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The Initial Formulation of Industrial Policy

The Statement of Industrial Policy of 1945

The problems of industrialization and the principal objectives of industrial planning in India are set forth in the Industrial Policy Resolution of 1948 (IPR of 1948)[1] and the revised Industrial Policy Resolution of 1956 (IPR of 1956).[2] Both set down the fundamentals for planned economic development with a strong ideological orientation. It is generally understood that the IPR of 1948 and the IPR of 1956, the latter in particular which was issued after the Parliament accepted the "socialist pattern of society" in December 1954 as the objective of social and economic policies, instituted the industrial development system in India. This understanding is acceptable if one's viewpoint is confined to the post-independence era. It is true that the resolutions of 1948 and 1956 officially determined the direction of India's industrial policy. They officially committed India to state intervention in the economy to achieve a certain pattern of industrial development and a certain manner of utilization of resources.[3]

These two resolutions came forth directly from the historical, political, and economic circumstances surrounding the struggle for independence. However these resolutions were not the first statements on industrial development strategy for India. The IPR of 1948 had been preceded by the Statement of Industrial Policy of 1945 (SIP of 1945)[4] issued by the Planning and Development Department in April of that year. The SIP of 1945 was the first comprehensive proposal for industrial development strategy issued by the government, and for this reason the content of this statement needs to be examined before looking at the IPR of the 1948 and the IPR of 1956.

The SIP of 1945 brought a new, explicit approach toward economic policy.

It called for government control over twenty key industries. Here was laid down the ideas for the division and controlling of industries which became characteristic of the later periods. Control meant government control over national resources and the private sector. Division meant the division of industries between public and private sectors and also within the private sector itself. The SIP of 1945 also advocated that basic industries of national importance were to be nationalized if adequate private capital for their development was not forthcoming.

The SIP of 1945 gave two reasons why government needed to be involved directly in the economy. "In the first place, the general economic policy pursued by the Government of India under their own constitutional powers exercises a profound influence over industrial development....In the second place, the progress of planning has made it abundantly clear that certain industries must be taken over under central control in the interest of coordinated development."[5] These two reasons support two ideas. One is that the central government should have power and influence over industrial development, and the second is that the government should take over certain industries. The former idea could be interpreted as an intentional departure from the concept set forth in the Government of India Act of 1935 which stated that the development of industries was a provincial matter, with the proviso that the central government could by law take control of certain industries for the public good. Since this proviso was not actually exercised, it was a common understanding that the development of industries was fundamentally a provincial responsibility.

The takeover of certain industries as called for by the SIP of 1945 was to take place after consultation with the provinces and leading Indian states. The twenty industries suggested for takeover were:

1. iron and steel,
2. manufacturing of prime movers,
3. automobiles and tractors and transport vehicles,
4. aircraft manufacturing,
5. shipbuilding and marine engineering,
6. electrical machinery,
7. heavy machinery, such as textiles, sugar, paper, mining, cement, and chemicals,
8. machine tools,
9. heavy chemicals and fine chemicals, chemical dyes, fertilizers, and pharmaceutical drugs,
10. electrochemical industry,
11. cotton and woolen textiles,
12. cement,
13. power and industrial alcohol,
14. sugar,
15. motor and aviation fuel,

16. rubber manufacturing,
17. nonferrous metals industry,
18. electric power,
19. coal, and
20. radio engineering.

The SIP of 1945 was a declaration of the government's determination to take positive steps toward rapid industrialization. It attached particular importance to the above industries which were mostly heavy industries and which were expected to contribute to the foundation of a modern industrial economy in India. The objectives and the approach embodied in the SIP of 1945 were further elaborated in the IPRs of 1948 and 1956.

The SIP of 1945 stated that basic industries whose promotion were regarded as essential to the national interest would be nationalized if adequate private capital was not forthcoming. Besides stressing the need for state control over heavy and basic industries, the SIP of 1945 called for controls over capital issue, controls over industrial enterprises through licensing, and controls over regional industrial concentration. It also proposed the setting up of a system of targets to determine the volume of capital flowing into excessive profits.

To better understand this strong inclination toward state control over the economy, we need to look at other political resolutions and documents reflecting the debate over development policy which led up to the SIP of 1945. In the next section, the trend of this debate will be examined through several important documents.

Political Resolutions and Declarations That Set the Stage for Post-Independent Policies

Prior to the SIP of 1945, there were several political resolutions and declarations which were important antecedents to the formulation of later industrial policy. I am going to take up three of these to show that the process of formulating industrial policy started before independence and became caught up in the political debate during the struggle for independence.

In 1931, a decade and a half before the SIP of 1945, the Karachi Session of the Congress Party passed a resolution called the "Fundamental Rights and Economic Programme" which advocated state control over key industries in order to attain economic freedom.[6] The same tone was expressed more explicitly at a meeting of the Congress Party's National Planning Committee held in 1938. The meeting declared the need for state ownership or control over key industries in order to pursue the objective of raising income and attaining national self-sufficiency. The committee also concluded that the establishment of heavy and basic industries was a strategic requirement in any plan for industrialization.

Thus as early as the 1930s a consensus had already been reached among political leaders over economic strategy which appeared clearly in the policies, plans, and measures that were carried out after independence. It is interesting and important to note that there existed in these early declarations the idea of linking state ownership or control of key industries with economic growth and self-sufficiency. It is possible to see in this idea the beginnings of government strategy which would be used later to justify nationalization and state intervention as desirable steps for the "common good." Also interesting is the importance placed on state development of heavy and basic industries as an effective measure for planned industrialization.

A similar approach was advocated in a proposal for economic development produced by a number of leading industrialists in 1944. The proposal was called "A Plan of Economic Development for India," and was popularly known as the "Bombay Plan."[7] This plan was presented at a time when the spirit of Indian nationalism was running high, and the Congress Party was expected to fulfill the people's aspiration for independence. The Bombay Plan was an expression of the cordial relationship existing between industrialists and politicians at the time; and it was because of this relationship that the ideas and substance of the Bombay Plan did not differ greatly from the policies and plans set forth in the SIP of 1945 or from those in the early period after independence.

However this cordial relationship quickly soured after independence, particularly at the end of 1947 when the All India Congress Committee approved a resolution known as the "Objectives and Economic Programme." This resolution called for a ceiling on incomes and landholdings, recommended that industries producing articles of food, clothing, and other consumer goods be kept in the small-scale sector, and proposed strict controls over large-scale industry. It went on to say that the process of transferring existing large enterprises from private to public ownership should be commenced within five years.

The resolution brought outrage and indignation from private entrepreneurs. The fact that the IPR of 1948 took a milder stand on private industry and its nationalization can be taken as a response to the sharp reaction from private industry. The difference in tone between the IPR of 1948 and the 1947 resolution is remarkable. It reveals the sharp conflicts between politicians and industrialists over the role of government in industrial development.

The Industrial Policy Resolution of 1948

The Industrial Policy Resolution of 1948 was adopted by the Parliament on April 6, 1948. It was the first official resolution on industrial policy after independence. The resolution emphasized the need for the state to play a progressively more active role in the development of industries. The most striking part of the resolution was its decision that India should have a divided economy with some industries reserved only for public sector investment and production while others would be open to the private sector. It delineated areas of public sector and private sector investment. The government reserved for itself the manufacture of arms and ammunition, the production and control of atomic energy, and the ownership and management of railway transport. Another six industries were set aside as the exclusive responsibility of the state.[8] These six were:

1. coal,
2. iron and steel,
3. aircraft manufacturing,
4. shipbuilding,
5. manufacturing of telephone, telegraph, and wireless equipment, excluding radio receiving sets, and
6. mineral oils.

It should be noted however that the resolution did not reject private investment in the above industries. It allowed that the state could secure the cooperation of private enterprise if it was deemed necessary to the "national interest."

Another eighteen industries were identified for government regulation and control. These industries were regarded as important for the whole nation and needing considerable investment or a high degree of technical skill; therefore their establishment was to be governed by the state. These were:

1. salt,
2. automobiles and tractors,
3. prime movers,
4. electric engineering,
5. other heavy machinery,
6. machine tools,
7. heavy chemicals, fertilizers, and pharmaceuticals and drugs,
8. electrochemical industries,
9. nonferrous metals,
10. rubber manufactures,
11. power and industrial alcohol,
12. cotton and woolen textiles,
13. cement,
14. sugar,
15. paper and newsprint,
16. air and sea transport,
17. minerals, and
18. industries related to defense.

The remaining non-designated areas were left to private enterprises with the proviso that the government could intervene when it felt necessary.

The list of industries reserved for government regulation and control is a strange mixture of heavy and light industries along with capital goods and consumer goods industries, the former tending to be more frequently represented. The list was basically the same as the list of industries reserved for the state drawn up in the SIP of 1945, but there were modifications. The IPR of 1948 had two lists of industries in addition to the sectors of industries which were reserved for the government. The first list of industries came under the exclusive responsibility of the government. The second list was under government regulation and control. Most industries on the SIP of 1945 list were put on either the first or second list in the IPR of 1948. While several industries such as transport vehicles other than automobiles and tractors and marine engineering which were on the list of the SIP of 1945, were dropped from the IPR of 1948, new industries such as the manufacture of telephone, telegraph, and wireless equipment were added to the first list, and salt, paper and newsprint, air and sea transport, minerals, and industries related to defense were added to the second list of the IPR of 1948.

When looking at these lists, one finds it difficult to understand the criteria used for dividing industries into three categories. There was insufficient explanation of the method and logic used for classifying industries, and there was no satisfactory reason why certain industries were listed while others were not or why certain industries were put on one or the other list. Given the nature and function of each industry, one can easily imagine the enormous difficulties the economy had to face within this framework of industrial division and classification.

The IPR of 1948 was formulated in an atmosphere heavy with ideology. The policymakers were convinced that the division of industries between private and public sectors was as or even more important than the coordinated functioning of industries. In other words, they thought that government intervention in the economic process to mitigate undesirable effects would compensate for any reduction in industrial coordination which is crucially important for well-functioning industrial activity.

Moreover there were few people who could foretell the exact problems which would eventually emerge from the negative features of the new economic policy. This handicapped industry later on since the classifications and divisions set down by the policy tended to be rigid and inflexible while industrial activity continually demanded a more pliable approach from the government. Thus, from the beginning, Indian industrial policy was burdened with the problem of trying to coordinate the activity of many different industries divided among various categories, and trying to maintain the smooth functioning of an industrial economy which was expected to develop as a mixed economy. This problem was carried over and exacerbated in the 1950s with the IPR of 1956. This resolution increased official rigidity in classifying industrial development and categorizing industries.

A look at the political background of these years explains the reason for this increasing rigidity. The IPR of 1948 became completely caught up in the heated debate then going on between the conservatives and radicals in the Congress Party over what Hanson called the "principled decision."[9] Some statements in the IPR of 1948 reveal this debates. For example, the resolution stated that "the mere distribution of existing wealth would make no essential difference to the people and would merely mean the distribution of poverty."[10] Here is a trace of pragmatism surrounded by overwhelming idealistic eagerness. Another interesting point was in reference to nationalization. The resolution said that, while the government claimed the right to take over any industrial unit within the industries of its exclusive responsibility, it would allow enterprises in these industries to develop for a period of ten years, during which time they could run all facilities. There was no call for them to terminate or prepare to terminate their business within this period. At the end of the ten years, the matter was to be reviewed and dealt with "in the light of circumstances obtaining at the time."[11] This kind of ambivalence could easily undermine the efforts at nationalization. Moreover, as noted earlier, the IPR of 1948 contained statements clearly showing that the government did not intend to reject private investment in the industries it was responsible for. Such ambivalence toward nationalization indicates a profound confusion and lack of consensus over the issue. The cause of this ambivalence has been summed up by Marathe. He says that the IPR of 1948 reflected a rather delicate political balance between the younger more radical elements in the Congress Party who followed the socioeconomic predilections of Jawaharlal Nehru, and the cautious and basically conservative approach of Sardar Vallabhbhai Patel and many others of the old guard.[12] Over time the balance shifted toward the former, especially after the death of Patel in 1950. This shift can be seen in the IPR of 1956.

The IPR of 1948 also brought up the matter of cottage and small-scale industries, an issue not raised in the SIP of 1945. These industries continued to be treated separately in successive policies as though they were an independent industrial sector unrelated to other industries. This attitude toward cottage and small-scale industries started with the IPR of 1948 and intensified thereafter causing serious defects in industrial development policy later on. This problem will be discussed in a later chapter.

The Industries (Development and Regulation) Act of 1951

As a first step in implementing important parts of the IPR of 1948, the Industries (Development and Control) Bill was introduced into the Legislature in 1949. The object of the bill was to create a suitable legislative framework for implementing the industrial policy set down in the IPR of 1948.[13] It declared certain basic industries of national importance, provided machinery for their development, and established a framework for the licensing and regulation of industrial investment. It also demarcated spheres for public and private enterprise. The important provisions of the bill were:

(1) No new industrial unit could be established nor substantial extension to existing plants made without a license from the central government; and while granting licenses for new enterprises, the government could if necessary lay down conditions regarding location, minimum size, and so on.

(2) The government could make investigations into certain specified industries or enterprises in industries: (a) which showed a fall in production, a deterioration in the quality of the product, a rise in the price of the product; (b) which used resources of national importance; and (c) which were managed in a manner likely to harm the interests of shareholders or consumers. The government could issue instructions for rectifying the drawbacks.

(3) The government could take over the management of enterprises which failed to carry out its instructions for improving management and policies.

The bill was expected to help planning for industrial development on a national basis with the use of licensing as an effective way to regulate and promote investment. The bill became law as the Industries (Development and Regulation) Act of 1951 (the IDRA). It was enacted after the appointment of the Planning Commission, but before the First Five Year Plan had been finalized.

There has been a lot of debate and discussion over the IDRA. It is one of the most important documents concerning India's industrial development; however the basic direction it set for executing industrial policy involved numerous contradictions, some were referred to above, and these inevitably posed difficult problems especially in such areas as the classification of industries, the role of the public sector in the economy, the promotion as well as restriction of private sector industries, the reservation of certain industries to certain sectors, etc. At the same time no clear directions were laid down about the operation of its regulatory provisions within the overall framework of the national plan. The shortcomings in the IDRA created many inadequacies that later reduced its effectiveness.[14]

The IDRA of 1951 was enacted in order to pursue the IPR of 1948, and the main objectives of industrial policy it sought to achieve were:

1. the regulation of industrial development and canalizing of resources according to planned priorities and targets,
2. avoidance of monopolies and preventing concentrations of wealth,
3. protecting small-scale industries against undue competition from large-scale industries,
4. the encouragement of new entrepreneurs to establish industries,
5. the distribution of industrial development around the country on a more widespread basis, and
6. fostering technology and economic improvement in industries through economies of scale and the adoption of modern processes.[15]

The First Schedule to the IDRA was composed of thirty-eight articles and listed certain industries which were called "scheduled industries." This listing was based largely on the list of the IPR of 1948.[16] Licenses were to be obtained from the government to manufacture specific articles listed in the schedule. Under the IDRA, it became necessary to obtain a license for:

1. establishing a new industrial enterprise,[17]
2. an existing industrial enterprise to take up the manufacture of a "new article" which was defined in the act,[18]

3. substantially expanding the capacity of an industrial enterprise in an existing line of manufacture,[19]
4. carrying on the business of an existing industrial enterprise which was originally exempt from the licensing provisions of the act but which later lost this exemption,[20] and
5. changing the location of an existing industrial enterprise.[21]

The phrase "substantial expansion" in Clause 3 was interpreted to mean an addition of more than 10 per cent to licensed capacity.[22] However a precise meaning of "substantial expansion" as well as what constituted "new articles" in Clause 2 was not set down clearly enough in the IDRA to prevent confusion and close loopholes. This resulted in a great deal of criticism over the "definition" and "non-definition" of these terms. Some critics rightly conclude that it was difficult to draw a clear line between manufacturing a new article and expanding substantially.[23]

Industrial licensing was not required for investment by manufacturers in the scheduled industries with total fixed assets not exceeding 500,000 rupees.[24]

One of the noticeable results of the IDRA was that it took responsibility and power over industrial regulation, control, and development from the hands of the state governments and put it into those of the central government. Since most industries were brought under this act, "something like a constitutional revolution took place, by virtually making industry a Central subject rather than a State subject as envisaged in the Constitution."[25] There was another outcome that emerged from the act. As Hazari observed, "under the IDRA, only the Central Government and specified Governments are exempted from licensing. State Governments and public sector corporate bodies have to apply for licenses in the normal course. The procedure for considering proposals from such applicants is not uniform. Apparently, many of the larger investment proposals do not come before the Licensing Committee."[26]

The IDRA gave birth to an intricate system of applying and granting licenses. The system grew more complicated over time as various modifications were made; categories acquired a growing number of subcategories, and exemptions from licensing obligations multiplied.

The Licensing Committee as an inter-ministerial unit was set up in September 1952 to give final clearance to applications for industrial licenses under the IDRA. An application had to be recommended by the ministry concerned before being sent to the Licensing Committee. Until November 1956, all licensing applications had been placed before the Licensing Committee. Subsequently, procedures were modified to allow approval of certain categories of applications by other authorities so as to lighten the burden on the Licensing Committee. After 1964 it became the practice of the Licensing Committee to initially issue a letter of intent valid for a specific period, then after completion of various preliminaries, to approve a license.[27]

As India's foreign exchange difficulties increased, a special procedure for the import of capital goods was introduced in January 1957. Licenses for such imports were to be examined by a new committee called the Capital Goods Committee. Since that time "licensing has also sought (more at the Capital Goods Committee than the Licensing Committee stage) to keep the volume of projected investment within the available resources of foreign exchange and/or to utilize available foreign credit."[28] Then "to reduce the burden of work on this committee, another committee (curiously known as the ad hoc Capital Goods Committee) was formed under the Chairmanship of the Chief Controller of Imports and Exports."[29] This ad hoc Capital Goods Committee was concerned with proposals for imports not exceeding 2 million rupees in value from rupee payment areas and imports from other areas up to 500,000 rupees in value.

A Directorate General of Technical Development (DGTD) was set up to examine the technical aspects of applications for industrial licenses.[30] The new directorate appraised the techno-economic aspects of an application according to the following criteria:

1. how much need there was for more capacity in the item(s) of production proposed in the application, taking into consideration also the import substitution and export possibilities,
2. the technical soundness of the proposed scheme,
3. whether the capacity asked for by the entrepreneur was commensurate with the capital goods to be installed, taking into consideration the capital goods which the producer already possessed,
4. whether the scheme as submitted or as modified through discussion with the DGTD would achieve maximum possible indigenous content within a reasonable time,
5. whether the plant to be installed and/or method of manufacture to be adopted was modern and economic, and
6. whether the location of production was suitable for economic viability and the disposal of production waste.

Based on the above criteria, the DGTD would recommend to the Licensing Committee either acceptance or rejection of the application.[31]

The central provision of the IDRA was that specific approval of the central government in the form of an industrial license was required for establishing any new industrial enterprise or substantial expansion of an existing enterprise in specified industrial sectors. This basic feature of the act has been retained since its enactment, but licensing procedures have undergone various modifications. As explained earlier, these modifications took the form of setting up more clearing authorities at various stages and adding newer and more elaborate regulations to the IDRA. Thus the process moved toward complicating rather than simplifying procedures and yielded little or nothing in the way of positive effects on policy objectives. Apart from the general criticism about delays or complicated procedures, there were serious arguments that the licensing policy was not effectively working to allocate and utilize resources or to check monopolistic tendencies.

A more fundamental question was raised by Hanson and others who argued that the adoption of a quantitative target system of planning led to the elimination of domestic competition. Hanson has argued that the Licensing Committee, even while attempting to eliminate monopolistic tendencies by encouraging new entrants and favoring smaller enterprises, created monopolies or at least oligopolies by its policy of trying to relate capacity to potential availability and demand. As the result, Indian industry was "feather bedded" to such an extent that a producer who failed to make a profit had to be spectacularly inefficient, even by the rather low Indian standards of efficiency.[32]

The licensing policy was supposed to operate based on criteria set by other agencies such as the Planning Commission. But Bhagwati and Desai have argued that a serious deficiency in licensing policy was the lack of criteria for dealing with applicants. They raised two essential questions: (1) what criteria were defined to deal with the applications; and (2) whether these were systematically employed in practice. They gave negative answers to both questions. Their study showed that the Licensing Committee operated essentially in an "ad hoc" manner. It provided no clear statements nor criteria which applicants could rely on to assess their chances of getting licenses and thereby plan more effectively.[33] Some might argue that Bhagwati and Desai have been too critical, but the point of their argument cannot be overlooked that India's licensing policy has created serious distortions in the economy by eliminating competition.

The Industrial Policy Resolution of 1956

In April 1956, the government issued a new industrial policy resolution, the IPR of 1956, which has been one of the most important policy documents related to Indian industry. The new resolution came out after the Indian Parliament's historic declaration that the "socialist pattern of society" should be the objective of social and economic policy. Although the new resolution was structurally similar to the IPR of 1948, it had a strong ideological orientation and was more elaborate and more committed to attaining a socialistic pattern of development under the undisputed leadership of Nehru.[34]

The IPR of 1956 explained the government's reason for the need to revise the IPR of 1948, stating that it had been brought about by the changes and developments which had taken place in India since 1948. The Constitution of India had been enacted in 1950, guaranteeing Fundamental Rights and enunciating the Directive Principles of State Policy. Economic planning had proceeded on an organized basis, and the First Five Year Plan (1951–56) had been completed. These important developments necessitated a fresh statement on industrial policy in conjunction with the Second Five Year Plan (1956–61) which was to be enacted.

The Second Five Year Plan period showed a marked shift in favor of capital goods industries under the influence of the model developed by P.C. Mahalano-

TABLE 1-1
DISTRIBUTION OF OUTLAYS IN THE PUBLIC SECTOR

(Rs. 1 million)

	First Five Year Plan Expenditures		Second Five Year Plan Expenditures	
	Value	%	Value	%
Agriculture and community development	2,910	14.8	5,300	11.5
Major and medium irrigation	3,100	15.8	4,200	9.1
Power	2,600	13.3	4,450	9.7
Village and small industries	430	2.2	1,750	3.8
Industries and minerals	740	3.8	9,000	19.6
Transport and communications	5,230	26.7	13,000	28.3
Social services and miscellaneous	4,590	23.4	8,300	18.0
Total	19,600	100.0	46,000	100.0

Source: Government of India, Planning Commission, *Third Five Year Plan* (1961), p. 33.

bis.[35] According to the model capital goods industries were to increase the capacity for capital formation, thus raising the general level of industrialization which was to make India independent of foreign imports of producer goods. Other industrial sectors including labor-intensive household industries were expected to produce consumer goods, but it was felt that the manufacture of consumer goods by non-household industries should be curbed until employment pressure was eliminated.[36] Table 1-1 shows the planned distribution of outlays in the public sector for the First and Second Five Year Plans. The drastic changes in distribution of outlays reflect the changes in emphasis between the two plans. The first plan placed relatively greater stress on programs for agriculture and irrigation which comprised 31 per cent of planned outlays. The second plan put greater emphasis on industrial development, and the relative share for industries and minerals increased from 4 per cent in the first plan to 20 per cent.

The IPR of 1956 declared that industrial policy had to be governed by the principle laid down in the Constitution, by the "objective of socialism,"[37] and by the experience gained during the years since independence.[38] The IPR of 1956 offered a wider scope of initiatives for the public sector than the IPR of 1948 had, and stated that "all industries of basic and strategic importance, or in nature of public utilities, should be in the public sector," and "other industries which were essential and required investment on a scale which only the state in present circumstances could provide had also to be in the public sector."[39]

Industries were classified into three categories as in the IPR of 1948, but the list of industries falling under state responsibility was larger than in the earlier IPR. The first category consisted of industries whose future development was to be the exclusive responsibility of the state; the second consisted of those industries which would progressively become state-owned and in which the state was generally expected to take the initiative in establishing new enterprises; and the third category of industries was left for the private sector. The first category was listed in Schedule A and consisted of the following industries:

1. arms, ammunition, and related items of defense equipment,
2. atomic energy,
3. iron and steel,
4. heavy casting and forging of iron and steel,
5. heavy plants and machinery required for iron and steel production, for mining, for machine tool manufacturing, and for such other basic industries as may be specified by the central government,
6. heavy electrical plants including large hydraulic and steam turbines,
7. coal and lignite,
8. mineral oils,
9. mining of iron ores, manganese ore, chrome ore, gypsum, sulphur, gold, and diamonds,
10. mining and processing of copper, lead, zinc, tin, molybdenum, and wolfram,
11. minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953,
12. aircraft,
13. air transport,
14. railway transport,
15. shipbuilding,
16. telephones and telephone cables, telegraph and wireless equipment (excluding radio receiving sets), and
17. generation and distribution of electricity.[40]

Most of the industries listed in this category were those needing heavy capital investment and the gestation periods were usually long.

All new enterprises set up in industries in Schedule A, except where their establishment in the private sector had already been approved, were to be set up only by the state. But the IPR of 1956 reaffirmed that this did not preclude the expansion of existing privately owned enterprises, nor the possibility of the state securing the cooperation of private enterprises in the establishment of new enterprises when the national interest so required. It said, however, that industries Nos. 1, 2, 13, and 14 were to be developed as central government monopolies with only a minimum of private cooperation.

The industries in the second category were listed in Schedule B. These were:

1. all other minerals except "minor minerals" as defined in Section 3 of the Minerals Concession Rules, 1949,
2. aluminum and other nonferrous metals not included in Schedule A,
3. machine tools,
4. ferro-alloys and tool steels,
5. basic and intermediate products required by chemical industries such as the manufacture of drugs, dye stuffs and plastics,

6. antibiotics and other essential drugs,
7. fertilizers,
8. synthetic rubber,
9. carbonization of coal,
10. chemical pulp,
11. road transport, and
12. sea transport.[41]

The state was expected to play an increasing role in the establishment of new enterprises in the above industries. At the same time, private enterprise was also given the opportunity to develop in these fields.

While the IPR of 1948 allocated nine industries to the public sector, the IPR of 1956 allocated twenty-nine. While new industries were added, some industries on the list of the IPR of 1948 were divided into two or three or more in the IPR of 1956. So the enlarged list of the IPR of 1956 was, at best, something which explained the government emphasis on the public sector. Since the IPR of 1956 allowed the private sector to enter and stay in the industries reserved for the public sector, it was inevitable that the more the list was elaborated and specified, the more the areas of ambiguity grew. This phenomenon continued to grow with successive policies, and the tendency was to create more complex, elaborate procedures to close the loopholes created by the ambiguities. Thus as time went on, the industrial classification policy generated an increasing number of new categories and subcategories.

The overlapping involvement of state and private enterprise in industries added more ambiguity and invited arbitration. The IPR of 1956 permitted the state to start up any industry not included in Schedules A and B when the needs of planning so required or where there were other important reasons for doing so. At the same time privately owned enterprises were permitted in appropriate cases to produce any item falling within Schedule A as by-products to meet their own requirements.

It is necessary to understand the nature of the relationship between the public sector and private sector proposed in the IPR of 1956 in order to follow the changes that came later. The IPR of 1956 stated that it considered the public and private sectors as mutually complementary, not mutually exclusive, and also that it recognized the growth of the private sector as essential for the industrial structure of the economy. But it was the same IPR that divided the industries into different categories and adopted different strategies for each category, and which defined the relationships among the various industrial sectors in vague, ambiguous terms. There were many industries where private sector entry and coexistence was allowed. These included electrical equipment, heavy engineering, machine tools, oil refining, fertilizers, aluminum, copper, drugs and pharmaceuticals, precision instrument, and shipbuilding. Since the private sector was already established in these industries, it was practical and realistic to allow it to continue. But over time the mutual complementing of state and private sectors increasingly tended to become a formality rather than a fact. As new industrial areas, like petrochemicals and electronics, opened up with the advancement of the development process, they were often reserved for the public sector as industries of crucial national importance.[42]

The reasons and rationality for dividing industries into three categories were neither fully explained nor convincing. The vagueness in terms and ambiguity in explanations contrasted strongly against the rigidity that divided the categories. The development strategy based on these divisions was accepted unconditionally in the IPR of 1956 and was carried out through a process that created a more elaborate and complicated system of classification.

The development of third category industries, those not included in Schedules A and B, was left open to the private sector, but the IPR of 1956 reiterated that industrial units in the private sector were subject to the controls and regulations under the Industries (Development and Regulation) Act of 1951 and other legislation which basically restricted the private sector.

The IPR of 1956 placed the private sector under central government responsibility by stating that "the division of responsibility between the central government and state governments in regard to industries had been set in the IDRA." Since it was the central government which enforced the IDRA, it was a clear departure from the stand taken in the IPR of 1948 which included the state governments in the "state," and also an apparent step to concentrate more power over the economy in the central government. Thus the IPR of 1956 emphasized that it was the central government which was to bear responsibility for the economy and control all economic activity.

However there was also a pragmatic side to the IPR of 1956 which should not be ignored, especially toward industries in the private sector. The IPR stated that while the private sector had to follow the norms set by the government, it was desirable to allow private enterprises to develop with as much freedom as possible, consistent with the targets and objectives of national planning. It also said that when privately and publicly owned enterprises existed in the same industry, it would continue to be the policy of government to give fair and non-discriminatory treatment to both. It further said that the division of industries into separate categories did not imply that they were placed in "water-tight compartment."[43] The framers of the IPR of 1956 were well aware that there would be areas of overlapping as well as a great deal of dovetailing between industries in the private and public sectors. Another point of pragmatism in the IPR of 1956 was the matter of nationalizing important private enterprises. This idea had been raised in the IPR of 1948 but was totally abandoned in the IPR of 1956. Because of this, Hanson declared that the IPR of 1956 was "less socialist" than the IPR of 1948.[44]

This acquiescent attitude toward the private sector seems to have been based on a realistic assumption about the economic condition of the country and on a pragmatic approach toward industrial development. There was no denying that a strong industrial base built up by the private sector already existed, at least in some areas, and this well-established private sector had no intention of being shut down in the name of nationalization or weighed down by state controls and regulations. But the pragmatism expressed in the IPR of 1956 fell victim to the growing rigidity and complexity of the industrial classification system as well as to the growing ideological belief in state control and intervention. As a result, more and more discretionary power moved into the hands of the bureaucracy to give or deny approval and favorable treatment to industrial enterprises. Later on, there came to be many instances of industrial proposals receiving individual treatment to circumvent or avoid the over-regulated nature of industrial policy. Many cases of favorable treatment for certain industries was based on ostensibly feeble reasons which implied political involvement in the decision-making.

Up to this point I have been presenting my view of India's industrial policy based on the contradictions between pragmatism and ideology. However there are other ways of looking at this policy and its implications. Marathe, for example, commented that "over a period of time, the trend was towards the State entering areas not specially reserved for it....But there was no corresponding flexibility with regard to the private sector being permitted to produce items included in Schedule A."[45] In his view this was in part a reflection of the political climate, but also a reflection of the political and administrative system becoming increasingly conscious of the advantages of greater control over and participation in industrial activity by the government.[46] Having long worked as a bureaucrat, Marathe's argument seems convincing, however he fails to explain the interrelationship between the political and administrative system on the one hand and the reality of the market mechanism on the other.

Marathe's view about the government's lack of flexibility toward the private sector is contested by others who stand against the economic concentration. Chaudhuri points out that "of the seventeen industries listed in Schedule A of the IPR, seven at least had been opened to private interests since 1958 or thereabout. They included arms, heavy plants and machinery all licensed early in 1959. The already substantial private sector in heavy electrical plants was further strengthened early in 1959."[47] While his analysis seems to be based on a too rigid understanding of the IPR of 1956, his argument proves the presence of a kind of ambivalence or pragmatism in policy implementation.

Similar arguments have been made by others. Rangnekar uses the examples of coal, oil, fertilizers, chemicals, and engineering to show that licenses were issued to private sector enterprises in areas which were exclusively reserved for state ownership and state control or where further expansion was intended to be in the public sector.[48] This inconsistent application of policy was, in Rangnekar's view, because "the policy and goals had not been strictly adhered to and deviation from prescribed norms were not uncommon. The loopholes and exemptions were indeed more readily available to the administration and businessmen," thus "the government belatedly recognized these loopholes during the period of the Second Five Year Plan and started to make modifications."[49]

I do not fully accept the nonadherence theory proposed by Rangnekar, nor Chaudhuri's noncommitment theory, nor Marathe's take-advantage theory. What these critics and analysts seems to have forgot is the nature of the policy itself. There were serious deficiencies in the fundamental makeup of the IPR of 1956 as a policy statement. It showed no regard for the economic rationality or for the concept of comparative economic advantage. The primacy of the state and the role of the state sector was never questioned. It was accepted a priori as fundamental to economic policy, thereby ignoring huge areas of the economy where reliance on the private sector was crucial and even indispensable. The iron and steel industries and coal industries are good examples of sectors which were reserved for the state without due regard for economic rationality or comparative advantage. Moreover there was no clause or statement in the IPR of 1956 calling for a review of policy within a prescribed period of time. Lack of such a time limit allowed the government to procrastinate and evade decisions about the direction of long-term economic and social development.

With such deficiencies, the policy was sure to run into difficulties as soon as it had to face economic reality. Many difficulties became apparent as the gap between the proclaimed objectives of the policy and the achievements of the Second Five Year Plan (1956–61) was widened along with the implementation of the industrialization program based on the IPR of 1956. The IPR envisaged a substantial expansion of the public sector, and the most impressive achievement during the Second Five Year Plan was the setting up of three state-run steel mills, each having 1 million tonnes ingot capacity.[50] At the same time in the private sector, the Tata Iron and Steel Co. and the Indian Iron and Steel Co. were modernized and expanded, providing an additional capacity of 10.5 million tonnes. In this regard, Chaudhuri rightly concluded that "the government never felt itself fully committed to a rigorous implementation [of the IPR of 1956]....The policy resolution worked in a manner as to cause the least difficulty to the growth and expansion of organized private enterprise,"[51] because economic reality did not allow government to adhere strictly to the IPR of 1956.

The contradiction between ideology and reality produced other snags in the policy. While the controls on industries tended to be influenced more by idealistic preference, the implementation of policy could not escape from the real economic conditions prevailing in the country, or from the fact that industries had already developed to a stage where it was virtually impossible to divide and classify them into clear-cut sectors.

Even later on as industrial policy was modified, the fundamental contradiction between ideology and reality remained because the basic approach, i.e., the development of industries within the framework of a mixed economy having public and private sectors and industries set into divisions and classifications, was never questioned at the policymaking level. The basic principles of industrial policy were left in place and never thoroughly reexamined even after policy became bent and modified by economic reality. The inevitable result was the countless incongruities and ad hoc corrective measures that came to characterize Indian industrial policy.

All those problems seem to be derived from the basic position of the planners at that time. As Chakravarty stated, the planners of the time basically subscribed to a supply side view of the planning problem. The argument that domestic demand could possibly be a constraint on the growth process was not even mentioned as a hypothesis that needed to be rejected. The reason was the belief that with an active investment policy, all possible slack in the economic system would be utilized. Chakravarty points out that what mattered most to the planners was the growth in the aggregate level of investment, and the growth process was unlikely to lose steam so long as public investment was growing at a fast pace.[52]

There are several other points I would like to raise about the IPR of 1956. One regards small-scale industries. The IPR of 1956 envisaged the encouragement of cottage, village, and small-scale industries in various ways, including restrictions on the expansion of large-scale enterprises. This issue will be discussed in another chapter. Another point concerns the problem of foreign exchange. The IPR of 1956 only stated that "the Prime Minister, in his statement in Parliament on the 16th of April 1949, had enunciated the policy of the state in regard to foreign capital. It is, therefore, not necessary to deal with these subjects in this resolution."[53] This gives the impression that the government was deliberately trying to be as vague as possible. It would have been more reasonable for the government to present a concrete proposal on the matter of foreign exchange and foreign investment. A third point concerns the development of industrial technology. The IPR of 1956 failed to produce any vision for such development. This was true not only of the IPR of 1956 but of other policies also. The absence of serious debate on the development of industrial technology within the wider policy framework for economic development is one of the conspicuous characteristics of Indian industrial policy, although on many occasions the importance of technology has been emphasized.[54]

Notes

1 Government of India, Industrial Policy Resolution, 1948 (hereafter the IPR of 1948). The text of the resolution is reprinted in the Appendix 1 ("Government of India Resolution on Industrial Policy, 6 April 1948") in *Essays on Industrial Policy*, by R.K. Hazari (New Delhi: Concept Publishing Company, 1986), pp.119–26.

2 Government of India, Industrial Policy Resolution, 1956 (hereafter the IPR of 1956). The text of the resolution is reprinted in *Programmes of Industrial Development, 1956–61*, by Planning Commission, Government of India (1956).

3 Many studies have been done on Indian industrial development policy and its industrialization. Below are some of the works done by Japanese scholars in Japanese. Masanori Koga, "Indo no kokuyu bumon (1 & 2)" [The public sector in India (parts 1 & 2)], *Keizaigaku zasshi* (Osaka), Vol.52, No.1 and No.2 (January and February 1965). Hideki Esho, *Gendai Indo keizai kenkyū* [Study on contemporary Indian economy] (Tokyo: Hosei University Press, 1987). Shōji Itō, ed., *Indo no kōgyōka: kiro ni tatsu haikosuto keizai* [Industrialization of India: a high cost economy at the crossroad] (Tokyo: Institute of Developing Economies, 1988). Eiji Shimoyama and Hiroshi Sato, *Indo ni okeru sangyō tōsei to kyoka seido* [The industrial regulation and licensing system in India] (Tokyo: Institute of Developing Economies, 1986).

4 Government of India, Planning and Development Department, Statement of Industrial Policy, 1945 (hereafter the SIP of 1945). The text of the statement is reprinted in *Regulation and Development: The Indian Policy Experience of Controls over Industry*, by Sharad S. Marathe (New Delhi: Sage Publications, 1986).

5 SIP of 1945.

6 Principle No. 19 refers to the "control by the state of key industries and ownership of mineral resources." The Resolution of the Karachi Session of the Congress Party is reproduced in *Resolutions on Economic Policy and Programme, 1924 – 54*, by All India Congress Committee (New Delhi: Indian National Congress, 1954), pp.5 – 6.

7 Sir Purshotamdas Thakurdas et al., *A Brief Memorandum Outlining a Plan of Economic Development for India* (Bombay, 1944). The eight signatories to the Bombay Plan were representative of a wide cross-section of India's business world. They were Sir Purshotamdas Thakurdas, "King Cotton of Bombay"; J.R.D. Tata of the House of Jamsetji Tata; G.D. Birla, representing the second biggest business group in India; Sir Ardeshir Dalal, a Parsi stockbroker; Sir Shri Ram of the DCM complex of north India; Kasturbhai Lalbhai, the leading textile mill owner of Ahmedabad; A.D. Shroff, a Bombay stockbroker; and John Matthai, an economist and a Tata director. On the Bombay Plan, also see Rajat K. Ray, *Industrialization in India: Growth and Conflict in the Private Corporate Sector, 1914 – 47* (Delhi: Oxford University Press, 1979). According to Ray, the Bombay Plan was in favor of government control over enterprise at least in the initial stage of development. Ray also points out that the Bombay Plan grew out of the objections that Indian industrialists had over the Indian government's plans for war (ibid. p.334).

8 The state included the central, provincial, and former princely state governments as well as other public authorities like municipal corporations (IPR of 1948).

9 A.H. Hanson, *The Process of Planning: A Study of India's Five Year Plans, 1950 – 1964* (London: Oxford University Press, 1966), p.449.

10 IPR of 1948.

11 IPR of 1948.

12 Marathe, p.41.

13 The explanation given by the Ministry of Industry and Supply to the Select Committee of Parliament on 16 April 1949.

14 Government of India, Ministry of Industrial Development, *Report of the Industrial Licensing Policy Inquiry Committee,* Subimal Dutt, the Chairman (1969) (hereafter *Report of the Dutt Committee),* p.244. Also, Government of India, Planning Commission, *Final Report—Industrial Planning and Licensing Policy,* R.K. Hazari, the Chairman (1967) (hereafter *Hazari Report*).

15 *Hazari Report*, p.i.

16 When the list of industries was enlarged in the IPR of 1956, the additional twenty-five industries were included in the scheduled list to the IDRA in 1956. Each article in the list was further divided and specified into many sub-articles.
17 Section 11 of the IDRA.
18 Section 11A of the IDRA.
19 Section 13 of the IDRA.
20 Section 29B(2) of the IDRA.
21 Section 13 of the IDRA.
22 It was raised to 25 per cent from October 1966.
23 For example, the *Hazari Report* and the *Ninth Report of the Estimates Committee (1967–68)*, Fourth Lok Sabha (New Delhi: Lok Sabha Secretariat, 1967) (hereafter the *Ninth Report of the Estimates Committee*). Also, Bhagwati and Desai claim that a possible way to minimize such inefficiencies would have been to define substantial expansion in terms of investment rather than output, but clearly no thought was given to the matter. J.N. Bhagwati and Padma Desai, "Industrial Licensing," in *Aspects of Indian Economic Development,* ed. Pramit Chaudhuri (London: George Allen & Unwin, 1971), pp.250–52.
24 From February 1960, all industrial enterprises in the scheduled industries employing less than 100 workers and with fixed assets of less than 1 million rupees were exempted from licensing. In January 1964, this exemption limits was raised to fixed assets of less than 2.5 million rupees, and in February 1970 to 10 million rupees.
25 S. Bhoothalingam, "Review of Industrial Policy since Independence," in *Industrial Development of India: Policy and Problems,* ed. C.N. Vakil (New Delhi: Orient Longman, 1973), p.3.
26 *Hazari Report,* p.11.
27 *Hazari Report,* p.10, and *Report of the Dutt Committee,* p.33.
28 *Hazari Report,* p.17.
29 *Report of the Dutt Committee,* p.33.
30 The system of applying to the DGTD tended to cause delays. When a list of goods is long, the scrutiny procedure takes considerable time. When domestic capacity for the manufacture of an item is inadequate to meet total demands, and imports must be permitted to some extent, the process of referring to indigenous manufactures has to be taken in the first place. As applicants often preferred imports because of their lower cost, even though indigenous products were fully available, the role of the DGTD tended to shift more to controlling imports. Apart from this, the technical inability and insufficient information system of the DGTD has often been noted. For example, see the *Ninth Report of the Estimates Committee,* pp.207, 218–22, and also the *Hazari Report,* pp.19–20.
31 *Ninth Report of the Estimates Committee,* pp.200–201.
32 Hanson, ibid.
33 Bhagwati and Desai, "Industrial Licensing," pp.240–41.
34 The Resolution of the Avadi Session of the Congress Party in January 1955 pledged to establish a "socialistic pattern of society," while the parliamentary declaration of December 1954 had pledged a "socialist pattern of society."
35 P.C. Mahalanobis, "Some Observations on the Process of Growth of National Income," *Sankya,* Vol.12, Part 4 (September 1953); ditto, "The Approach of Operational Research to Planning in India," Vol.16, Parts 1 & 2 (December 1955). There

are two Mahalanobis models: the "two sector model" and the "four sector model." The former represents capital goods sector and another sector, the latter models the capital goods sector, factory production consumer goods sector, household production of consumer goods sector including agriculture, and the sector providing services such as health and education (J.N. Bhagwati and Sukhamoy Chakravarty, *Contributions to Indian Economic Analysis: A Survey* [Bombay: Lalvan Publishing House, 1971], p.12).

36 Hanson, pp.125–28.

37 IPR of 1956. According to Chaudhuri, this was only one of the few times that a major policy document of the government used the term "socialism" and not "socialistic or socialist pattern of society" as the objective (Asim Chaudhuri, *Private Economic Power in India: A Study in Genesis and Concentration* [New Delhi: People's Publishing House, 1975], p.51).

38 IPR of 1956.

39 IPR of 1956.

40 IPR of 1956.

41 IPR of 1956.

42 Bhoothalingam, p.9.

43 IPR of 1956.

44 Hanson, p.463.

45 Marathe, p.47.

46 Marathe, ibid.

47 Asim Chaudhuri, p.162.

48 D.K. Rangnekar, "Industrial Policy," in *India's Economic Policies, 1947–1977,* ed. J.N. Mongia, (New Delhi: Allied Publishers, 1980), pp.205–6.

49 Rangnekar, p.206.

50 These were at Bhilai, Rourkela, and Durgapur.

51 Asim Chaudhuri, p.149.

52 Sukhamoy Chakravarty, *Development Planning: The Indian Experience* (Delhi: Oxford University Press, 1988), p.11. Katano has critically reviewed various models and pointed out the insufficient considerations given to demand side aspects in India's development plans. Hikoji Katano, *Indo ni okeru keizai keikaku no riron* [Theory of economic planning in India] (Tokyo: Institute of Developing Economies, 1966).

53 IPR of 1956.

54 The government's "Technology Policy Statement" was not issued until 1983. Until then the Scientific Policy Resolution which had been announced in 1958 was considered the guideline for India's technology policy. But it should be noted that "science" and "technology" have totally different roles in economic development.