader perspective the pressure exerted by the Bretton Woods institutions, notably the IMF, was replaced after the mid-1990s by pressure from the WTO and some of its leading member states, the USA in particular.

By joining the WTO Indian policy-making came under added external pressure, particularly due to the obligations following from the so-called TRIMs and TRIPs agreements (concerning 'trade-related investment measures' and 'trade-related intellectual property rights', respectively) [cf. Dhar, 1995].

During the Uruguay Round negotiations, the USA in particular argued for prohibiting or restricting the use by member states of policies that in their view were biased against foreign investment such as local-content rules, export performance requirements, etc. It was argued that such measures

restricted or distorted international trade. India and many other developing countries, on the other hand, regarded such measures as essential elements of their industrial development strategies. They also regarded TRIMs as necessary for restraining TNCs from indulging in restrictive business practices.

The outcome of the negotiations was more favourable to the highly industrialised countries of the OECD than to India and developing countries in general. The TRIMs agreement prohibits measures to the extent that they are trade-distorting, i.e. if these measures violate the 'national treatment rule' or imply any use of quantitative restrictions or other non-tariff barriers. The TRIMs agreement include no attempts to limit the potential trade-distorting activities of TNCs [Morrissey and Rai, 1995: 704; Dicken, 1998: 99].

The TRIPs agreement establishes an international intellectual property rights regime and requires member-states to amend their own laws in conformity with the agreement within a given time frame. The TRIPs provisions of the WTO agreement, unlike previous rules, disallows patenting of alternative processes, when the product concerned has already been patented. This will affect hundreds of firms in India, particularly in pharmaceutical and chemical industries, which use locally invented processes, often more labour-intensive and with lower-cost inputs, to produce patented products. In more general terms, the TRIPs agreement is likely to strengthen existing trade monopolies and adversely affect technology transfer to developing countries [Dhar and Rao, 1996]. Others have argued that the new patent regime will result in rising the costs of industrial development in technology importing countries, partly because of increased royalty payments to patent holders abroad, partly due to increased prices of products manufactured under licence [Griffin, 1996: 112].

The effects of the various WTO agreements were not felt much in India during the period up till 1998, because member countries were given time to adjust their policies. The wider implications of India's joining the WTO and the outcome of the external pressure on India to comply with the 'new rules of the game', therefore, are addressed in a later section dealing with the shaping of policies after 1998. But it should be noted here that increasing awareness among politicians, government officials and business representatives of the wide-ranging implications of the WTO membership began to impact upon the policy process in India even before 1998. The approaching deadlines for complying with various WTO agreements were

by more and more key decision-makers perceived as threats to Indian national interests. This change of perception was reinforced by the fact that India had benefited only modestly from opening up the economy during the 1990s. This is the topic of the following section.

Implications for India's industrial development of increased openness

Views among economists differ considerably as to whether increasing international economic integration and openness to trade and foreign investment 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 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.

Many neo-classical economists argue that openness and economic integration by themselves will promote growth [cf. Sachs and Warner, 1995]. 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.[40]

According to other economists, however, the outcomes differ among developing countries. Joseph Stiglitz, former Chief Economist of the World Bank, has 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.[41] Based on a more detailed analysis, Dani Rodrik has argued that openness in itself is not an independent source of

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[40] 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.' (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).

[41] Stiglitz at the same conference. 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.

growth [Rodrik, 1999; 2000]. 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.

Policy-makers in India tended to rely on the optimistic neo-classical interpretation in the early and mid-1990s. This was also the period where representatives of Indian industry were very supportive of the new policies. As noted, this gradually changed, chiefly based on the evidence of the modest progress achieved, especially after 1995. We shall briefly look at selected indicators to assess how increased openness has worked in the case of India.

The indicators chosen are: (a) industrial growth and especially growth of manufacturing; (b) export performance (manufacturing exports now account for around 80 per cent of total exports); (c) industrial investment; and (d) foreign investment with special emphasis on foreign direct investment (FDI).[42]

Industrial growth

Indian economists disagree on the interpretation of the growth figures for industry. 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 [Kumar, 2000: 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: 14; cf. also Agaraj, 2000: 2833].

What is important in the present context is that the evidence does not suggest that increased openness brought about industrial growth at a significantly

[42] The main reason for focusing on indicators 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 the 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).

higher level than before the policy reforms in 1991. This is clear from figure 1 which presents annual growth rates for industry since the early 1980s. 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.

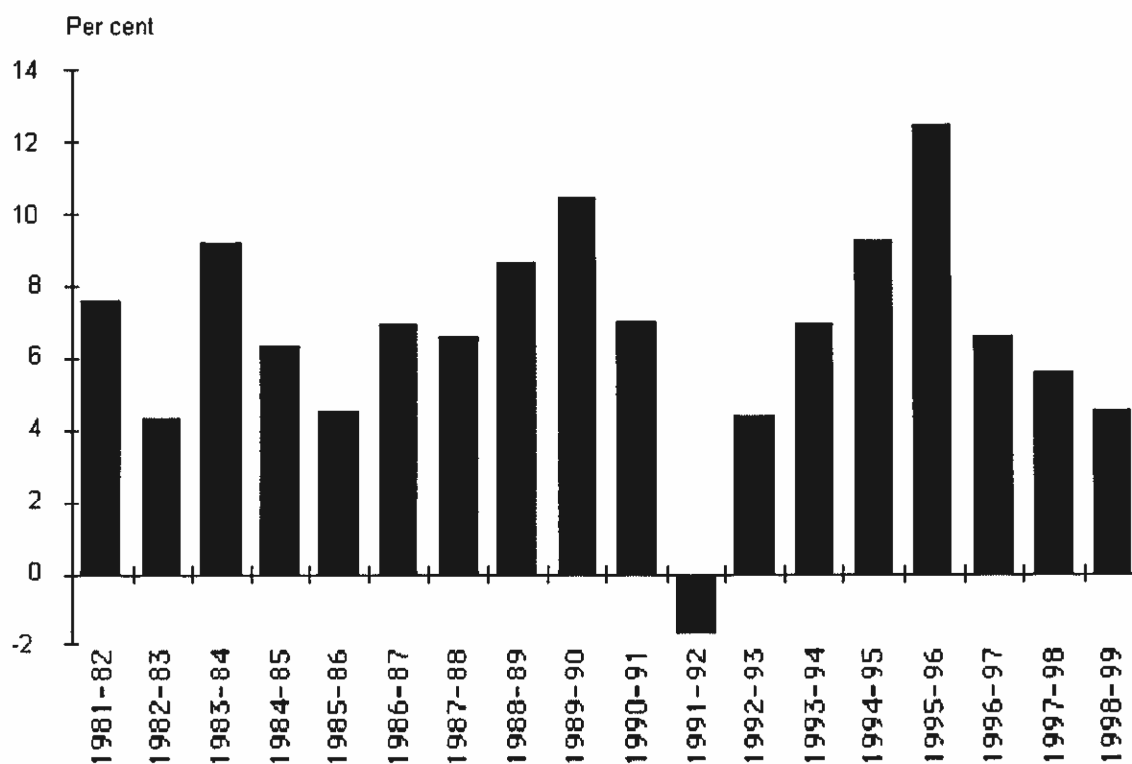


Figure 1 Annual growth rates for industry, 1981-99 (At constant prices)

Source: Economic Survey 1999-2000: S-10. Note: For the period up to 1993-94 growth rates are based on 1980-81 prices; for the period after on 1993-94 prices.

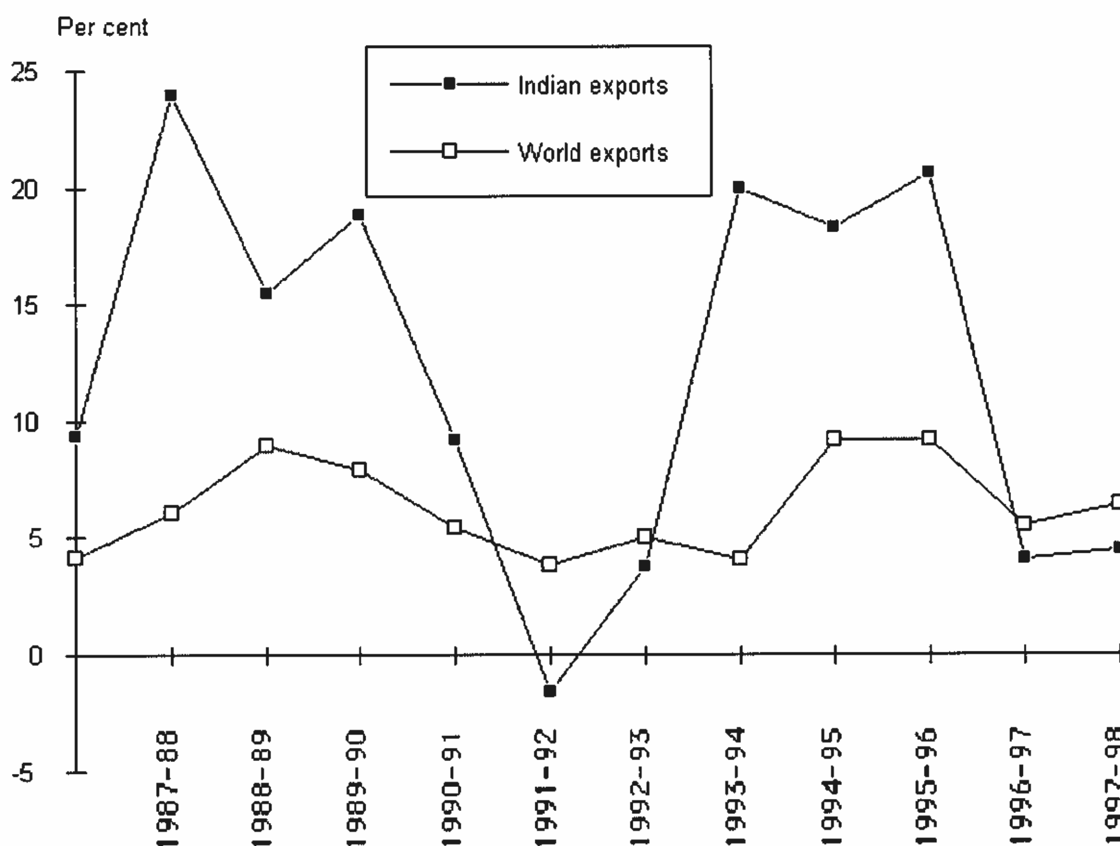
What if we look at manufacturing separately? Manufacturing registered a growth rate of around eight per cent per annum during the 1980s. This level of growth has been achieved during only a few years in the mid-1990s and in fiscal year 1999-2000. Rather, growth of manufacturing as well as overall industrial growth have fluctuated significantly over the last decade, indicating that other factors than the new policies have had a strong impact upon industrial development, as also noted in recent official publications [cf. Economic Division, 1999: 96].

Export performance

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 per cent, up from around 50 per cent in 1982, but only a modest increase from around 70 per cent in 1991 [Ganesh-Kumar et al., 1999: 181; Economic Division, 2000: S-90]. Moreover, 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 (low value-added) manufacturing - pearls and precious stones - also constituted the largest item in imports.

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 per cent and 0.7 per cent since 1970. It was much higher in the 1950s and as high as around two per cent at independence. Moreover, the growth of Indian exports after 1991 can be attributed to other factors than the new economic policies. 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: 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.

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



Source: Gupta, 1998: 98.

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 per cent to less than five per cent as shown in figure 2. In Dollar value terms Indian exports recorded a negative growth of almost four per cent in 1998-99 [Economic Division, 2000: 87].

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

Openness and increased competition have for some commodities been associated with 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: 186].[43] 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: 33f.].

To economists who are sceptical about the virtues of openness as a development strategy and 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

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

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

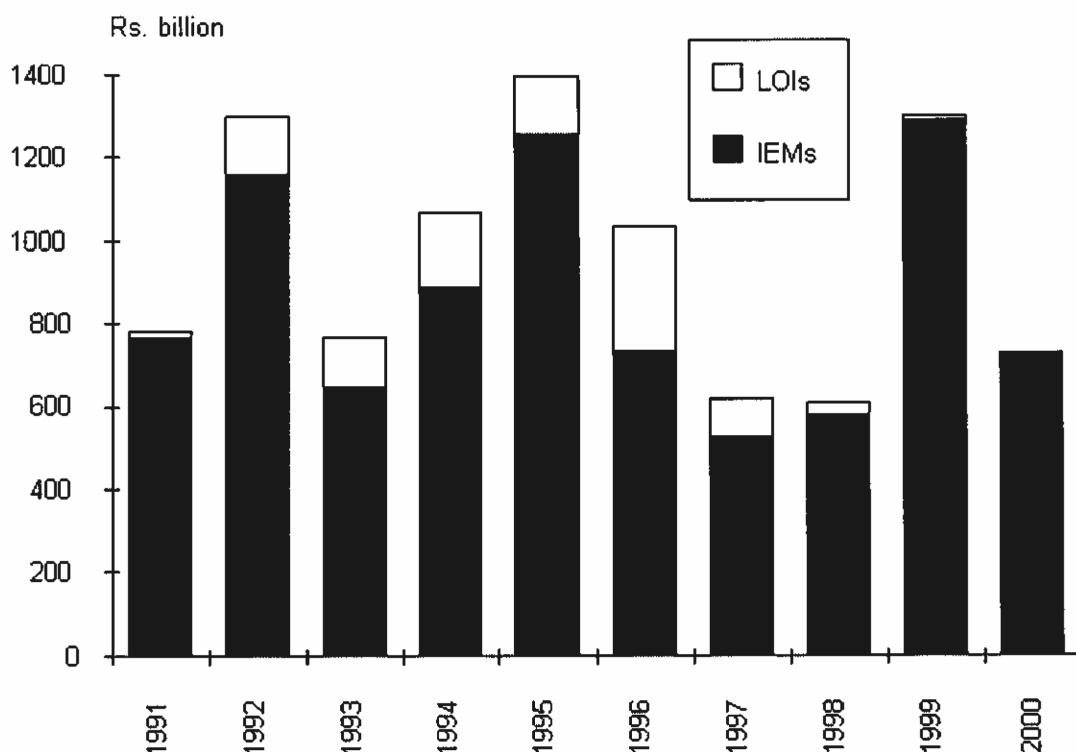


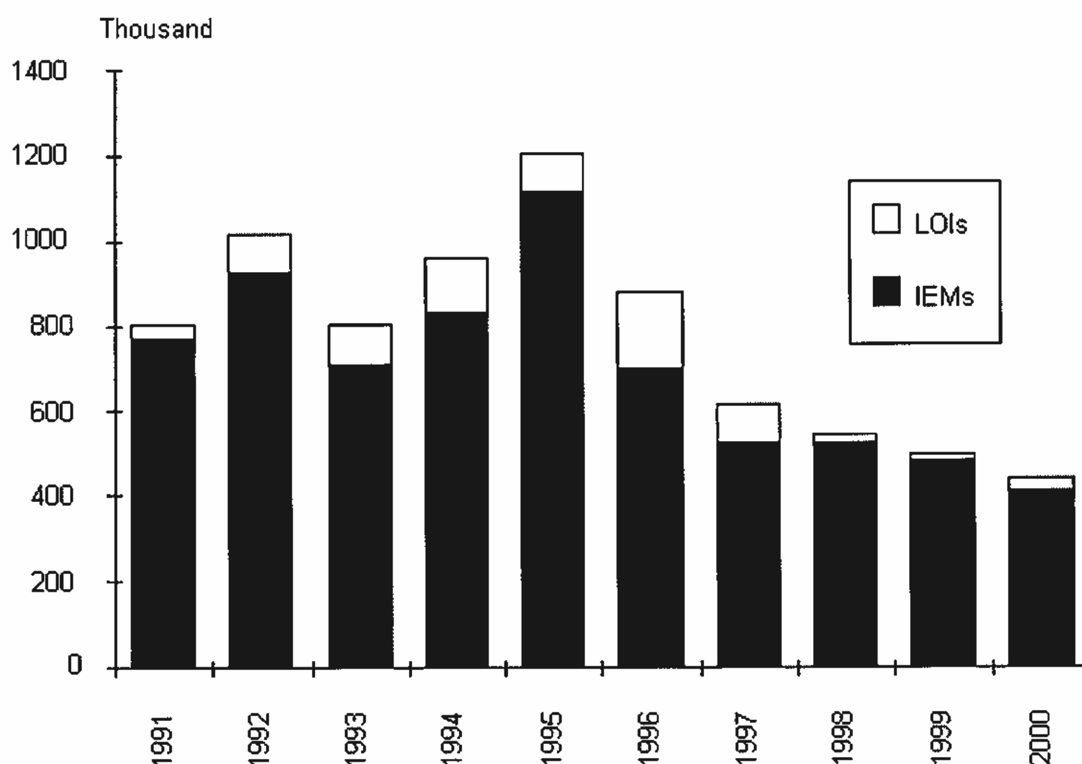
Figure 3 Proposed industrial investment, 1991-2000 (Rs. billion)

Sources: Economic Division, 1998: 101; Secretariat for Industrial Assistance, SIA Statistics, October 2000; March 2001.

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 in 1999 but fell again the following year. 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 a previous 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 proposed investment as a whole has been slow. By Nov. 1998, commencement of commercial production had been intimated for less than 19 per cent of the investment proposed according to the Secretariat for Industrial Assistance. By Feb. 2001, however, this percentage had risen to around 27 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 and continued to decline. Implementation in terms of employment creation has been even slower than in terms of investment: By the end of 1999, only around ten per cent of the employment proposed during the period after 1991 had actually been reported to the Secretariat for Industrial Assistance. By Feb. 2001, this percentage had increased to 19.8, which, however, could not be deemed very satisfactory considering the falling number of jobs associated with new investment in the second half of the 1990s.

Figure 4 Proposed employment, 1991-2000 (in thousand)



Sources: Economic Division, 1998: 101; Secretariat for Industrial Assistance, SIA Statistics, Nov. 2000; March 2001.

Foreign investment

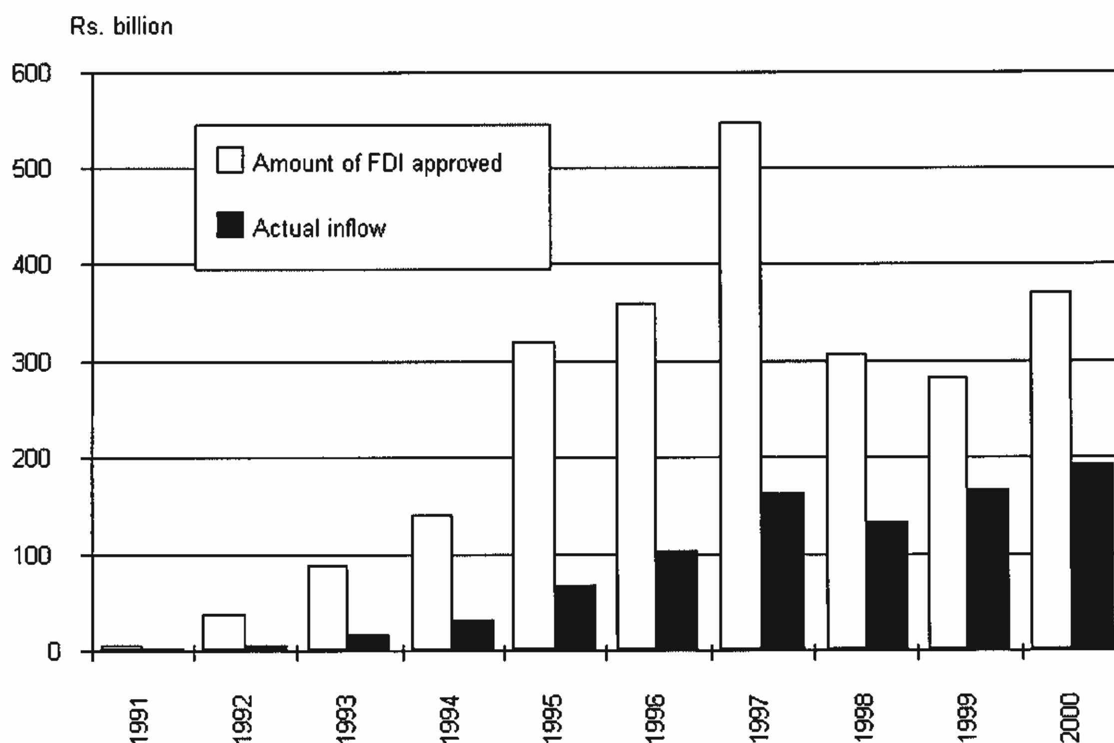
Concerning the last indicator chosen, the inflow of foreign investment and particularly the inflow of FDI, the new policies of opening up the Indian economy did bring about very significant increases. One of the main objectives of the new economic policies was to attract more foreign capital

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, the peak year, was more than US$ 15 billion, indeed a very significant increase that could be attributed to a large extent to the new open-economy policies adopted after 1991.

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$ ten billion a year). Figure 5 presents data on approved FDI as compared with the actual inflow. For the period from 1991 to 1999 actual inflows came to only around 35 per cent of total approved investment - as compared with 70-80 per cent in some of the fast-growing East Asian countries. There was some improvement in implementation in 2000 where actual inflow amounted to 52 per cent of the approved amounts. This may, however, 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 for Industrial Assistance.[44]

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

Figure 5: FDI approved and actual inflows, 1991-2000



Source: Based on statistics provided in SIA Newsletter, April 2001.

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: 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. In 1996, this form of FDI accounted for only three per cent of total actual FDI, but this share went up to 5.8 per cent in 1997 and 30.5 per cent in 1998 (figure 6).

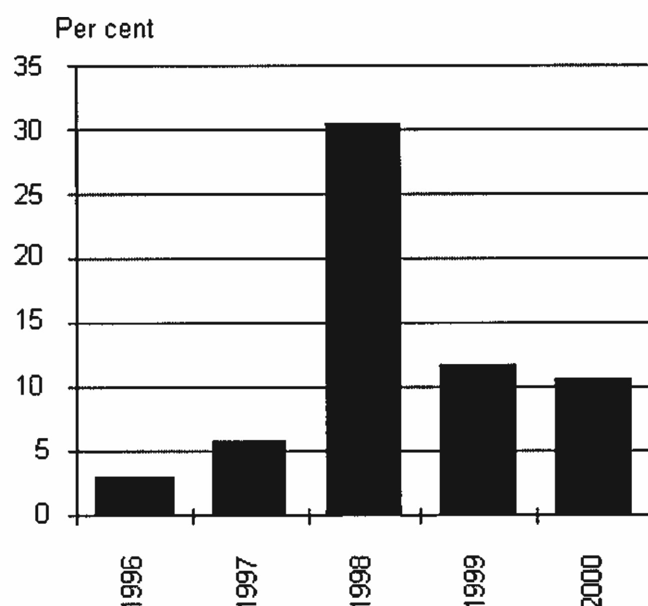


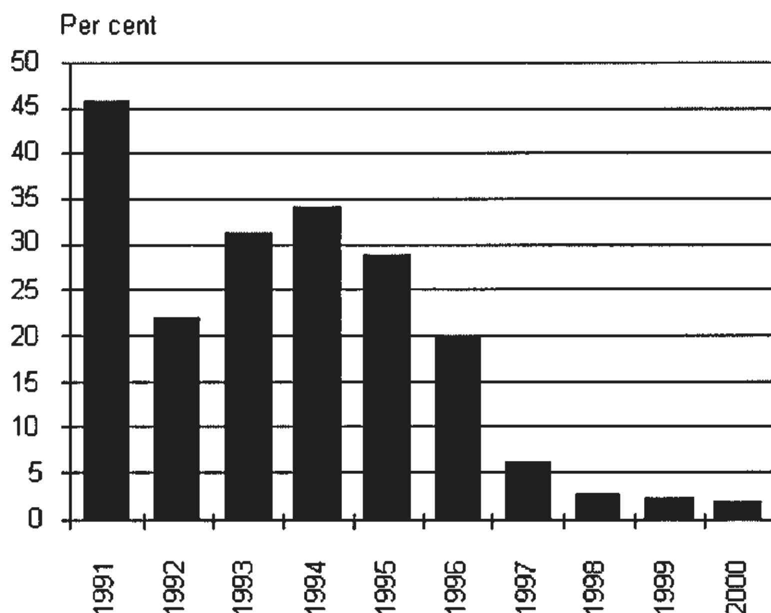
Figure 6 Inflows on acquisition of shares, 1996-2000 (per cent of total inflows of FDI)

Source: Based on statistics provided in SIA Newsletter, April 2001.

It should further be noted that investment from Non-Resident Indians (NRIs) has played a significant role in the first half of the 1990s, as indicated in figure 7. 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 has dried 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 currency.[45]

[45] 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.

Figure 7: NRI investment as percentage of actual inflow, 1991-2000



Source: Based on statistics provided in SIA Newsletter, April 2001.

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 s have been offered attractive rates of interests and other incentives.[46]

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,

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[46] 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 Bagchi, 1999; and Department of Company Affairs, 1997, p 11).

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: 87f.]. This again is an indication that the new economic policies have had an impact as intended. In a comparative perspective, however, the increase of FDI flows has been modest. India's share of total FDI to developing countries rose after 1991 to a peak of 1.9 per cent in 1995, but in 1999 it had declined again to 1.0 per cent [UNCTAD, 2000: Annex Table B.1].

The overall conclusion is that India has not been able to reap the potential benefits from increasing openness and international economic integration and that these changes by themselves have had little positive impact upon industrial development and export performance. In a more comprehensive assessment of the new policies several other aspects of their effects should be noted. Especially as seen form the point of view of Indian middle class consumers there is little doubt that the new policies have had beneficial effects: these consumers are given choices they did not have before and more important, they can get the products - cars, scooters and motor bikes, in particular - without having to wait for years. Liberalisation may also have contributed to making manufactured goods cheaper relative to farm products to the benefit of the farm sector [Economist Survey June 2, 2001: 4]. These other effects, however, are not the topic of this article.

New challenges and the shaping of India's economic policies after 1998

The unsatisfactory progress achieved in industrial development by the late 1990s and the widely perceived threat of WTO-driven liberalisation probably helped strengthen domestic opposition to further economic reform.[47] One indication was that the BJP and its allies fought - and won -

[47] This observation is also based on several interviews undertaken in 1998 and 2000-01 among business representatives and government officials. Trade Counsellor Vinay Capila assisted in collecting information and carrying out interviews on my behalf in the Spring of 2001.

the elections in 1998 on an anti-reform platform emphasising their long-cherished policy of Swadeshi (self-reliance and first priority to Indians and things Indian).[48] When in government, the BJP did not attempt to radically change the economic policies, but the new coalition government did adopt a different attitude and approach to formulation and implementation of policies in compliance with WTO agreements and rules. Key political and bureaucratic decision-makers started working more closely with the business associations to delay and dilute the impact of the WTO membership. During the period from 1998 to 2001 this was particularly evident in relation to the TRIMs agreement and the forced abolition of quantitative restrictions. This section deals with these topics in turn.

The official Indian position on the WTO has been presented under headings like 'implementation issues' and 'implementation concerns'. According to the key government agency responsible for dealing with WTO matters, the Department of Commerce, the 'implementation concerns' fall broadly into three categories: (a) imbalances inherent in some of the Uruguay Round Agreements; (b) lack of sincere implementation of provisions existing in favour of developing countries; and (c) non-implementation of 'Special and Differential Treatment' clauses which could have benefited developing countries [Department of Commerce, 2001: 123].

Among the imbalances the Department in official statements has referred to the TRIPs agreement which does not recognise the rights of countries of origin while granting patents on products developed by using traditional knowledge or bio-resources of developing countries. Another reference is to the TRIMs agreement, particularly the provision that prohibits any local content requirements - contrary to the interests of developing countries.

Lack of sincere implementation of some provisions, according to the Department, is found especially with respect to the Agreement on Textiles and Clothing where developed countries have postponed the lifting of quotas. They have also denied effective market access to developing countries with high tariffs for selected products where India and other developing countries are competitive.

[48] The University Business School, Panjab University, in 1999 organised a two-day seminar on 'Swadeshi Today'. A total of 44 papers from that seminar were published in Arya and Tandon, 1999. Combined, they provide an interesting overview of the Indian debate on Swadeshi. Several papers attempt to outline a policy framework for economic nationalism.

With regard to non-implementation, the Department has noted several instances, including non-implementation of most provisions that allow consideration of the needs of developing countries (e.g. relating to balance-of-payments concerns).

In an official response to questions raised by the present author the Department of Commerce summarised the implementation concerns in this way:[49]

> However, while some of the WTO measures which form part of the obligations undertaken by India in WTO are consistent with the direction in which domestic policy formulation is progressing on an autonomous basis, there is a strong feeling among certain sections of domestic stakeholders that some of the provisions, especially those related to TRIMs, TRIPs, SPS, TBT, etc.,[50] are not taking into account the developmental needs consistent with the stage of development of developing countries and LDCs, nor are they taking cognisance of the capacity constraints of developing countries... There are certain provisions which have an in-built anti-development bias and there are other provisions (especially those related to Special and Differential Treatment provisions in favour of developing countries) which have not been implemented sincerely by the developed countries.

Business associations and other business representatives interviewed generally agreed with the criticism put forward by the Department of Commerce, but some of them added that the Indian Government itself was partly to blame. The government officials who had originally negotiated and signed the various agreements were mainly 'generalists' who had acted without legal or professional assistance. They were therefore unable to understand the long-term implications of what they committed India to. As bluntly stated by a representative of one of the apex business associations: 'They had no idea of the implications of the TRIMs and TRIPs agreements.'

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[49] In a written response to the following question presented to the Department in May 2001: 'Have recent policy adjustments been driven mainly by national priorities or WTO rules and pressure from the US and the EU?'

[50] SPS refers to the Agreements on Sanitary and Phytosanitary Measures; TBT to the Agreement on Technical Barriers to Trade.

High-level government officials gradually came to a similar conclusion which prompted them to include legal experts and other professionals in the delegations at WTO meetings, including persons appointed by the business associations. This was one of the major shifts in the government's approach in the late 1990s. Another was to build up coalitions with other developing countries within the WTO, especially when preparing for the 1999 Ministerial Conference in Seattle. An important outcome of this endeavour was the preparation of a document on 'implementation issues' jointly submitted by India and eleven other developing countries [WTO, 1999]. This document reflected most of the concerns and criticism referred to above. It continues to provide a basis for influencing the implementation of WTO agreements.

Other areas where the Indian Government has tried to build coalitions concern the agenda for future negotiations within the WTO. Special attention is given here to avoid inclusion of labour standards and environmental standards in the trade negotiations, not because India is officially opposed to such standards, but due to their potential (negative) implications for market access in the developed countries. According to the Special Secretary for WTO matters, Nripendra Misra, India is 'against any inclusion of non-trade issues that are directed in the long run at enforcing protectionist measures, particularly against developing countries.' [Interview, Times of India, 7 June 2001].

India's efforts to delay and adjust the implementation of the agreements reached during the Uruguay Round have not prevented the country's policy-making from coming under increased external pressure, partly due to approaching deadlines for complying with various earlier WTO agreements, partly due to the cases against India filed by the USA, in particular.[51]

The demand for an extension beyond the year 2000 concerning the TRIMs agreement, especially the provision prohibiting local-content requirements, has not been accepted. India is therefore obliged to comply with the WTO restrictions on industrial policies that protect and promote particular sectors. In line with the more defensive and pro-active approach adopted since 1998, however, the Indian authorities have

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[51] Details of cases where India has been defendant are provided in Department of Commerce, 2001, p 127.

responded by introducing indirect protection and promotion of Indian industry.

An example is the legislation on competition. The original Competition Bill, introduced in 2000, could not be adopted. Both business representatives and key government bureaucrats opposed it on the ground that it would impede the emergence of larger Indian firms and conglomerates who could compete with incoming TNCs and in the world market. This led to a revision of the Bill in 2001. The provisions against anti-competitive practices such as cartelisation, under-pricing and bid rigging were retained from the original Bill, but at the same time new provisions were added to facilitate and encourage emergence of larger Indian enterprises. An important indication of the new approach was that advance notice of mergers of Indian companies was made optional. This change was presented by the Law Minister as a means to 'encourage Indian companies to gain in size' and 'withstand the onslaught' of TNCs [Economic Times, 4 July, 2001].

Another example (with much wider repercussions) of official Indian resistance to accepting the full implications of WTO rules and regulations is the reaction to the forced abolition of quantitative restrictions (QRs) on imports in 2001. When joining the WTO, India had retained QRs on imports 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. The Panel ruled against India, arguing that the QRs were not justified on balance-of-payments grounds (based on an assessment done by the IMF). The Indian Government appealed before the Appellate Body of the WTO, which, however, upheld the rulings of the Panel. India therefore had to enter into a bilateral agreement with the USA according to which all QRs[52] should be phased out by April 2001 [Economic Division, 2000: 99].

In the Export-Import Policy for 2001-02 the government accordingly removed QRs for 715 products, mainly consumer goods, but retained

[52] I.e. the QRs justified on balance-of-payments grounds.

restrictions on 600 other items on different grounds than balance-of-payments considerations. Imports of all primary products of plant and animal origin remained subject to permits to be issued by the Ministry of Agriculture after a risk assessment based on SPS measures and other provisions of the WTO. Moreover, imports of several goods were allowed only through the designated state trading enterprises.

In other words, India complied with the rulings of the WTO dispute settlement bodies but evidently without enthusiasm. The government at the same time introduced various safeguards to protect Indian industry. Most QRs were replaced by high tariffs, and a 'war room' of highly placed bureaucrats was set up to monitor the import status of 300 'sensitive' items. Should imports of any of these items surge, the newly created body was empowered to re-introduce restrictions.

When deciding on the tariffs, the government was clearly influenced by particularly powerful lobbies representing various sectors of Indian industry such as liquor and car manufacturing. To illustrate, the domestic liquor producers were protected by a stiff countervailing duty [Economic Times, 10 April, 2001]. Moreover, some of the states added excise duty on 'imported liquor' - contrary to the stipulations of India's Constitution according to which states can levy excise duty only on liquor 'manufactured or produced in the state'. The new excise duties are probably also violating the WTO rules on national treatment [ibid.]. With respect to car imports the manufacturers in India, including the TNCs who had earlier set up plants in the country such as Ford, Hyundai, General Motors and Daewoo, persuaded the government to raise duties on second-hand cars to a level where the costs of buying such cars would exceed the costs of buying comparable new cars.[53] In addition, prohibitive non-tariff barriers for imports of second-hand cars were erected.[54]

The 'safeguards' introduced by the government were assessed very differently by business representatives and the business press, varying from positive endorsement to the view that they were unnecessary or

[53] According to a calculation presented in *Business Newsweek* (April, 2001), the price of a second-hand Toyota Corolla 1999 model would be higher than the price of a new 2001 model.

[54] Imports were allowed only through the customs port at Mumbai and on arrival the importer had to submit the cars for testing by designated agencies in, e.g., Ahmednagar or Pune. For other non-tariff barriers, cf. Jitendra Sanghvi, 'Afraid of WTO', *Business Newsweek*, April 2001.

even harmful to both industrial development and Indian consumers. The important point in the present context, however, is that the measures adopted showed that the Indian Government was not prepared to give up more autonomy in policy-making than strictly required to meet the formal obligations following from WTO rules and rulings. Or as the Minister of Commerce and Industry, Murasoli Maran, put it: 'we have lifted QRs with all suitable precautionary measures.' [Business India, April 16-29, 2001].

In addition to imposing tariffs and erecting non-tariff barriers, the Indian Government has strengthened its policies on anti-dumping provided for under Article VI of GATT 1994. A Directorate General of Anti-Dumping and Allied Duties has been established and India has initiated a large number of investigations to determine whether products are sold in the country at prices less than the prices prevailing in the exporting countries' markets. By early 2001, India had become one of the leading users of anti-dumping measures in the world - along with the EU.[55]

Conclusions and some theoretical implications

Based on the above review of policy-making and industrial development in India we may extract four major findings in response to the two main questions posed in the introduction.

First, it may be noted that Indian policy-makers were able to build up sufficient capabilities and capacities to adopt and retain a state-led industrial development model over four decades with a substantial element of import substitution, even in the face of persistent external pressure on the country to de-regulate and liberalise imports and capital flows. When it came to implementing the policies and bringing about intended impact in terms of industrial growth and technology upgrading the record was, however, less impressive.

Second, the emergence of serious macro-economic imbalances, further compounded by unfavourable external conditions around 1989-91, paved the way for drastic policy changes. The post-1991 economic policies in India were in many respects similar to the IMF and World Bank prescriptions, but in other respects they deviated from these prescriptions.

[55] Details of the 86 cases initiated for investigation by Feb. 2001 are provided in Ministry of Commerce and Industry, 2001, p 4 ff.

This seems to indicate that although Indian policy-makers were under pressure to adjust to external constraints and circumstances they did so in a selective manner in order not to provoke unmanageable resistance from pressure groups and voters within India. The business community in general supported the new economic policies and also endorsed India's signing the agreements negotiated during the GATT Uruguay Round as well as the country's membership of the WTO.

Third, there is strong indication, however, that liberalisation went too far - and was carried out too fast - as seen from the perspective of India-based companies. By the mid-1990s, an increasing number of Indian business representatives began expressing concern about the implications of liberalisation and increased international competition. They claimed that the pace, sequencing and character of policy changes were shaped more by the IMF in the early 1990s and subsequently by the WTO than by Indian interests and priorities. The fact that India was not able to reap the potential benefits from increasing openness and international economic integration during the 1990s contributed to strengthening domestic opposition to further reform. It became apparent that increased openness had not by itself brought about higher industrial growth, improved export performance, higher levels of industrial investment, or inflows of foreign investment at the level aimed at.

Fourth, the evidence of unsatisfactory progress achieved by the late 1990s, combined with renewed pressure from the WTO on India to comply with agreements and rules, prompted the Indian authorities to adopt a new approach. Key political and bureaucratic decision-makers started working more closely with the business associations to delay and dilute the impact of the WTO membership. The official position on the WTO became much more critical, and India started building coalitions within the Organisation to affect the implementation of agreements and rules. Moreover, when adopting policies in keeping with these agreements and rules, the government introduced several 'safeguards' to protect Indian industry. During the period from 1998 to 2001 this was particularly evident in relation to the TRIMs agreement and the forced abolition of quantitative restrictions. The new approach showed that the Indian Government was not prepared to give up more autonomy in policy-making than strictly required to meet the formal obligations following from WTO rules and rulings.

At a higher level of abstraction the analyses indicate that the policy options available to the Indian state may have been narrowed since the late 1980s due to the financial crisis, increasing external pressure, and the 'new rules of the game' established with the WTO. But the analyses also show that the Indian Government can still play an important role. Several policy options are still available. This conclusion is in line with the views propagated by authors such as Paul Hirst, Grahame Thompson and Linda Weiss who all argue that developing country states continue to have considerable power to influence cross-border transactions and national economic development. It requires, however, that they adopt comprehensive growth-promoting strategies rather than accept the prescriptions of economic liberalism uncritically [Hirst and Thompson, 1999: 153ff.].

Simply deregulating and opening up to freer trade and investment flows has not been 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 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 do not address the several structural problems of industrial development that India is facing [cf. Degnbol-Martinussen, 2001: 231ff.].

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 [Weiss, 1998; cf. also Rodrik, 2000]. It seems that the new approach adopted by the Indian Government in recent years implies a move - though a modest one - in these directions.

India's industrial and overall economic development depend critically on further reform that extents beyond the declaration of policies and addresses procedural and institutional obstacles. It also depends on successful implementation of a national development strategy that facilitates and orchestrates 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 is argued here is that Indian authorities 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, 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 coordinating national development efforts.

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