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# The 1980s—the Era of Liberalization

## Policy of Liberalization

The highly protective industrial policy of the past started to be reversed from the beginning of the 1980s. In general, the changes that took place were in the nature of modifying the existing policies and streamlining certain procedures. The process of the change was further accelerated under the leadership of Rajiv Gandhi who succeeded the prime minister's post when Indira Gandhi was assassinated in October 1984.

In retrospect, the main emphasis of government policy during the 1970s, especially during the latter half of the 1970s, was on reducing the restrictive and complex features of the licensing policy. But the overall institutional framework was treated as a given factor. This is the main reason why there should be a conscious effort to make a comparative study of India's development policies in order to analyze the nature of policies in the 1980s. In this chapter I am going to examine the new policies taking note of the aspects which differ from hitherto regulatory policies, especially noting the system of direct controls and the means of allocating resources. By doing so, it becomes possible to draw conclusions about the nature of industrial policy of India, highlighting its basic characteristics which have not been altered by the changes and modifications made to policy and, at the same time, make assumptions about the transitional aspects of industrial policy.

The 1980s were characterized by the large number of notes and notifications issued by the government. Most of these notes and notifications were directed at revising and modifying the existing policies. India's industry had been very well protected from international competition, partly through heavy import duties and partly through outright "bans." Orientation toward import substitution through administrative controls had produced industries lacking export capability. The extreme domestic orientation had a negative effect on exports. The closed domestic market offered ideal conditions for the oligopolist strategies of large affiliated groups. These tendencies were further intensified by the licensing policy. Even if they were not interested in implementing the licensed capacities, large-scale entrepreneurs "use" their preempted licenses for industrial goods markets to exclude troublesome competitors. Profits were increased through price manipulations rather than through cost reductions or qualitative improvements in supplies and standards.[1] The implementation of an import substitution approach, combined with the specific characteristics of India's industrial licensing, small-scale industry, and anti-monopoly policies, deprived India of many possibilities to take advantage of the development of its large internal industrial market by subsequently expanding exports of industrial products.[2]

Lack of export capacity, uneven product quality, fragmented production systems, lack of export incentives to some modern manufacturing firms, these deficiencies came to be felt very strongly, especially in the latter half of the 1970s. In the prevailing regulatory policy structure, it was only the political leadership which could take action to change the system. From the beginning of the 1980s, some aggressive measures started to be taken to stimulate industry, and these were implemented more aggressively in the latter half of the 1980s.

## The Statement on Industrial Policy of 1980

In 1980 the new Indira Gandhi government issued its own Statement on Industrial Policy (SIP of 1980),[3] which was characterized by its strong support for growth. Before looking at the SIP of 1980, I want to describe the state of the cconomy which compelled the government to take a growth conscious orientation.

In the latter half of the 1970s, the pace of India's economic growth was relatively smooth. The Fifth Five Year Plan (1974–79) had achieved a 5.2 per cent real annual GDP growth which surpassed the growth target of 4.4 per cent. The country enjoyed good agriculture production and a low rate of inflation, as well as a comparatively healthy balance of payments and an increased foreign exchange reserves thanks to increased remittance from Indian migrants living abroad and a comparatively good foreign trade performance.

However, in 1979, with the rise in international oil prices, the cost of imported oil and oil products rose sharply, and consumer prices showed a marked rise due to a severe drought which caused food shortages. At the same time, industrial production remained stagnant. The result was a big drop of $-4.8$ per cent in economic growth in 1979/80. The increase in oil prices and unfavorable weather conditions revealed the vulnerability of India's economic structure and forced the country to face up to the need to cope quickly with a worsening balance of payments.

With the hike in international oil prices, the cost of imported oil and oil products jumped.[4] At the same time, other imports also rose sharply, and with exports failing to keep pace, India's trade deficit showed a steep rise, while the balance of current accounts together with the balance of payments worsened. Even if India were to meet the immediate crisis with measures such as using some of its foreign exchange reserves accumulated during the 1970s, obtaining further foreign assistance, and relying on aggressive borrowing, some fundamental and long-term form of economic restructuring was necessary.

Improving the trade balance depended on increasing exports and holding down imports. Both required strengthening and expanding domestic production. Measures to cope with oil imports which accounted for 30–40 per cent of all imports, were crucial to hold down overall imports. Moreover, domestic production needed to be expanded to hold down large volumes of other imports such as iron and steel, cement, paper, fertilizers, and foodstuffs. Industries whose products would replace imports had been given high priority by successive governments, but progress had been slow. In fact, protective measures had the opposite effect of lowering technological and productive levels in many sectors.

Under these circumstances, to promote domestic industries as an alternative to imports, it was essential that productivity and the quality of goods be raised. But to do so, the bottlenecks in production had to be overcome in goods and services that were basic to the economy, such as electricity, coal, and transportation. Other pertinent issues involved the quality, cost, and availability of machinery and of basic industrial materials and products. There was also the problem of technology and capital availability. Consequently, India was faced with the need for a comprehensive program covering all the foregoing issues.

In July 1980 the government announced its industrial policy which was a strange mixture of political statements keen to show the government's eagerness to attain social justice in economic development but at the same time covertly supporting the resumption of the economy's uninterrupted growth through optimum utilization of existing capacity as well as expansion of industries. A feature of the SIP of 1980 was the pledge to relax production controls on private enterprises, although the SIP reaffirmed the principles of the IPR of 1956.

The SIP of 1980 set forth the following socioeconomic objectives:

1. optimum utilization of existing capacity,
2. maximizing production and achieving higher productivity,
3. higher employment generation,
4. correction of regional imbalances through preferential development of industrially backward areas,
5. strengthening the country's agricultural base by giving preferential treatment to agro-based industries, and promoting optimum inter-sectoral cooperation,

6. faster promotion of export-oriented and import-substitution industries,
7. promoting economic federalism with an equitable spread of investment, and the dispersal of returns amongst widely distributed and small but growing enterprises in rural as well as urban areas, and
8. consumer protection against high prices and bad quality.[5]

The idea of economic federalism was a new device in the SIP of 1980. It presented the idea as a counter to the previous Janata Party government's artificial division between small and large-scale industry. The SIP stated that the previous government's idea was based on the misconception that the interests of large and small industries were essentially in conflict, and it proposed the concept of economic federalism with the setting up of a few "nucleus plants" in each district identified as industrially backward to generate as many ancillaries and small and cottage enterprises as possible. The SIP of 1980 then explained that the nucleus plants would concentrate on assembling the products of the ancillary enterprises falling within their orbits, on producing the inputs needed by a large number of smaller enterprises, and on making adequate marketing arrangements.[6]

The SIP tried to link small enterprises with large industries, but it fell into the same trap that previous policies did when it said that the nuclei would also ensure a widespread pattern of investment and employment and would distribute the benefits of industrialization to the maximum extent possible. It failed to set forth a logical and feasible policy for creating employment opportunities and spreading industrialization into industrially backward areas in accordance with overall development policy. The role of creating larger employment and attaining more equitable distribution were again turned over to the small and ancillary enterprises without regard for the capabilities and effectiveness of these industries.

The government presented a scheme of phased development for industrially backward areas through "ancillarization." To carry this out, the SIP of 1980 redefined small-scale and ancillary enterprises.[7] It raised the investment limits for tiny enterprises from 100,000 rupees to 200,000 rupees, for small-scale enterprises from 1 million rupees to 2 million rupees, and for ancillaries from 1.5 million rupees to 2.5 million rupees. The government promised in the SIP of 1980 that the policy issued in 1975 for permitting additional capacity to stimulate production in certain selected industries would be continued and measures would be taken to expand those facilities to other areas.

Following the SIP of 1980, notes and notifications were issued to enhance the policy. Most of them brought further relaxation of regulations such as permitting excess production capacity in certain areas of industries including mass consumption goods industries,[8] simplified procedures for MRTP companies,[9] promoted the setting up of 100 per cent export-oriented enterprises,[10] endorsed and recognized production and production capacity for export purposes,[11] permitted production of leather footwear and other leather goods in large and medium-scale industries, MRTP companies, and FERA companies under certain conditions,[12] and introduced several measures for increasing utilization of industrial capacity.

At the same time, for the promotion of industries in backward areas, government pledged special consideration for the enterprises which want to locate in such areas. With the Press Note of February 27, 1982, "no industry districts"[13] were identified for preferential treatment in licensing to set up industries or in infrastructure and other support.[14] In relation with this, state governments were directed to take appropriate steps in compliance with central government policy. State governments jumped at this opportunity. They enhanced programs to promote industries in "backward districts" in states which were not necessarily remote or industrially disadvantageous but industrially promising districts.

In general, the operation of private enterprises was further liberalized and encouraged. In particular, large industrial groups and foreign companies were no longer barred from producing transportation machinery and tools, electrical equipment, chemicals and pharmaceutical products, and industrial machinery. They were also permitted to enter fields of production hitherto restricted to small-scale enterprises on condition that such production would promote exports. Exemption from licensing was further eased by raising the investment limit from 30 million rupees to 50 million rupees, partly taking into consideration the general increase in project cost.[15]

The MRTPA and the FERA were also eased. The definition of "dominant" in the MRTPA was revised, and the restrictions on the operations of dominant enterprises were relaxed. The maximum 40 per cent foreign equity regulation applied to Indian "foreign companies" under the FERA of 1973 was later modified, and foreign equity of 51 per cent was approved in some cases such as when technology not available in the country was involved or exports were expected to increase.

Furthermore, in certain industries foreign capital participation was allowed where hitherto it had been prohibited under the FERA. To attract foreign investment, various promotional measures were introduced. In 1982 approval was given for nonresident Indians to invest in Indian companies through equity purchases.

One of the spectacular examples during this period was the business tie-up between Maruti Udiyog Ltd., a government enterprise, and Suzuki Motor Co. Ltd. of Japan for production of a car called the "Maruti." The contract was formally signed in October 1982. In the past, tie-ups between Indian public enterprises and foreign companies had taken the form of turnkey production of materials, services, and capital. But under the Maruti-Suzuki contract, foreign capital participation in an Indian public sector enterprise was approved for the first time with Suzuki authorized to acquire a 40 per cent equity in Maruti.[16] The establishment of the Maruti-Suzuki joint project was a clear indication of the Indian government's policy to positively welcome foreign capital and technology.

The new economic policy after 1980 put greater emphasis on private enterprises the intention being to mobilize resources through the modernization of technologies and the creation of conditions for more dynamic industrial progress. There was another factor which compelled the government to make this change. In November 1981 the Indian government decided to take advantage of the International Monetary Fund's Extended Fund Facility and borrowed a total of 5 billion SDR over a three-year period to overcome the country's balance of payments difficulties after the second oil price increases.[17] In return the government pledged to carry out a mid-term economic adjustment incorporating measures to expand production and capital investment by liberalizing imports and introducing new technology and to control inflation through financial and fiscal measures. The acceptance of large-scale IMF financial assistance indicated that India was earnestly setting out toward economic development through liberalization using the IMF funds as leverage. For this reason also the government liberalized its import and industrial policies and adopted a more liberal attitude toward foreign enterprises to improve industrial competitiveness in order to increase export. Imports were further deregulated, increasing the supply of important inputs to indigenous industries.[18]

## Liberalization Accelerated

With the establishment of the Rajiv Gandhi government in October 1984, many important changes in economic policy took place. These were basically of the nature of relaxing regulatory policy and continuing policies which India had been consistently following since the middle of the 1970s. The Rajiv Gandhi government inherited the opening-up policy the previous Indira Gandhi government had started.

The major difference was that Rajiv Gandhi put more emphasis on the liberalization of foreign trade policy.[19] This is not to say that trade liberalization had no place in the Indira Gandhi government. On the contrary, it can be said that the direction had been set by Mrs. Gandhi's government. In April 1982 her government had announced an import-export policy for 1982/83 which became the start of trade liberalization. This was followed by the import-export polices for 1983/84 and for 1984/85. Under these policies, the Open General License (OGL) list was expanded, the procedures and conditions for import-export licenses were relaxed, the list of restricted imports was enlarged, and the foreign exchange quota for imports was expanded. The steps the Rajiv Gandhi government took were basically not different from the steps taken by his mother's government. The only real difference was the special emphasis on trade liberalization and the nature of this liberalization. While taking steps toward further liberalization, his government showed an inclination toward certain areas related to modern technology such as electronics.

Another difference was the pace and manner which the new government took when carrying out its policy. This can be observed in the way the government executed its policy. Most of the steps were taken in the form of case-by-case modifications in existing policies, and not in the form of formal government policy statements proposing systematic or comprehensive reform in policy structure. This in brief summed up the nature of the Rajiv Gandhi government's industrial policy. The manner and the pace adopted by the government while modifying the system affected the economic structure, and this changed the economic situation. In January 1985 the government allowed a "product mix"[20] to private industries which were engaged in producing motorized two-wheeled vehicles enabling them to produce any type of "motorized two wheelers up to 350cc engine capacity."[21] Those industries were exempted from licensing when they wanted to start production of any type of two-wheeled vehicle up to 350cc. This brought about a boom in two-wheeled vehicles, and many producers of such vehicles were interested in setting up plants to produce 100cc motorcycles in collaboration with Japanese motorcycle companies. The product-mix system was called "broad categorization" which was expanded to other industrial areas, like motorized four-wheeled vehicles,[22] machinery for the chemical, pharmaceutical, petrochemical, and fertilizer industries,[23] and paper and pulp products.[24] The broad categorization system was soon called the "broad banding" system which became one of the features of government policy. Another sixteen items came under the broad banding system in June 1985,[25] and the list of broad banding items continued to expand thereafter.[26]

In 1985 licensing exemptions were allowed for many industrial sectors, on condition that the enterprises were neither MRTP nor FERA companies, the products were not on the reserved list for small-scale industries, and enterprises were not located in specified urban areas. In March, sixteen items were added to the exemption list,[27] and another thirteen items were added in April.[28] The licensing exemption scheme was intended to further simplify the licensing procedures for non-MRTP and non-FERA companies for articles not reserved for the small-scale sector. Later on exemptions were extended on certain conditions to MRTP companies which were engaged in the production of twenty-seven specified industries.[29] In 1986 and 1987 a series of steps further relaxed regulations not only for MRTP companies but also FERA companies. In 1988 it was decided that dominant enterprises under the MRTPA with total assets up to 1 billion rupees would be treated on par with non-MRTP and non-FERA companies.[30]

The manufacture of telecommunications equipment which was earlier reserved exclusively for the public sector was opened to the private sector and allowed a maximum 49 per cent equity participation in joint projects with public enterprises.[31] This allowed private sector companies to enter the area of telephones, teleprinters, and other types of data communication equipment.

The investment limit for small and ancillary enterprises was raised from the hitherto 2 million rupees and 2.5 million rupees to 3.5 million rupees and 4.5 million rupees respectively.[32]

In January 1986 the scheme for licensing exemptions was extended to MRTP and FERA companies in twenty-three of twenty-seven specific industries, provided such enterprises applied for locations which the central government had declared backward areas.[33] This scheme was introduced with the twin objectives of liberalizing procedures and developing industrially backward areas. However five industries, viz., inorganic fertilizers, drugs and intermediates, newsprint, portland cement, and motorized four-wheeled vehicles, were not exempted from licensing, the reason being that these five industries involved (a) the import of high technology, capital goods, raw materials, and components, (b) foreign collaborations, (c) large amounts of investment, and (d) long gestation periods. The basic approach behind these measures was to channel investment by large industrial groups and MRTP/FERA companies into exempted industries which were capital-intensive or prone to risks, or which involved sophisticated technology or would promote development in industrially backward areas, particularly the "no industry districts."

Within a year after the government's announcement, a positive response was observed, and by March 1986, 1,523 registrations had been granted in the twenty-five broad industry groups exempted from licensing in March 1985. About 25 per cent of these registrations were in the central government's declared backward areas.[34] Later licensing exemption was extended to other industries like chemicals, computer software, and so on.

Another relaxation of controls over private industry was the recognition of productive capacity over licensed capacity for export purposes.[35] This freed registered or licensed industrial enterprises to produce in excess of licensed or registered capacity if 100 per cent of such additional production was for export.

The government's budget of 1985/86, which was the first budget proposal by the Rajiv Gandhi government, presented the proposals detailing the new economic policy. Behind the proposals were a set of assumptions on which the government constituted its new policy. These assumptions were concisely set forth by Dutta as follows:

1. The private sector is more efficient than the public sector in producing goods and creating employment. It is therefore necessary to offer fiscal and other incentives to the private sector.
2. Private sector output will increase if taxes are reduced.
3. The government's tax receipts are unproductive, or are at least less productive than the funds released through tax relief.
4. Relief in direct taxes increases demand and/or savings because of the increase in disposable income.
5. If tax relief granted to the private sector leads to a shortage of government resources, then it is justifiable to curtail the government's socioeconomic commitment. In other words, the planned public sector outlay can be reduced to widen the field for private investment.
6. Social justice is not an essential objective of a growing economy. If ine-

qualities have to be increased, in order to achieve the expected results through the private sector, this must be accepted.

7. An inflationary deficit in the government budget can be easily absorbed by the economy.[36]

The proposed tax reform measures aimed at alleviating the tax burden on private income and business transactions so as to improve the climate for revenue receipts and incentives for private investment. The maximum tax rate on the income was lowered from 67.5 per cent to 40 per cent, and the tax exemption limit for private income was raised from 15,000 rupees to 18,000 rupees. The number of income tax brackets was decreased from eight to four. Also the exemption limit on the wealth tax was raised and the tax rate was lowered. The estate duty was abolished. These measures which were described as "growth oriented" in the budget proposal were criticized as tax relief for the rich.

In order to help private industry, the assets limit for MRTP companies was raised from 200 million rupees to 1 billion rupees. The government claimed that one reason for this was to offset the effects of inflation since the previous limit was fixed in 1969. But the raise was more than that needed to bridge the inflation gap. Since 1969 inflation had increased about three and a half times, but the limit was raised fivefold.[37] The corporate income tax on private firms was reduced by 5 per cent, or, by up to 10 per cent to promote investment through tax benefits on capital market financing. The tariff rates were lowered on a number of capital goods. The revenue gap was planned to be filled mainly by indirect taxes.

There was a lot of criticism of the 1985/86 budget as well as the government's policy change. Some envisioned a fiscal crisis and worsening inflation, and some voiced worries that a fiscal crisis could be used as a rationale for demanding the gradual loosening of government control over the economy.[38] The policy reorientation itself was severely criticized especially the incentives and concessions given to upper income groups and larger industries. The government's assumption that the rise in production in the private sector would filter down to benefit lower levels was opposed as a deception.[39] Instead critics said the policy would further widen income inequalities in the society and the actual burden would be borne by the poor income groups through direct taxes and inflation.

Although the 1985/86 budget was fundamentally within the same liberalizing framework of fiscal and industrial policy which had been evolving since the mid-1970s, the difference now was that the government had determined to help private industry get out of industrial stagnation, even at the risk of a fiscal crisis. The change had a big impact on the economic situation. The incentives and concessions given to upper income groups invited "upper income group consumption led growth."[40] This gave birth to a dependence on growth in demand for consumer durables as the new driving force in the economy.[41]

The change in policy had a remarkable effect on the economy. Starting from the year 1984/85, the industrial sector began to experience a consistently good performance compared to the stagnant conditions of the 1970s and early 1980s. The growth rates in the index of industrial production were 8.6 per cent, 8.7 per cent, 9.1 per cent, and 7.4 per cent in 1984/85, 1985/86, 1986/87, and 1987/88 respectively. Industries in many sectors underwent a structural transformation. In the manufacturing sector which accounts for 77.1 per cent of industrial production, industry groups such as food products, jute, textiles, chemicals and chemical products, nonmetallic mineral products, basic metals, nonelectrical and electrical machinery, and transport equipment showed positive rates of growth. Letters of intent giving approval to set up new capacity were 2,642, 3,517, and 2,858 during 1985, 1986, and 1987 respectively.[42]

But this remarkable performance was not spread evenly through the economy. The leading sectors were such industries as consumer durables which were supported by the government policy and were facilitated by foreign collaboration, technology imports, and the relaxation of regulations. In the latter half of the 1980s, while industrial production showed good performance as a whole, a detailed analysis of industrial production data presents a highly uneven growth pattern.[43] While some traditional industries showed high growth rates, most of the growth leaders were either largely import based or contributed little to value added and employment generation. Computers, consumer electronics, and other electronic products, as well as other consumer goods such as consumer durables and synthetic fibers were such cases.

Debate on the policy change could not avoid the public sector. The public sector had become a preserve not to be interfered with. It had expanded its areas of activity under the constant nurturing of the government. There were even public sector enterprises which had started producing goods which only the private sector had once produced. Thus when policy became growth- and productivity-oriented, it was natural that debate would be directed at the public sector which was notorious for its inefficiency, low productivity, and for being a burden on government finances. The opinion which claimed to review and reassess the role of public sector, was based on the assessment that most public sector enterprises were inefficient and operated perennially in the red; therefore except in the core sector, the government needed to privatize, rehabilitate, and merge public companies in order to lessen the burden on the economy. This argument was partly derived from "a certain degree of disenchantment with the public sector."[44] Chelliah provided four sufficient reasons for the need to review public sector policy.

First, several large public enterprises in which huge sums of money had been invested had been unable to acquire either technical or financial efficiency. Many public enterprises produced low or negative rates of return and with a few exceptions they had not shown themselves to be leaders in technical progress.

Second, while the growth of government expenditures had conferred substantial benefits on the economy, there was great concern over the fast growth of the bureaucracy (whose productivity was not high) and over visible signs of wasteful expenditures.

Third, attempts to collect higher tax revenues resulted in the creation of complicated and harsh tax structures which were partly responsible for the creation of a parallel economy.

Fourth, the regulatory apparatus led to delays and distortions and, instead of promoting development, was thought to have contributed to the slowing down of industrial growth and to inefficiency. The comprehensively applied licensing procedures and import controls in particular were responsible for such results. They also led to oligopolistic situations and cases of uneconomic production.[45]

Chelliah's arguments caused debate because they struck at the very base and spirit of economic policy that the country had continuously pursued. Counter opinions came from ardent supporters of the ideology that the state should have the controlling power over the economy, particularly over industry, and given its leading role in economic development, the state could effectively work for this purpose. Supporters of government intervention and control argued that it was only the government that could effectively assure public interest and social justice by intervening and controlling the economy.[46] Supporters of government intervention and control over the economy had always been strong and were always able to maintain the basic principles of policy whenever questions arose about the role of the public sector. This time again they were able to exert their power, and the government was unable to take any positive steps to tackle the problems of the public sector such as low productivity and the burden on government finances. As a result the liberalization policy failed to break down the public sector preserve.

Over the period of a decade and a half starting in the early 1970s, the government carried out a series of measures which gradually reduced the degree of intervention in capacity creation through licensing. This liberalization was accelerated after March 1985 when the Rajiv Gandhi government announced its first budget. This not only speeded up the process but also brought about a qualitative change in the nature of the policy. Licensing exemptions for many industries, changes in the definition of MRTP companies, and the relaxing restrictions on the MRTP and FERA companies were measures which no doubt narrowed the range of licensing. Moreover, these measures were accompanied by other modifications to policy, such as "broad banding," capacity re-endorsement, capacity expansion, and simplified procedures. One critic described the new measures as "sweeping changes" that amounted to "a near dismantling of the industrial licensing system which to the extent it remains can neither influence the direction of industrial growth nor restrict the growth of monopoly."[47] The licensing system could merely control the entry of monopoly groups into some specified industries in non-backward areas and could restrict the activity of FERA companies with foreign equity participation of more than 40 per cent of total shares. At the same time liberalization expanded the area for the private sector. Production of items reserved for public sector and small-scale industries were taken up by the private sector, either with simple relaxation or special permission.

Although the effects of Rajiv Gandhi's liberalization policy are difficult to measure over the short span of several years, evidence suggests that there was a clear impact on the economy. Relaxing restrictions on imports of capital goods, intermediates and components for rapid growing areas of industries, and expanding the activities of the private sector stimulated production of certain commodities demanded by social groups having additional and disposal income. Liberalization helped the private sector to use the new opportunities for expansion, diversification, and new investment. High costs were compensated by high profits. But industrial growth was lopsided and consumption uneven. The narrow base of the newly emerging industries is reflected in the figures on new investment since the middle of the 1980s. The number of foreign collaborations approved, letters of intent issued, industrial licenses granted, and registrations with the DGTD and the Secretariat for Industrial Approvals show that the stimulus created by the new policy was short lived,[48] although these indicators have to be examined carefully before reaching a conclusion on the effects of the policy.

The government's liberalization policy had to be gradually halted toward the end of the 1980s when the government began to lose its grip on power. The number and the nature of notes and notifications issued after 1987 clearly show that liberalization had lost strength and the power to mobilize industries. At the end of the 1980s, the state of Indian industrial policy was like a convoluted cobweb which was so entangled that only great political strength would be able to untie and reorient it. But the political situation was deteriorating as no party seemed to be in a position to establish a stable government, and economic conditions steadily headed downwards because of the country's growing internal and external financial difficulties.

## Protective and Promotional Policy in the 1980s

The government's relaxation policy paralleled another protective and promotional policy line. When the Sixth Five Year Plan (1980–85) was formulated in 1980, a number of poverty eradication measures were introduced, namely, the rural employment expansion program, rural industries promotion program, and intensified industries dispersal program. This line of strategy can be traced back to the Fifth Five Year Plan (1974–79) of the Indira Gandhi government which pledged to strongly promote a poverty alleviation program for the poor.

It may sound contradictory to say that government could afford a protective and promotional policy for small and rural industries to cope with the problem of industrially backwardness and the dispersal of industries to disadvantageous areas where infrastructure and other facilities were not organized, when the most urgent job for the government was to raise the productive capacity and efficiency of industry and modernize industry so that it could attain competitiveness. The government had to improve industrial performance where possible. However the government also could not take any step which might run against rural development, the creation of job opportunities in rural and backward areas, and rural industrialization.

The government invented a marvelous way to tackle this contradictory policy problem within the prevailing policy structure. It combined two opposing strategies in the economic liberalization process. When the government announced a liberalizing step, it frequently accompanied this with clauses of exceptions and limitations where the liberalization did not apply or only partly applied. Promises of special consideration for enterprises setting up in notified backward areas and increases in the number of items reserved for small-scale industries were major conditions put on the relaxation measures. At the same time the government intensified the promotional steps for small-scale industries and industrial enterprises which showed an interest in setting up in backward areas. Exemption from licensing was even applied to MRTP and FERA industries which were willing to establish enterprises in backward areas.[49] The steps were accompanied by financial assistance, tax relief, infrastructure support, and other back-up measures. In May 1986 the Small Industries Development Fund was established in the Industrial Development Bank of India to specially finance small-scale industries.

In 1987 a National Equity Fund was set up with the objective of providing seed capital in the form of soft loans to small and tiny industries with project costs not exceeding 500,000 rupees and located in villages or towns with population not exceeding 500,000.[50] New enterprises as well as potentially viable sick enterprises in the small-scale sector got support from the fund.

In 1988 a comprehensive step was taken for industrialization and industrial promotion in backward areas through incentives and licensing exemptions.[51] Non-MRTP and non-FERA industries were exempted from licensing if they were located in or around specified municipal areas, or their fixed assets did not exceed certain limits. The limits on fixed assets for exemption were increased form 50 million rupees to 500 million rupees for projects located in centrally declared backward areas and to 150 million rupees for projects located in other areas. The government announced a plan to set up Development Growth Centres and promised financial assistance. The plan was to set up at least 100 such growth centers within five years and ultimately to have one center in each of all the 430 districts in the country. Fiscal incentives consisted of income tax relief for ten years in the form of a 20 per cent tax deduction, and a 25 per cent deduction on profit tax for eight years, when the enterprise was located in a notified backward area. Monetary incentives such as working capital funds were to be examined by a committee.

Despite these various concessions and incentives, industries remained reluctant to invest in backward areas. Along with the high cost of setting up enterprises, firms had to contend with insufficient infrastructure, supply bottlenecks, the paucity of raw materials, the lack of skilled labor, and the absence of markets in the locality, all which proved to be great disincentives.

Regulations on the location of enterprises were also relaxed. These concerned the distance limits for establishing projects that were nonpolluting in nature and that involved investment in fixed assets up to 50 million rupees under certain condition.[52]

Number of items reserved for production by small-scale industries increased to more than 800. Originally the reserved items for small-scale industries had consisted largely of handicrafts. In 1967 these items were expanded to include some machine-made items. At the end of 1977 these reserved items numbered 180. Then in 1978 the Janata government expanded the number to more than 800. This grew to 834 by 1981 with a significant proportion of the production of light engineering products, some consumer durables and components of larger products being reserved for small-scale enterprises.

Some industrial enterprises were required to produce for export as one of the conditions for being allowed to produce items hitherto banned, or being allowed to expand capacity in excess of licensed or registered limits. But even the requirement to export was removed or relaxed if the enterprises were set up in backward areas.[53]

An important feature of the government's protective-promotional policy cum liberalization policy was that relaxation was always paralleled by a number of binding conditions. This was typical of the notes and notifications issued at the height of the liberalization drive under the Rajiv Gandhi government. Such paralleling of opposites produced tremendous lacunas and loopholes in the policy system, leaving areas of discretion to the government. Many projects which would not even have been considered under ordinary conditions were allowed to start under extraordinary conditions. It is quite presumable that one of the reasons behind the spurt of industries during the few years after 1985 was the government's discretionary power over the economy. But this power was unable to sustain the motivation for industrial development for a longer period because of the nature of the liberalization policy pursued by the government. Thus the spurt was confined to limited areas; its effects failed to spread to the entire economy, and this increased disillusionment with the government.

The government's protective and promotional policy for smaller industries and its policy for developing backward areas can be observed more clearly at the state level. It would be relevant therefore to look at industrial development at the state level. This will be discussed in the next chapter where a case study of state development is taken up.

## Notes

1 Jürgen Wiemann, *India in Transition: Industrialization Policy and Economic Cooperation* (New Delhi: Allied Publishers, 1986), p.93
2 George Rosen, *Industrial Change in India: 1970–2000* (New Delhi: Allied Publishers, 1988), p.452.
3 Government of India, Statement on Industrial Policy, July 23, 1980 (hereafter the SIP of 1980).
4 Oil and oil products imports jumped from 16.9 billion rupees in 1978/79 to 52.6 billion rupees in 1980/81.
5 SIP of 1980.
6 SIP of 1980.
7 The definition of a small ancillary industry is one which has investments of fixed assets in plant and machinery held on ownership terms or by issues or by hire purchase not exceeding 1.5 million rupees and engaged in (a) the manufacturing of parts and components, bus assembling, tooling of intermediates, or (b) the rendering of services, and supplying or rendering of 50 per cent of their production or the total services, as the case may be, to other enterprises for production of their articles, except a subsidiary of, or owned or controlled by other enterprises. Office of the Development Commissioner (Small Scale Industries), Notification No.402, September 3, 1979. The investment limit was raised to 2.5 million rupees by the SIP of 1980 and put into effect by the Notification of July 31, 1980.
8 Press Note, August 29, 1980.
9 Press Note, December 30, 1980.
10 Press Note, January 14, 1981.
11 Press Note, March 20, 1981.
12 Press Note, May 21, 1981.
13 "'No Industry Districts'—Preference in Licensing for Setting Up of Industries," Press Note, February 27, 1982.
14 The districts which have no large and medium-scale industries and thus are classified as "no industry districts" are: 1. Purnea, Saharsa, Aurangabad, Bhojpur, and Nalanda in Bihar; 2. Kulu, Kangla, Chamba, Lahul and Spiti, and Kinnaur in Himachal Pradesh; 3. Kupwara, Poonch, Doda, Ladakh, Pulwama, Udhampur, and Rajori in Jammu and Kashmir; 4. Chattarpur, Sidhi, Chhindwara, Balaghat, Seoni, Tikamgarh, Guna, Narsinghpur, Jhabu, Panna, Mandla, Dhar, Surguja, Bhind, Daita, Shivpur, and Damoh in Madhya Pradesh; 5. Manipur-Central, Manipur-North, Manipur-West, Manipur-South, and Tengnoupal in Manipur; 6. East Garo Hills, West Garo Hills, and Jaintia Hills in Meghalaya; 7. Tuenssang in Nagaland; 8. Balasore, Bolangir, and Pulbani in Orissa; 9. Tonk, Banswara, Sirohi, Sikar, and Jaisalmer in Rajasthan; 10. Gantok, Mangami, Gyalsing, and Namch in Sikkim; 11. Tripura-North-26 Tea Plantations, Tripura-South-2 Estates, and Tripura-West-26 Tea Gardens in Tripura; 12. Banda, Pauri Garhwal, Hamirpur, Uttarkashi, Sultanpur, Fatehpur, Chamoli, Jaunpur, Tehri Garhwal, and Jalaun in Uttar Pradesh; 13. Cooch Behar, Darjeering, Maldah, Bankura, and Jalpaiguri in West Bengal; 14.

Kamong, Suansari, Siyang, and Tirap in Arunachal Pradesh; 15. Union Territory of Dadra and Nagar Haveli; 16. Aizawl and Lungali in Mizoram; 17. Laksimpur and North Cachar Hills in Assam; 18. Bidar in Karnataka. With the Press Note of December 11, 1982, the list of "no industry districts" was expanded and classified into three categories for the purpose of obtaining preferential treatment in concessional finance, central investment subsidies, and nuclei plant facilities. On September 7, 1983, the number of "no industry districts" was increased to 131.

15 Press Note, April 23, 1983.

16 At the outset, Suzuki Motor's initial equity in Maruti was 26 per cent.

17 In January 1984, Prime Minister Indira Gandhi announced the decision not to use the unused 1.1 billion SDR of the IMF loan.

18 Kyōko Inoue, "India's Open Door Economic Policy," *Journal of Japanese Trade & Industry,* July/August 1984, pp.51–53.

19 Esho emphasizes this and makes a background analysis on the trade liberalization policy. Hideki Esho, *Gendai Indo keizai kenkyū* [Study on contemporary Indian economy] (Tokyo: Hosei University Press, 1987).

20 In 1983, the Indira Gandhi government allowed a product mix in the machine tool industry. Press Note, July 20, 1983.

21 Press Note No.1, January 11, 1985.

22 Press Note No.2, January 19, 1985.

23 Press Note No.3, February 8, 1985.

24 Press Note No.5, February 18, 1985.

25 Press Note No.15, June 17, 1985.

26 Items which came into the broad banding category in 1985 were typewriters (manual, electric, and electronic), fiber board, electrical equipment, synthetic fiber and synthetic filament yarn, the handling equipment, earth moving machinery, and electronics. Press Notes Nos.16, 21, 22, 23, 26, 28, and 29 of 1985.

27 Press Note No.7, March 16, 1985.

28 Press Note No.12, April 25, 1985.

29 Notification, May 22, 1985.

30 Press Note, June 30, 1988.

31 Press Note No.10, March 26, 1985.

32 Press Note No.9, March 19, 1985.

33 Press Note No.6, January 30, 1986.

34 Centre for Monitoring Indian Economy, *The Liberalization Process* (Bombay, 1986), p.26.

35 Press Note No.29, September 25, 1986.

36 Bhabatosh Dutta, "The Central Budget and the New Economic Policy," *Economic and Political Weekly,* Vol.20, No.16 (April 20, 1985), p.693.

37 Ibid., p.698.

38 Sanjaya Baru, "The State in Retreat?" *Economic and Political Weekly,* Vol.20, No.16 (April 20, 1985), p.705.

39 Dutta, p.694 and passim.

40 Baru, p.706.

41 Arun Kumar, "Union Budget, 1985-86: Haves Have While Have-nots Nought," *Economic and Political Weekly,* Vol.20, No.16 (April 20, 1985), p.717.

42 Government of India, Department of Industrial Development, *Report, 1988/89,* pp.2–3.
43 See for example, Vivek Bharati, "Industrial Performance (Parts 1, 2 & 3)," *Economic Times,* January 21, 22, and 23, 1988.
44 See for example, R.J. Chelliah, "Re-assessing the Role of the Public Sector," *Hindu,* March 8, 1988.
45 Ibid.
46 See for example, N.L. Krishnan, "PSUs: Favourite Whipping Boy?" *Hindu,* March 22, 1988.
47 C.P. Chandrasekhar, "Industrial Policy: Waning Stimulus," *Frontline,* August 6–19, 1988, p.108.
48 Ibid.
49 For example, Press Note No.6, January 30, 1986, and also Press Note No.16, October 20, 1987.
50 Tiny enterprises were defined in 1977 as enterprises with investment not exceeding 100,000 rupees and located in villages and towns with populations of less than 50,000. In 1980, the investment limit was raised to 200,000 rupees.
51 Press Note, June 3, 1988.
52 Government of India, Department of Industrial Development, *Report, 1988/89,* p.10.
53 For example, Press Note No.35, December 31, 1985.