Conclusion

The origin of licensing system can be traced to the industrial policy resolutions of 1948 and 1956 which elaborated the strategy for industrial development pursued by the government. The government took control over the economy by limiting the role of the private sector and by channeling investment according to the priorities set by the government. A consideration for social justice was another important element in the policy. At the beginning the concentration of assets and income in private hands was checked, and later as industrial policy developed, small-scale industries and backward areas were specially targeted in the name of raising income levels among the poorer strata of society.

The Industries (Development and Regulation) Act of 1951 firmly tied the hands of the private sector and ironically the hands of the government too. The latter had to formulate its industrial development policy within the framework of the restrictive licensing system rather than by carefully considering the needs of actual economic activity. The government kept control over industrial development using its function to determine output levels for all large and medium-scale industries. It did this through:

1. its own direct production of a wide variety of inputs and final products,
2. its power to grant or refuse permission to private firms to produce new items or to expand production,
3. its power to provide capital funds to private firms and its control over security issued by these firms,
4. its control of access to foreign exchange, and
5. its control of imports.[1]

The licensing system demarcated the private sector's sphere of operation and determined its production capacity. The list of ''scheduled industries'' which had to register under the IDRA numbered only forty-two in the beginning, but this list continued to expand as time passed.

While the demarcation gave the public sector the prime position in industrial development, it did not necessarily imply a gradual erosion of the role of the private sector as ardent supporters of the public sector like to imagine. The regulatory system became cluttered with a growing volume of details, minutiae, and exceptions as it struggled to comply with economic necessities and the demands of the private sector. The unwieldiness of the policy system produced a wide area of loopholes and irregularities where the private sector could move in and develop.

It has been argued that the licensing system and other regulatory practices did not necessarily restrain large private industries.[2] Given their wide interests, financial strength, past performance, and ability to bear the costs of obtaining information, the large industrial groups have always had an edge over others in a system where capacity is licensed with the aim of achieving planned targets. Studies reveal that large industrial groups have been able to muster a disproportionate share of licenses issued by the government for various areas of industrial activity. The large private industries have thus been able to acquire certain advantages by using the irregularities of the system, and they have not suffered tremendously under the regulatory system.

Another problem with licensing is that it has not necessarily led to the creation of capacity. Instead many studies point out that industrial groups have always followed a twofold strategy. In the fast growing areas where profit margins are high, industrial groups have adopted an offensive strategy in obtaining licenses, establishing capacity, and bidding for a dominant share in the market concerned. On the other hand, in the areas where demand is slow or profits are low either because of slack market conditions or price controls, industrial groups have preempted capacity by obtaining licenses in order to prevent others from entering the market but do not exercise their own licenses to increase production.[3] Even if they are not interested in implementing the licensed capacities, large-scale entrepreneurs "use" their licenses for industrial commodity markets to exclude potential competitors. Profits have tended to increase through price manipulations rather than through cost reductions or qualitative improvements in supplies and standards.[4] Rosen sees that the restrictions placed on growth and entry by large and small firms have created new opportunities for private firms to earn monopoly rents, or enhance the existing rents. Such rents arise from having first access to restricted or reserved production areas.[5] Many cases have been reported indicating that income from rents may possibly be higher than the expected income from actual production. This kind of manipulation can be understood as a protective measure used by the private sector under the regulatory system. But a growing number of cases have gone beyond even India's permissive limits. Large-scale entrepreneurs even go so far as to hoard licenses to exclude smaller entrepreneurs from entering the market.

But the private sector is not the only one to be blamed. It is the regulatory system and the inconsistencies in the policy itself which must take most of the responsibility. At the beginning when the government made up the basic structure of industrial policy, it justified state control over the economy as the most effective way to attain the policy objectives. So strongly was this justification held that a change of direction was made virtually out of the question. When the government had to take steps to readjust policy in order to cope with changing economic circumstances, it did so not by reviewing the basic structure of the policy, but by making numerous detailed reforms, revisions, and additions to the policy. Over time these sorts of changes made the policy unwieldy and inconsistent. On numerous occasions efforts were made to correct the deficiencies, but these efforts often produced new loopholes and inconsistency.

Bhoothalingam points out another wasteful practice arising from the licensing system. He has observed that the capacity permitted by an industrial license frequently came to be regarded as the ceiling for actual production, although whoever, by greater managerial efficiency or adoption of improved techniques and practices not involving much capital investment, was able to produce more than the licensed capacity.[6] When determining the number and capacity of new enterprises licensed, the judgment of the government and the planners about size, the type of equipment, the process, and the location of a enterprise often prevailed over the judgment of the entrepreneur. These conditions and restrictions naturally led entrepreneurs to seek ways of getting around them which in turn attracted government countermeasures. This process led to more government interference than was originally intended.[7]

Bhoothalingam noted that until the start of the Fourth Five Year Plan in 1969, industrial licensing was used mainly to regulate the development of the private sector to make it conform with the five-year plans and particularly with the role assigned to the public sector. He comments that during the early years, the regulation was comparatively light, nevertheless there was a gradual but stead tendency toward increasing controls. Conditions incorporated into licenses grew more numerous and detailed, extending to matters such as the introduction of new products, the process to be adopted, and raw materials and fuels to be used. At the same time there was no systematic policy for discouraging large industrial groups or encouraging new entrepreneurs with relatively less resources, except for providing reservations for small-scale business and determining the nature and degree of foreign collaboration.[8] My own observations on the evolution of regulatory policy are identical with Bhoothalingam's and with Rosen's as well. Rosen has compared the present control system with the one in the late 1950s, and he was surprised to see how extensively the control system over industry has grown.[9]

Lack of export capacity, uneven product quality, fragmented production systems, lack of incentives to promote some modern industries, all these became acute, especially during the 1970s. With the start of the 1980s, the government began taking more aggressive measures to stimulate industry. It was gradually recognized that licensing could neither be effective for curbing monopoly nor channel investment in a planned way. Moreover there was a growing recognition of the inefficiencies in industry, although the licensing system had not been wholly responsible for this problem. There was an insufficient supply of most consumer goods. The lack of investment in the consumer goods sector in turn led to low utilization of productive capacity in the basic and capital goods industries. The industrial licensing system was recognized as having encouraged this unbalanced development in industry that economic planning was expected to counteract. The problems facing the economy began to cause thoughts within the government that the direct control of enterprise through administrative regulations could not achieve the desired results.

The liberalization of the economy began with the easing of import restrictions and investment controls in the middle of the 1970s when foreign exchange reserves increased sharply. The new economic policy started in 1980 put greater emphasis on private enterprise in an effort to mobilize resources through modernization of technologies and creation of conditions for a more dynamic industrial progress. Most of the measures introduced were relaxation of controls on private industries and case-by-case modifications of regulations.

Policy changes in the 1980s helped private industries to use the new opportunities for expansion, diversification, and new investment and also helped them to concentrate in more profitable areas. These changes have led to lopsided industrial growth and uneven consumption, and the narrow base of newly emerging industries has become a favorite target for opponents of liberalization.

There have been many critical reports raising doubts about the effects of the liberalization policy over the long run. For example, Chakravarty, in his analysis of import liberalization, contends that if the induction of new technology is largely influenced by considerations of short-term profitability, and if short-term demand is significantly determined by the prevailing pattern of income distribution, it is very likely that the impact of today's liberalized import policy on capital goods will be largely confined to the sector serving consumer durables.[10]

There is much evidence to support this argument. But the blame should be placed primarily on the industrial licensing system, not on the liberalization policy. Restrictions and regulations have created many unnecessary obstructions to industrial development. Technological development is a typical example of the disadvantageous aspects of the policy. An industrial enterprise does not like to take financial risks for research and development under existing conditions where the utilization of possible results are dependent on acquiring a license from the government.[11]

Some of the restrictions and regulations cannot be justified even for the purpose of attaining social justice. They have led to the wastage of scarce resources in the name of small-scale industrial development and the dispersal of industries to backward areas. If there was any impact of the intentioned policy, this required time to produce effects; meanwhile the burdens on industry have been enormous, even with financial and other form of government assistance.

Emphasis on a political goal like social justice has distorted India's industrial development policy, not because the goal itself was wrong but because the government was concerned primarily with achieving direct results. The government connected the solution of unemployment with the promotion of labor-intensive industries which in its view consisted mainly of small-scale and rural industries. The validity of this strategy is filled with problematic questions and the effectiveness of the strategy has not been fully proved.

One of the unanswered questions is whether the specialization of developing countries in labor-intensive industries alone can guarantee lasting comparative advantages when these are easily undermined by technological developments in industrially developed countries.[12] But the government determined that proportionately more people should be employed in industry to reduce the overpopulation in the rural sector. The government had a good political reason for pursuing this policy, but it is apparent that the rapid population increase coupled with the slow pace of industrial development did not allow industry to absorb the country's huge unemployed population.[13]

Questions must also be raised about the policy's misconceptions concerning technology. The policy aimed at enabling small industries to manufacture electronic components, but this has led to excessive fragmentation of production capacity into thousands of small uneconomic enterprises. Small companies are not in a position to manufacture efficiently on an industrial scale, nor can they afford the large investment for research and development that is necessary to keep up with international technological developments.[14]

At present opinions on industrial strategy in India are divided. There are ardent supporters of more liberalization and relaxation. They even criticizes the country's goal of attaining a "socialist pattern of society," arguing that it has fostered a strong patron-client system in industrial development and an economic climate fearing global competitions. As a consequence, low productivity, low capacity utilization, and uncompetitive costs have become a widespread phenomenon.[15] However there continue to be the large number of strong advocates of state control over the economy. They see such control as the only way for achieving the basic goal of the country. They are proud of being the true successors of the spirit of the founders of the nation. They argue that the enormous difficulties facing the country justify their position that the government must take strong politically progressive steps to alleviate socially unacceptable problems such as poverty, unemployment, and the unequal distribution of income.

The social ideals of India's founders remain strongly entrenched, and raising the number of small-scale enterprises in rural areas and dispersing industrial enterprises to backward areas are highly attractive political and social measures that India's leaders cannot resist. This is the main reason why the Indira Gandhi and even the Rajiv Gandhi governments could not take comprehensive drastic steps to change the whole industrial policy structure, though they were strongly inclined toward doing so.

Another reason which has limited the scope of policy change has been the way protective and restrictive policy expanded. The policy system became cluttered with details and minutiae producing inconsistencies, contradictions, and expanding gray areas. The whole policy structure grew to a complicated labyrinth where industry could not progress except through byways of exceptions and additions. Government circles have often talked of simplifying procedures and removing unnecessary regulations, but no steps have been taken that touch the policy core. Studies of India's industrial policy indicate that the policy has become sanctified and has grown to such an extent that drastic cuts have been close to impossible despite the increasingly ardent support for liberalization, the growing suspicion about the negative effects of the "license *raj* (rule)," and the marginalization of India in the world economy.

With the start of the 1990s, India has plunged headlong into a new era of aggressive economic liberalization. After two short-lived governments which unsuccessfully tried to liberalize the economy, the Narasimha Rao government began an offensive to open up India's economy. Its first step was to introduce changes in import-export policy. The exchange rate was adjusted on the 1st and again on the 3rd of July 1991. Then the Rao government released a new industrial policy on July 24, 1991. Under this policy, the industrial licensing system has been abolished except in eighteen critical sectors, the MRTPA is to be eased out, foreign companies will be allowed to have 51 per cent equity shares in Indian companies, and foreign technical agreements are to be approved automatically. The view that the Rao government has gone beyond anything the Rajiv Gandhi government would even have dreamt of is shared by many.[16]

The policy change was compelled by pressures from a number of factors such as the severe balance of payments position, internal resources constraints, and instructions from the IMF. But the Rao government had also concluded that the country's industrial policy structure had grown to be an obstacle rather than a support to the economy, and this was the government's first consideration when it carried out its policy reorientation.

Analyzing India's new industrial policy and its changing economic situation will be the next task in this continuing study. The Rao government is still in the midst of carrying out its policy reorganization, and more time is needed to gain a perspective on the course that economic change in India will take. Deadlines for completing this study have also caused me to confine it to the period from around independence to the end of the 1980s. However, some thoughts drawn from the present study on the evolution of India's industrial policy seem useful for examining the new Rao government policy.

I will mention only two important elements which concern the political feasibility of a policy change. The first is the ideological element. My studies on the industrial policy formulation process show clearly that the ideological orientation in India's industrial policy has been very strong especially when political instability has been imminent. Therefore the ideological element will pose many political problems for the Rao government. It is a minority government and is taking extremely bold steps that even the Rajiv Gandhi government, which had a stronger political base, could not have taken without the fear of losing political support. The second element is related to the small-scale industries and industrially backward areas whose promotion is the main concerns of state governments. The new policy suggests allowing large industries to enter the areas reserved for small-scale industries and overlooking the problems of developing industrially backward areas. If implemented, the new policy will simply erode the political structure base of the state governments and invite political difficulties for the states by taking away benefits from small-scale entrepreneurs and from backward areas. Political instability at the state level could inevitably upset the political base of the central government. The central government therefore may find it difficult to persuade state governments to follow a new policy which will affect their popularity.

The presence of many interest groups which have benefited and been nurtured by the process of policy formulation will also make the government's task difficult. The Rao government has set out on a policy which only a stable and strong government should dare to attempt. Whether the policy will succeed or not will depend on the government convincing the nation that the new industrial policy is the only way to overcome the internal and external economic maladies now confronting India.

Notes

1 Rosen, p.15.
2 See for example, S.K. Goyal, *Monopoly Capital and Public Policy* (New Delhi: Allied Publishers, 1979); and Society for Democracy, *Monopolies and the Public Policy: A Round Table Discussion Organised by the Society for Democracy* (New Delhi: People's Publishing House, 1972). Also see C.P. Chandrasekhar, "Industrial Policy," pp.103–8.
3 Chandrasekhar, ibid.
4 Rosen, p.33. Also see Shōji Itō, ed., *Indo no kōgyōka.*
5 Rosen, p.20.
6 Bhoothalingam, p.4.
7 Ibid., pp.4–5.
8 Ibid., p.10.
9 Rosen, p.20.
10 Chakravarty, *Development Planning,* p.68.

11 Wiemann, p.44.
12 Ibid., pp.91–92.
13 Chakravarty, p.87.
14 Wiemann, pp.55–62.
15 For example, "Dismantle Economic Controls: JRD," *Times of India,* August 2, 1990, which is an interview with J.R.D. Tata.
16 R. Vijayaraghavan, "Restructuring the Economy—II," *Hindu,* August 11, 1991.