External and Internal Constraints on Policy-Making:

A Case Study of India's Industrial Policies in the 1990s

John Degnbol-Martinussen
International Development Studies
Roskilde University

The aim of this paper is to summarise studies of external and internal constraining influences on Indian industrial policies. The main focus is on external constraints over the last decade, but attempts are also made to assess their varying relative importance in a longer time perspective and vis-à-vis internal conditions and intra-societal actors in contemporary India.

Introduction

In very broad terms, it may be argued that India has passed through four distinct phases with respect to the relative importance of external influences on the shaping of industrial policies:[32]

(1) During the colonial period, when India was part of British India, industrial policies and economic policies in general were essentially shaped by British interests - although with increasing incorporation of

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[32] I have dealt extensively with the shaping of economic policies in British India and post-colonial India till the mid-1970s. The most elaborate presentation of the findings is included in my four-volume doctoral dissertation (Martinussen, 1980). Brief descriptions of industrial policies in independent India are given in Martinussen, 1988.

the interests and demands of both the Anglo-Indian and Indian industrialists.

(2) After Independence in 1947, industrial policies came increasingly to reflect the interests of Indian industrialists as outlined in the so-called Bombay Plan.[33] The basic legal framework was established already in the early 1950s. This framework provided for extensive government regulation of the private industrial sector. Officially, no discrimination against foreign capital was intended, but along with several other types of state interventions the outcome was a policy framework that favoured the large Indian business houses. Significant expansions of the public industrial sector played a crucial role in this context by, on the one hand, preempting opportunities for foreign direct investment, and on the other hand, providing a basis for diversified development of the private industrial sector under Indian control. For several years, however, foreign companies remained too powerful for the policy framework to become effectively implemented. But by the mid-1970s, I would say that the Indian industrialists and the state-run public enterprises had obtained power positions sufficient to ensure that their interests came to dominate industrial policy-making at both the decision-making and implementation stages.[34]

(3) Thus, a third phase, beginning in the mid-1970s, was characterised by a comparatively low level of extra-societal influences on Indian policy-making. Industrial policies as well as economic policies in general reflected the outcome of bargaining and coalition building among Indian actors, leaving foreign actors only limited scope for influencing the policy-making processes. There were variations among the industrial policy areas, but the overall observation remains valid as such.

(4) This all changed around 1990, however, when India encountered a severe financial crisis. This prompted the Government of India to adopt policies broadly in conformity with standard IMF stabilisation policies and World Bank structural adjustment policies. The policy changes

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

[34] Cf. the conceptualisation of the policy process outlined in my introductory paper in the present volume.

> were to some extent supported by powerful Indian business lobbies, but they nevertheless reflected a shift in the balance of power between Indian and foreign interests.

I will comment in greater detail on the recent changes which may have brought about a situation where extra-societal constraints and direct influences have become more important than internal factors and intra-societal forces. But before turning to this issue, I will propose another general observation for subsequent discussion.

As indicated in the introductory paper to this volume, considerable differences may occur at the various stages of the policy process as regards the relative importance of determining factors. Those formally entitled to make industrial policies may dominate at the decision-making stage, while bureaucratic entities such as line ministries or public corporate bodies may dominate the outcomes at the implementation stage. Conditions and actors outside the state apparatuses may further have decisive influence on the actual impact of policy implementation. Using this kind of conceptualisation and mode of reasoning I will argue that extra-societal conditions and non-Indian actors influence industrial policy making in India chiefly at the decision-making stages where policies are being formulated, while parliamentary authorisation and actual implementation of policies through bureaucratic action (or inaction) continue to be strongly influenced by Indian actors, especially Indian business houses, business associations, and trade unions. As part of this interaction with state-external Indian actors I will further claim that leading government officials play important and to some extent independent roles.

Attempting to substantiate these general observations the following sections first take a closer look at the introduction of new economic policies from 1991 onwards and then at the implementation of policies at Union and State levels. Finally, I will briefly look at the combined impact of the policy framework and the institutional arrangements for their implementation, noting in this context the powerful positions occupied by representatives of foreign capital within the industrial structure of India. This part of the analysis will further reveal how pressure continues on the Indian authorities to further adapt to both external and internal demands.

The Crisis in 1991 and the New Economic Policies

Towards the end of the 1980s, India experienced surprisingly high growth rates. In the fiscal year 1988-89 alone, GDP increased more than 10 per cent. This level of growth, however, could not be sustained, because serious internal and external macro-economic and fiscal imbalances were building up. These imbalances reached crisis proportions in 1991, when India came close to default in meeting its international payment obligations.

The 1991-crisis in most official statements has been explained with reference to changes in the international context. Such changes undoubtedly did contribute to deepening the crisis as I will argue below, but their impact would have been very different had the Indian government pursued more prudent economic policies during the 1980s. On this topic I tend to agree with the conclusions of an analysis undertaken by Deepak Nayyar (Nayyar, 1998). He argues that the Indian state became increasingly unable to mediate between conflicting interests and competing demands as a result of the break-down of the Congress Party system and the intensified regionalisation of Indian politics in the 1970s and 1980s.[35] Increased competition among political elites for votes prompted most of the political parties to pursue populist policies. Governments at both Union and State level substantially increased transfer payments on subsidies in order to please voters.[36] At the same time, government consumption was expanded, driven in part by the competitive politics of populism. Nayyar sums up the changes in the 1980s in this way:

> "First, there was a proliferation of subsidies. Some, such as the subsidies on food, fertilisers and exports, were explicit. These meant expenditure disbursed. Others were implicit in under-priced services of public utilities such as irrigation, electricity and road transport, or in under-priced goods produced in public sector such as steel and coal. These meant revenue foregone." (Nayyar, 1998, p 3126)

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

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

The fiscal regime that evolved during this period essentially implied public borrowing to support expenditure that did not yield any direct returns to the exchequer, nor did it expand the revenue base. To this should be added the increased utilisation of public lending to private companies as political patronage by political and bureaucratic elites. State-led industrialisation based on a broad national consensus, which had been a prominent feature from the mid-1950s to the early 1980s, was thus replaced by conflicting demands on public resources and policies driven by populism and patronage. The balance tilted from bureaucratised rent-seeking by the state as an institution towards (even more) rent-seeking by individual members of the political elites and the bureaucracy.[37]

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

One of the important changes was Iraq's invasion of Kuwait and the ensuing war in the Gulf area. This affected the Indian economy drastically. The largest single source of convertible currency in the years before the war had been remittances from Indians working in the Gulf area. Forced repatriation of several thousand migrant workers reduced these remittances substantially. In addition, the war resulted in considerable increases in oil prices.

Another important factor was the break-up of the Soviet Union which resulted in a significant decline in Indian exports to this previously very important trading partner.

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

In July 1991, the Government announced drastic changes in the industrial and foreign trade policies. Since then, further liberalisations have been introduced every year with each new Budget. The changes have included:

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[37] The formulation here is inspired by Kristen Nordhaug who, with reference to Taiwan, has described bureaucratised rent-seeking as increases of the share of revenue from a more or less stagnant national economy by improving the state's organisation and capability to extract resources from local communities - without providing much in return (Nordhaug, 1997, p 134).

- abolition of state licensing in most industrial sectors;
- removal of most of the regulations restricting the growth of large companies;
- opening up for the private sector of many areas previously reserved for development by the public sector;
- removal of numerous regulations pertaining to foreign investment and transnational business collaboration;
- introduction of various incentives to encourage technology transfers in general and foreign investment in high-priority industries in particular;
- freeing of foreign trade from government interference; and
- steps to making the Rupee fully convertible on the current account (not the capital account).

The new economic policies marked a fundamental break with the past (cf. Martinussen, 1993). They have significantly reduced the degree of state regulation in several respects and introduced a much more market-friendly and open-economy policy environment. Why did the Indian government introduce such drastic policy changes and why have they been sustained since 1991? This is the overall question that I will attempt to answer in the following sections. Following to some extent the approach of Grindle & Thomas (cf. the introductory article in this volume) I will start by briefly outlining the contextual factors which set the agenda for policy-making in India around 1991 and the following years.[38]

The Agenda-setting Phase

The political discourse in India around 1991 was dominated by four main ideological positions which may be summed up as follows (cf. Panini, 1995):

- Socialist values stressing poverty eradication, equality and the need for some degree of state planning and interventions in the economy;

[38] An interesting and more extensive attempt at analysing the three phases of policy-making more stictly in accordance with the Grindle-Thomas approach than attempted here is found in an unpublished thesis by Søren Hansen (1994). For an explanation that emphasises the importance of intra-societal changes preceding the economic reforms, see, e.g., Pedersen, 1994.

- Gandhian ideals opposing market values, consumerism and big business (although the latter can be accepted if they take upon themselves a 'trusteeship role');
- Economic-cum-cultural nationalism as propagated by the BJP and the RSS which opposes the entry of foreign companies, especially in consumer goods and media; and
- Liberalism advocating pro-market reforms and a reduced role for the state in economic development.

To these could be added opposition to the pro-business and pro-market positions from environmentalist movements and feminist movements.

It is interesting to note that the pressure from competitive politics of populism (referred to above) implied that even propagators of Hindu nationalism and advocates of pro-market reforms appealed to the voters for support by endorsing to a fairly high extent socialist values. Based on a review of the parties' political manifestos and the official statements of leading politicians of all persuasions I would tend to conclude that socialist values, including anti-business and anti-market stances, even after 1991, continued to hold sway over the other prominent ideologies. One would thus expect that in a policy-as-usual situation (in the Grindle-Thomas terminology) the agenda for policy-making would be shaped mainly by socialist values in combination with the other ideological positions. In retrospect, this was essentially the case during the 1980s, although towards the end of that decade state planning and the belief in the state as the main engine of growth and social development had come under increasing pressure. The disintegration of the Soviet Union and the break-down of other Communist regimes contributed to this change. The same applied to the experiences of the so-called high-performing Asian economies which encouraged Indian decision makers to pursue similar pro-market and market-governing policies rather than central planning and market-replacing development strategies.

Of greater importance, however, was the transformation of the policy-as-usual situation into a crisis-ridden situation in 1991. This paved the way for basic changes in agenda setting which directly impacted upon the decision-making processes. In this context it should be borne in mind that the shaping of macro-economic policies had for some time been dominated by non-elected top bureaucrats and economic advisers, especially in the Ministry of Finance. Several among these government officials had advocated pro-market and open-economy reforms from the mid-1980s onwards (see, e.g.,

Jalan, 1991). With the severe crisis in 1991 this segment of the policy-elite was given an opportunity to reinvigorate the reform process initiated by the Rajiv Gandhi government in 1985. They were given this opportunity also because of changes within the realm of party politics.

The Decision-making Phase

In March 1991, the minority coalition government led by Chandra Shekhar fell, forcing elections to the Lok Sabha. During the election campaign Rajiv Gandhi, son of Indira Gandhi and leader of the Congress (I) party, was assassinated. He was succeeded by P. V. Narasimha Rao, who formed a minority government after the elections. The Rao government took office 21 June 1991 at a time when there was an acute risk of India defaulting on its international payment obligations, threatening the survival of the government itself. In response, Rao brought into his government two leading representatives of the pro-reform bureaucratic policy-elite, Manmohan Singh and P. Chidambaram. Under their guidance the budget for 1991-92, which introduced the new economic policies, was prepared and presented to the Lok Sabha 24 July 1991.

The Rao government presented the new economic policies as an expression of the Congress Party manifesto and as the most rational response to changes in economic conditions within India and abroad (Hansen, p 78 ff). The Indian Finance Minister, Manmohan Singh, summed up the reasons for the policy changes in this concise manner:

> "There is a growing recognition that while the country did make substantial progress in the 1980s, its full development potential has not been realized. The world in which our old policies were conceived is now a very different place. Technology is today the main determinant of power and wealth of nations. That technology is with multinational corporations, not the public sector. To get access to modern technology, India has had to change its attitude to direct foreign investment. The old bureaucratic methods of controlling economies through quantitative import restrictions and industrial licensing will simply not work in India now that our economy has grown in depth and width. That is why we are deregulating and opening up to foreign investment."[39]

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[39] Finance Minister Manmohan Singh in an interview with the *International Herald Tribune*, October 21, 1991.

This could be taken as an excellent summary of the line of reasoning informing Indian pro-market decision-makers' re-thinking of the role of the state.

Indian scholars, particularly those adhering to socialist values, have distanced themselves from the official version of rational policy-making based on national priorities. They have argued instead that the change of economic policies in 1991 was brought about chiefly because of pressure from the World Bank and the IMF (e.g. Oommen 1993)[40]. Others have noted that every step taken by the government was in accordance with the major prescriptions of neo-classical economics which are also embodied in the IMF reform and crisis-management approach (Dasgupta, 1998, p 366 ff.).

Key bureaucratic decision makers, however, have rejected this interpretation, claiming that the pressure from the Bretton Woods institutions had been there all the time - without India submitting to their conditionalities.[41] Instead, they have argued that the policy changes were prepared already by the mid-1980s, but could not be effected because of opposition from a majority of the members of the Lok Sabha. The main reason why the policy changes could be effected in 1991 was because, at that time, they could be presented primarily as necessary crisis-management instruments. The seriousness of the macro-economic imbalances was so evident that it was widely accepted among politicians that radical steps had to be taken, even though they might undermine the system of political patronage and deviate significantly from earlier policy statements. The initiative came from the Ministry of Finance and the Ministry of Commerce. Core decisions were taken by the Ministries and Secretaries of these ministries in conjunction with Cabinet Secretary and with strong political support from the Prime Minister. Apparently, the Ministry of Industry did not play a major role in the decision-making process, and although consultations took place with business associations and individual business representatives their direct involvement was very limited.[42] The acute risk of defaulting on international payments apparently had provided the narrow bureaucratic policy-elite

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[40] Some of the critics noted that the documents prepared officially by the Ministry of Finance used US spelling which they took as an indication that IMF and World Bank economists had actually written them, even including letters from the Ministry of Finance to the IMF. Hansen (1994, p 89 f) brought this to my attention.

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

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

with a considerably higher degree of autonomy than in the preceding years. According to their own interpretation, the IMF and the World Bank were involved in the decision-making process merely as advisers.

This may be a correct description of the prevailing perceptions among key decision-makers, but then their perceptions of the options available were narrowed down and essentially made to conform to several of the IMF and World Bank recommendations.

Seen in retrospect, the response in 1991 to the financial crisis was to a surprisingly high degree in conformity with standard IMF stabilisation policies and World Bank structural adjustment policies. This was surprising because until then most economic policies in India had reflected the outcome of bargaining and coalition building among Indian actors, implying considerable attention to the specific economic and political conditions obtaining in the country. The new economic policies were not the outcome of such bargaining and coalition building. It was further surprising because several Indian economic advisers were very conscious about the unrealistic assumptions underlying the IMF approach in an Indian context (as well as in many other countries). The basic mode of reasoning among IMF staff may (with some simplification) be summed up in this way: The core problems were government deficits and a deficit on the balance of payments. Government deficits would lead to monetary expansion, increased demand in excess of supply, and thus inflation.[43] The remedy is to cut down on government spending. Similarly, the balance-of-payments deficit must be reduced by cutting down on imports through compressing demand and increasing exports by means of devaluation.

However, in an economy like India's where wages and prices are rigid the impact of compressing demand falls mostly on output and employment levels rather than on price levels. The outcome in India appears to have been exactly a reduction in demand which has brought about a reduction in the level of economic activity, especially industrial activity (as envisaged by Bhaduri & Nayyar, 1996, pp 32, 59 f).

Further, devaluation will increase exports only if the currency of the country concerned actually achieves a relative depreciation, not if other countries devalue at the same time as happened after the East Asian financial crises.

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[43] Or as summed up by two leading Indian economists: "The presumption is that the problems are attributable to government deficits which cause monetary expansion which in turn feeds demand in excess of the available supply of goods and services in the economy, thus fuelling inflation." (Bhaduri & Nayyar, 1996, p 31).

Since 1993, India has had no formal programme with the IMF but economic policies in general continue along the same lines, though with the very important exception that India did not introduce convertibility on the capital account and is not presently contemplating doing so. The Indian government also has not followed recommendations from the IMF and the World Bank concerning exit policies for fear of provoking strong opposition from the trade unions. For similar reasons privatisation of public sector companies has been pursued only in a cautious and selective manner.

These observations combined seem to indicate, on the one hand, increasing external influence on policy-making in certain respects, but on the other, careful selectivity and sequencing in accordance with conditions prevailing in India (a weak financial system unable to cope with full convertibility on the capital account) as well as in order not to provoke unmanageable internal opposition from organised labour.

In order to further determine what kind of perceptions and interests were reflected in the new economic policies it may be fruitful to try and assess them from different perspectives. The following section provides a general assessment in the context of Indian debates on state-led versus market-driven industrialisation. Then follows a section on the assessments of the three leading business associations in India.

General Assessment of the New Industrial Policies

There is widespread agreement among both Indian and foreign investors that business opportunities in India have improved after 1991 for two types of reasons: Because of the new industrial policies and because of a sustained higher level of growth (that in part or even primarily should be attributed to other factors). More specifically, the following positive effects on private industrial investment - including foreign investment - and international trade are often emphasised as outcomes of the new industrial policies:

(1) Costly and time-consuming controls have been abolished. Until 1991, the industrial approval system implied that private investors and companies had to spend considerable time and resources to obtain the necessary clearances. Most big companies had to maintain a special lobbying unit in Delhi to deal with government officials both formally and informally to speed up the approval procedures. Now, very few approvals are needed from the Central Government. Most clearances which are still required can be obtained at State government level. Because the States are often competing

with each other to attract private investment, processing of applications have generally been speeded up and streamlined considerably - at least in some of the States.

(2) It has been made easier for big companies to expand. Monopolies and restrictive trade practices legislation has been radically changed so that even big companies with market shares above one third can expand their production and sales without prior approval from Government.

(3) Several sectors which used to be reserved for the public sector have been opened up for private investment and in some of the sectors special incentives are offered for foreign investors.

(4) Foreign majority ownership is now allowed as the general rule while before the general rule allowed only 40 per cent of foreign ownership.

(5) Quantitative import restrictions have been abolished and tariffs lowered. On average, weighted tariffs have gone down from 87 per cent in 1991 to less than 30 per cent in 1997.

(6) Convertibility of the Rupee on the current account has been introduced. This is not particularly important for foreign investors. They have for long had the opportunity to repatriate profits without restrictions - and when investments have been financed in foreign exchange there have been no difficulties obtaining hard currencies for import. But seen from the perspective of Indian promoters, this change of policy has been an improvement.

Assessment of the New Industrial Policies by Indian Business Associations

It may be useful to briefly review the assessments of the new policy framework as formulated by big Indian business houses and their interest organisations. This can provide a different indication of the extent to which the post-1991 policies reflect external constraints and pressures. The overall assessments of the three apex bodies - CII, Assocham and FICCI[44] - are rather different.[45]

CII has recently adopted a very critical attitude to the Government's new policies, claiming that they favour new foreign companies coming to

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[44] The acronymns stand for: Confederation of Indian Industry; Associated Chambers of Commerce and Industry; and Federation of Indian Chambers of Commerce and Industry.

[45] The follwing observations are based on interviews with leading representatives of the business associations and individual companies as well as reviews of their public statements. Detailed references are not included here.

India for the first time as compared with both Indian controlled companies and 'old' transnational corporations in the country. CII is now endorsing the demands for 'a level playing field', earlier put forward by some of its leading members, incl. Rahul Bajaj. The basic position of the CII is that India has moved from too much protection to too little protection which may eventually result in policy-induced de-industrialisation.

Assocham in its public statements is less critical and instead prefers to reiterate its preference for free flows of capital and investment. Many of its leading members, however, do not share this attitude. While Ratan Tata as Chairman of the Tata group of companies supports both liberalisation and an open-economy approach to globalisation, some of his own directors are of the opinion that the opening up of the economy has happened too fast and gone too far. The existing companies have not been given sufficient time to adjust, and several regulations continue to prevent them from doing so even today. They feel that the Government of India is giving so much priority to attract new foreign investment that the whole incentive structure has been biased in favour of foreign investors. Other existing companies have expressed similar views, including established transnational corporations like Hindustan Lever and Siemens.

FICCI has tried to adopt a middle-of-road position welcoming foreign direct investment but expressing some reservations regarding foreign portfolio investments from institutional investors because this type of investment is too mobile and therefore might destabilise the economy as experienced in some of the high-performing Asian economies in 1997.

Although the opinions differ from one association to the other it appears that broad agreement has emerged among Indian industrialists that the new policy framework has introduced certain biases in favour of foreign companies and new foreign investors. Based on several interviews and a review of existing rules and regulations, the following factors and specific stipulations indeed appear to have created disadvantages for Indian promoters and companies vis-à-vis new foreign investors:

- Foreign investors can access capital funds abroad at much lower interest rates than Indian promoters can obtain in India. In recent years, the difference may have been as high as 12 per cent. The steep rise in interest rates after liberalisation and the depreciation of the Rupee both added to the difficulties of Indian promoters and companies. The former had no access to the kind of cheap credit which the transnational corporations could easily obtain abroad, and the Indian

owners were unable to prevent several take-overs of Indian assets quite cheaply.[46]

- Indian companies pay customs duties on all their imports while foreign companies can obtain exemption.
- Sales tax (4 per cent) in relation to inter-state transfers apply only to Indian companies; this is also the case for turn-over tax (2 per cent).
- While Indian companies have to pay excise duty immediately, foreign companies can often postpone their payment.

To these biases could be added the extra advantage of incoming transnational corporations who can use transfer pricing to reduce taxes paid in India. The same applies to established foreign controlled companies, provided their intra-firm transactions and the applied over- and under-invoicing can be done for products and services with no global market price, as in basic chemicals and pharmaceuticals. Utilisation of the transfer pricing mechanism is generally not available to Indian controlled companies, because they have very few activities abroad and because their cross-border capital transactions are tightly controlled.

Policy Implementation

The assessments outlined in the above sections focus on the policies formally adopted by the Central Government in India - with a few added observations concerning the perceptions of the new policy framework among business representatives. The assessments seem to indicate that post-1991 industrial policies more than the pre-1991 regulatory framework reflect external constraints and pressures. They leave the impression that important aspects of the new policies have been shaped in accordance with the interests of non-resident corporate and other investors as well as international trading companies. However, if we look at the actual implementation of the new policies, the picture becomes much more blurred and generally appear to indicate that intra-societal pressure groups and other actors, particularly large enterprises and business houses, continue to exercise considerable influence.

To substantiate this hypotheses requires detailed analysis beyond the scope of this paper. Some supporting observations may, however, be presented

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[46] An example of this was the acquisition by Coca-Cola Corporation of market-leading Indian soft drink brands such as Thumps Up.

concerning non-implementation of new policies, lack of transparency, State-level bottlenecks and other aspects of the overall incentive structure which, unlike the policy framework formally adopted by the Central Government, tend to disfavour foreign companies and newcomers. When studying these matters it may be helpful to make a crude analytical distinction between (a) the main features of the policy framework and formal procedures; (b) the institutional arrangements for policy implementation and the prevailing culture of bureaucratic decision-making; and (c) the wider institutional setting in which policies are being carried out and bureaucratic action taken. I will deal with these aspects of the implementation processes in turn.

As regards the main features of the new policy framework and formal procedures, the following are particularly worthy of note:

- Deregulation has been effected to a large extent in areas previously coming under the purview of the Ministry of Industry. A similar degree of deregulation has not been brought about even at the level of declared policies when it comes to the Ministry of Commerce and the Ministry of Finance. External trade is still heavily controlled by international standards, and reforms of the financial sector have not been taken very far.[47]
- Deregulation has been confined mainly to Central Government policies and procedures. Only a few State governments have followed suit and adapted their regulatory frameworks to those of the Central Government.[48]
- Processing of applications at State level continue on a case-by-case basis in many areas - without adherence to universal and publicised criteria.
- Regulations and procedures are frequently changed.

These features in various ways seem to disfavour newcomers in general and foreign promoters in particular. While established companies and business houses have opportunities to closely monitor policy shifts and procedural changes relating to their activities and the specific locations thereof, new

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[47] The literature on India's economic reforms is extensive. I think one may acquire a balanced view of the progress and shortcomings by combining the studies in Jalan, 1996; Cassen & Joshi, 1995; Bhaduri & Nayyar, 1996; and Ahluwalia & Little, 1998.

[48] According to a CII study, the number of clearances still required (in 1996) at State level vary between 25 and 101, depending on the State and the type of project. A respondent from the Tata group said that 39 steps were involved when setting up a power plant.

promoters often face difficulties finding out about the wide variety of regulations and procedures applied by different clearing agencies and departments, especially at State level. These difficulties are further accentuated by widespread non-implementation and inconsistencies in the regulatory framework as when so-called automatic clearances do not come forward in practice or when one-window approval agencies are not actually empowered to give the necessary clearances.[49]

The difficulties facing new industrial promoters, particularly those unacquainted with Indian conditions, are compounded by the institutional arrangements for policy implementation and the prevailing culture of bureaucratic decision-making. Important features here are lack of transparency in decision-making and the discretionary powers vested in bureaucratic agencies and even individual government officials. As a legacy from British colonial administration, processing of applications and decision-making within Indian bureaucracies even today are enveloped in secrecy, frequently even concerning the criteria applied and contracts signed by the authorities.[50] At the same time government officials at higher levels of the hierarchy are vested with considerable discretionary powers in their discharging of administrative functions. This provides scope for outside influence and for discrimination based on personalistic relationships. These features, in turn, work in favour of established Indian owners and managers who are generally in better positions than their foreign counterparts and newcomers to transgress the wall of secrecy and exert influence on key decision-makers.

It came out clearly from my studies at State level in Karnataka and Tamil Nadu that industrial promoters as well as managers of established companies often had to approach top-bureaucrats and even individual politicians in order to get clearances in principle. The Secretaries (i.e. heads) of the Industries Departments in the two States apparently spent most of their time meeting with business representatives and discussing with them in great detail their expansion plans or proposed projects. Support and approval

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[49] Even in a state like Karnataka where compliance with Central Government reform policies has come far, the one-window agency established to facilitate new investment (actually two, depending on the size of the investment) only issues clearances in principle. Actual approvals and inputs (power and water connections, for instance) must be obtained from the relevant departments, which takes time and often presupposes payment of 'speed money' to each of these departments.

[50] An excellent insider's analysis of bureaucratic decision-making with emphasis on the rules and procedures which constitute breeding ground for corruption is given in Gill, 1998.

in principle was frequently given based on these discussions and without consulting subordinate government officials. Top managers of large private sector companies would typically interact directly with top bureaucrats on a weekly or fortnightly basis.

Foreign promoters may be able to develop and exploit to their advantage such personalistic relationships with the higher echelons of the bureaucracy, but most likely incurring much higher costs and experiencing longer delays than established Indian promoters and managers. Two aspects of the wider institutional setting are believed to favour the latter: The economy of affection, and the economy of corruption and patronage.

The economy of affection as a general concept refers to networks of mutual obligations based on kin, community, religion or other shared affinities (cf. Hyden, 1983; Martinussen, 1997, p 246 ff.). In the present context, it refers to the social networks which link government officials with outside groups. Although separated from the rest of society by intensive socialisation processes and specific rules that govern their behaviour, Indian government officials frequently remain loyal to outside social networks. They are inclined to favour members of their own network. Others who do not belong to their 'in-group' have to provide something extra to obtain similar favours - not necessarily in the form of simple bribes, but more often in more subtle forms of reciprocal exchange of services and favours.

When bureaucratic decision-making is heavily influenced by economy-of-affection considerations - as is often the case at State level in India - the outcome is governed more by a patronage logic, rather than by formal rules and a policy logic.[51] Or in other words: Policy implementation is not chiefly shaped in accordance with policy decisions and formal rules and criteria, but distorted and biased by external social and political pressures and ties. Under such conditions, implementation processes and actual procedures take precedence over formal policy-making. Further, such conditions tend to benefit owners and managers of large established firms and industrial houses, because they belong to the most powerful social networks. They may not always have as many resources to support their claims for bureaucratic action and privilege as competitors among incoming transnational corporations, but they start out with more knowledge about informal procedures and much closer personalistic ties with key decision-makers among both government officials and

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[51] Hans Blomkvist has provided a good analysis of decision-making governed by a patronage logic in an Indian context; cf. Blomkvist, 1988. His analysis to some extent builds on Gunnar Myrdal's earlier conceptualisation of the 'soft state' in India; cf. Myrdal, 1968, Ch. 18 (summarised in Martinussen, 1997, p 225 ff.).

politicians. The main line of demarcation here is not between Indian controlled and foreign controlled companies. It is rather between, on the one hand, companies established in India with strong Indian management, and on the other, incoming foreign companies and those with foreign management.

The above outline of the interference of the economy of affection with the implementation of industrial policies to some extent overlaps with the point I want to make regarding the role of the economy of corruption and patronage. However, exchange of privileges and services based on shared affinities need not involve corruption in the sense of bribing. It may rather be seen as complex forms of nepotism and favouritism and associated patronage. Corruption in the narrow sense comes in when bribes are paid to bureaucrats or politicians in order to obtain favours, clearances, etc., from the state. Bribery has been used extensively by both foreign and Indian firms over the last decade. This can be seen as part of a broader economy of affection where affection not provided by shared affinities and identities is paid for, but I think it is more valuable for analyses to make a distinction here. Exchanges and patronage within the economy of affection are based on enduring or semi-permanent personalistic relationships. This ensures a high degree of transparency and predictability for those directly involved. This is often not the case with regard to exchanges of payment and patronage between parties not affiliated and without shared affinities and identities. As a result of this, foreigners (and newcomers) may again find themselves disadvantaged when trying to get the necessary approvals and services from public agencies in India.

Politicians and bureaucrats may often and easily accept bribes from 'foreigners' (in a broad sense of the term), but especially the politicians are unlikely to build their future mainly on such relationships. They are more prone to rely on what has over the years become a well-structured and robust system of corruption and patronage, where the main players are Indian industrialists and property owners (and powerful criminals) who pay politicians and top bureaucrats for privileges, services and protection. The politicians, for their part, rely heavily on such illegal payment for financing election campaigns and providing patronage to their supporters and those who could threaten their power positions.[52] The main point in the present context is to further stress the observation above that this system embodies preferences among politicians for enduring relationships with established

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[52] The literature on corruption in India has grown in recent years with more insiders coming forward with convincing evidence. Some of the more important works in this area include Wade, 1989; Gill, 1998; and Visvanathan & Sethi, 1998.

Indian industrialists and property owners, while bribes from foreigners and newcomers can only be used as less predictable supplementary funding.

This is not to say that foreign companies cannot establish themselves successfully in India with the necessary assistance and support from the politicians and bureaucratic agencies. A large number of companies have evidently done so since 1991, as well as before. But they have done so in a less friendly environment and at higher costs than established Indian promoters and business houses have faced when these have wanted to expand their operations. The whole institutional set-up for policy implementation has not been very conducive to foreign direct investment. Instead, it has favoured existing enterprises, especially large business houses with enough resources and capacities to cope with lack of transparency, the culture of political and bureaucratic decision-making, and administrative bottlenecks at the State level.

This may be an important reason why new foreign investment has not come forward since 1991 to the extent expected by the Indian authorities. In more general terms, the impact of the post-1991 policies has fallen far short of expectations as will be shown in the next section.

Policy Impact

Turning to the issue of impact it should be stressed from the outset that the policies adopted and the ways in which they have been implemented constitute only part of the complex determination of the pattern of industrial development. Other important factors are global and regional conditions and actors affecting cross-border economic transactions and the parameters for domestic and international combativeness of India's industrial companies. Additional determining factors are the strategies adopted by both Indian and foreign companies in response to changes in the policy framework and the economic conditions. It appears warranted to conclude that while India's post-1991 industrial policies reflected attempts at accommodating more than before the interests of foreign capital, the actual implementation of these policies embodied biases mainly in favour of established and large companies in India, national as well as foreign controlled. The pertinent question then in relation to impact is whether the actual outcome implied the strengthening of India's industrial enterprises in accordance with their relatively strong influence on policy implementation. Again this kind of analysis is beyond the scope of a brief paper, but I will argue that the patterns of industrial and economic development in India since 1991 indicate that the biases embodied in policy implementation in favour of India-based industrial enterprises have

been largely offset at the impact stage by extra-societal economic conditions and actors.[53] I will attempt to show this by first looking at reactions among India-based companies and subsequently at some of the disappointing results of the new industrial policies at macro level.

Companies involved in India's industrial development through investment and/or trade can be divided into categories according to their status in relation to the pre- and post-1991 regulatory frameworks.[54] At least five main categories may be identified in this way:

- Indian controlled companies and groups of companies who previously, until 1991, came under the purview of the Monopolies and Restrictive Trade Practices Act (the MRTP Act). These are the big Indian companies and business houses.
- Foreign controlled companies established in India before 1991 who, until 1991, were affected by the Foreign Exchange Regulation Act (FERA) and at the same time came under the MRTP Act. These are the big foreign branches and subsidiaries of transnational corporations with foreign held equity at 40 per cent and above.
- Foreign companies considering establishing manufacturing branches or subsidiaries and/or entering into strategic alliances (incl. joint ventures) in India after 1991.
- Foreign companies interested only in trading with India.
- Indian companies not covered by the MRTP Act, including small and medium-sized companies.

There is little doubt that the post-1991 industrial policies and trade policies constituted improvements as seen from the perspective of foreign companies considering establishing themselves in India or wishing to initiate or expand trade with India. Representatives of such companies have continued to complain about government restrictions and bureaucratic red tape, but most would agree that political and bureaucratic interferences with business transactions have gone down drastically since 1991. I will not in the present context go further into their perceptions and how they have been affected by

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53 'India-based' industrial enterprises refer to both Indian controlled companies and foreign companies established in the country. As argued above representatives of India-based companies, irrespective of ownership, have tended to assess the new economic policies essentially from the same perspective.

54 I have dealt with the regulatory framework which applied from 1974 to 1991 in greater detail in Martinussen, 1988, p 43 ff.

the new economic policies.[55] Indian small and medium-sized companies also will not be considered here. Instead, I will concentrate on the two remaining categories of companies because their reactions provide particularly interesting inputs to the discussion of biases in their favour or disfavour as a result of the opening up of the Indian economy to foreign investment and trade.[56]

Indian controlled companies and groups of companies who previously came under the purview of the MRTP Act have generally expressed great appreciation of the policy changes since 1991 as regards delicensing and other aspects of internal deregulation. They have been less enthusiastic about the rapid opening up of the economy.

The scrapping of MRTP restrictions and de-licensing have allowed these companies to expand in core sectors. The increased competition, mainly from new foreign companies and imports, however, has affected these companies negatively in several sectors where entry has been easy, where gestation periods have been short, and where quality of products has mattered.

The strategies adopted by several Indian companies have resulted in discontinuation of activities in areas meeting the above description. For instance, the Tatas withdrew from textiles and oil mills, partly because they were facing fiercer competition in these areas, partly because they could concentrate on expanding in the group's core sectors like steel, automobiles, power and chemicals where stipulations under the MRTP Act had previously restricted growth. Another example was L&T's withdrawal from office equipment - mainly because of increased competition and the fast technological developments in this area (printers, fax machines, etc.) which put the group in a disadvantageous situation as compared with the global leaders. This illustrated also how Indian controlled companies came under pressure especially regarding standard products where technological development is fast and where, therefore, high expenditure is required for R&D.

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55 A good indication of the changed perceptions among potential foreign investors may be obtained by comparing Price Waterhouse's assessments in 1987 and 1993; cf. Price Waterhouse, 1987; 1993.

56 The following observations are based on interviews with managing directors and other key informants representing the two categories of companies. These interviews were carried out in 1996 and 1998. I have talked to company managers also before the economic reforms to solicit their opinions about policies and conditions prevailing in India: in 1997, 1979, 1983 and 1988.

The Indian companies were less affected in areas where technological innovation is slow or where large-scale projects constitute the core of the activities. The latter could be explained by the fact that in project-related activities gestation periods would be long and continue to require several clearances from the authorities at both Union and State level. Indian controlled companies - along with 'old' foreign controlled companies in the country - continue to have an advantage in these areas as compared with newcomers, both Indian and foreign. They are more acquainted with and in better positions to extract the necessary clearances. This observation contradicts with the impression that at least some of the new foreign companies setting up in India have been able to negotiate very favourable package deals with the authorities, Enron and Cogentrix being particularly conspicuous cases. But these outcomes have been achieved only after long periods of negotiation and renegotiation.

Foreign controlled companies established in India before 1991 who were affected by FERA and MRTP Act stipulations can only to some extent be treated as one category, because the new policy framework affect the different sectors of industry in dissimilar ways. Both FERA and the MRTP Act, however, impeded overall growth of most of these companies prior to 1991. More specifically, the regulatory framework prevented the companies from expanding in product lines of their own choice, particularly when these product lines belonged to the consumer goods sectors. Moreover, mergers and amalgamations were difficult.

After 1991, these foreign controlled companies were allowed to expand in all the deregulated sectors, and most obstacles to amalgamations were abolished. Several of the companies reacted by concentrating their activities and selling off unrelated affiliates. But some of the very big transnational corporations pursued interesting combinations of strategies, expanding in their original core sectors while at the same time amalgamating with other companies to achieve "a well balanced portfolio of product categories" with a further view to "make the business more robust and less amenable to cyclical variations."[57] An important example was Hindustan Lever Limited (HLL), one of the very powerful companies in India, which started a process of amalgamations and mergers a few years after 1991. HLL thus took over Tata Detergents and Tata Oil Mills in 1993-94. The following year HLL amalgamated with Brook Bond Lipton India.

As for the impact on investment and growth, transnational corporations in consumer goods have generally expanded significantly faster after 1991,

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57 Hindustan Lever Limited, 1995 Report and Accounts, p 9.

and their overall growth rates have gone up. Transnationals in consumer goods, at the same time, have faced stronger competition from new international companies, but apparently they have been able to cope. They have complained, however, that the newcomers have often been allowed 100% ownership, while they - as already established companies - could only gradually increase their percentage of the voting shares. Companies like HLL in principle has favoured liberalisation of imports also in consumer goods, but along with most other established companies in this sector the management of HLL has argued strongly for simultaneous introduction of anti-dumping laws.

TNCs in more capital- and technology-intensive areas have faced fiercer competition from new international companies which they have not always been capable of handling. Siemens, for instance, has incurred losses in some of its activities for the first time since establishing in India.

The overall picture that emerges from these observations is that the new economic policies in some areas reflect so much emphasis on attracting foreign investment and facilitating international trade that they, at the same time, reflect less attention to the interests of established industrial enterprises, Indian as well as foreign controlled. Much more analysis is required at company level, but it seems that the combined impact of the new policies and other determining factors, such as increased competition from abroad, has augmented the pressure on India-based companies. Even the professionally managed and high-performing Indian companies mentioned above have encountered difficulties due to increased competition and threats of foreign take-overs.

Turning now to the impact of the post-1991 policies at macro-level it should be stressed that other determining factors have strongly affected the outcome. Especially the East Asian financial crisis and global recession in recent years have probably prevented some of the new policies from achieving their intended impact. International sanctions following India's nuclear tests may have added further to weakening industrial growth.

The Indian Government's own assessment, however, is generally positive. The official interpretation is that the reforms undertaken since 1991 have led to a revival of strong economic growth; a dramatic increase in foreign private investments; rapid expansion of productive employment; a reduction of poverty; a substantial boom in exports; and a marked decline in inflation rates.[58]

[58] The official interpretation is given primarily in the annual Budget Speech and the annually published Economic Survey. The figures given in the following sections are from the latter.

While this may be a too optimistic assessment of the impact of the reforms - giving too little credit to other growth-facilitating factors like normal monsoons every year since the reform process began - there are strong indications that the new policies helped the Indian economy recover from the crisis and start to grow faster and in a more sustainable way than previously.

Despite the deep crisis in 1991-92, average annual growth from 1992 to 1996 has amounted to an average of 5.8 per cent per annum in real terms. This is deemed a remarkable post-crisis achievement even by international standards. The external accounts strengthened considerably. After registering a decline in the dollar value of merchandise exports in 1991-92, India experienced a strong boom with annual export growth averaging 19 per cent in 1993-94 and 1994-95 and then accelerating to 21 per cent in 1995-96. However, export growth slumped to only 4 per cent in the fiscal year 1996-97. The overall improvements in the trade account since 1991, though, have been reinforced by favourable trends on invisible transactions, thus reducing India's current account deficit in the balance of payments from 3.2 per cent of GDP in 1990-91 to an estimated 1.6 per cent in 1996-97.

Meanwhile, foreign direct and portfolio investment flows have contributed to a large surplus in the capital account. Growth of foreign direct investment has averaged around 100 per cent 1992-93 to 1996-97. In 1994-95, foreign direct investment amounted to USD 1.3 billion, up from USD 620 million the year before. Foreign direct investment in 1995-96 rose to USD 2.1 billion; in 1996-97 to USD 2.7 billion; and in 1997-98 to USD 3.2 billion.

These favourable trends in both current and capital accounts of the balance of payments have been reflected in a rapid rise in foreign currency reserves - from USD 1 billion in 1991 to USD 16.3 billion in January 1996, equivalent to about 5 months expenditure on imports. The continued surge of capital flows into India swelled the foreign exchange reserves to USD 25.4 billion in mid-1997. India's external debt situation has also improved markedly in the past few years.

The impact of the new policies is particularly visible in the industrial sector which has surged ahead, registering a growth of 8.6 per cent in 1994-95, up from 2.3 per cent in 1992-93 and 6 per cent the following year - but down to 4 2 per cent in 1997-98.

While the setbacks in 1997 and 1998 may chiefly be attributed to the East Asian crises and global recession it seems warranted to conclude that, during the period 1991-1996, the new economic policies did contribute to improving India's economic performance over the pre-1991 period. The results, however, have fallen short of official expectations and increasingly so in recent years, particularly in the area of foreign investment. Moreover, recent

policy adjustments have indicated that external pressure on Indian policy-making has further increased and reduced the room for manoeuvring.

One of the main objectives of the new economic policies was to attract more foreign capital and particularly more foreign direct investment. As mentioned above, much more foreign capital poured into India after the reforms than before and net private capital inflows remained at a significantly higher level. However, the annual inflow has not reached anywhere near the level aimed for. Besides, a very substantial part of the inflow came in the form of portfolio investment from non-resident Indians who have been offered attractive rates of interests and other incentives.[59] The official objective was to attract US$ 10 billion a year in foreign direct investment alone, while the actual inflow has never reached much beyond US$ 3 billion. Moreover, India's performance in comparative terms has not been impressive, as may be inferred from the table below.

Inflow of foreign capital, selected developing countries (annual averages)

	Net private capital inflows as pct. of GDP		Net foreign direct investment as pct. of GDP	
	1983-1991	1991-1996	1983-1991	1991-1996
India	1.4	1.5	0.1	0.4
China	1.1	3.5	0.6	0.5
Indo-nesia	2.6	4.8	0.6	1.8
Brazil	0.6	3.5	0.4	0.5

(Source: IMF, 1998, Part II, Table 3.5)

Net foreign direct investment has increased as a percentage of GDP, but from an extremely low level, and not as much in absolute terms as in the case of China and Indonesia. As for total private capital inflows, the increase has

[59] Amiya Kumar Bagchi, among several other Indian economists, has criticised the new economic policies for being biased in favour of foreign financiers and speculators; cf. Bagchi, 1998.

remained very modest, up from 1.4 to 1.5 per cent of GDP. This is very disappointing as seen from the Indian policy-makers' perspective.

As argued above, liberalisation and deregulation were brought about in ways that favoured foreign companies and importers over domestic producers. The BJP-led government which took office in the Spring of 1998 tried to correct this with the 1998-99 Budget which stipulated an across-the-board increase of import duties/tariffs of 8 per cent. This increase was primarily motivated by 'level-playing-field' considerations. It was an attempt to reduce actual discrimination in favour of importers over domestic producers (Indian as well as foreign). The tariff increase, however, was challenged by the EU Commission who threatened to bring the matter to the WTO - arguing that with the increase more than 200 products imported into India would be levied duties above the WTO standards. The Indian Government responded by lowering the tariff increase to 4 per cent and by entering into consultations with the EU Commission on the matter. Further action was postponed by the Commission in October 1998 awaiting an explanatory note from the Indian Government. But pressure to further reduced the tariff level was maintained.

The point I want to make here is that the Indian Government was not in a position to enforce higher tariffs in accordance with national priorities but had to adjust to WTO standards, even though the authorities could probably justify the move, at least to some extent, with reference to the need for balancing policy impact upon India-based versus foreign-based industrial companies.

Similar adjustments in conformity with WTO requirements are expected in several other areas - indicating the increasing extent to which Indian policy-making is under external pressure. By accepting the Marakesh agreement of 1994 and joining the WTO, the Government of India also accepted to adopt revised policies in conformity with global standards in areas such as Trade-Related Investment Measures and Trade-Related Aspects of Intellectual Property Rights. This implies further policy adjustments that are likely to submit India-based companies to increasing competition from foreign companies, particularly in pharmaceutical and chemical industries, as well as intensify the pressure on these companies to invest much more in R&D and other productivity enhancing measures. A large number of India-based companies and especially Indian controlled companies are not in a good position to cope with these challenges.[60]

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60 For a discussion of these issues, see, e.g., Bagchi & Bhattacharya, 1995; Oommen, 1994; Dhar, 1995.

Concluding Observations

The post-1991 economic policies in India are strikingly similar to the IMF prescriptions with some exceptions, though, as regards non-convertibility on the capital account, exit policies, and the extent of privatisation of public sector undertakings. This seems to indicate, on the one hand, increasing external influence on policy-making in certain respects, but on the other, careful selectivity and sequencing in accordance with conditions prevailing in India (a weak financial system unable to cope with full convertibility on the capital account) as well as in order not to provoke unmanageable internal opposition from organised labour. External pressures undoubtedly contributed to bringing about the policy changes but these also reflected a combination of necessary crises management and sequencing of reforms in accordance with demands from influential Indian pressure groups.

There is strong indication, however, that liberalisation went too far - and was carried out too fast - as seen from the perspective of India-based companies.

While the new industrial policies reflected attempts at accommodating more than before the interests of foreign capital, the actual implementation of these policies embodied biases mainly in favour of established and large companies in India, national as well as foreign controlled. The actual outcome, however, did not imply a strengthening of India's industrial enterprises in accordance with their relatively strong influence on policy implementation. Rather, the patterns of industrial and economic development in India since 1991 indicate that the biases embodied in policy implementation in favour of India-based industrial enterprises have been largely offset by extra-societal economic conditions and actors.

Meanwhile, there is little doubt that the modest economic achievements by the late-1990s and the membership of the WTO have reduced the scope for any reversals of the reform process. Yet, opposition is building up in India against further opening up of the economy. The need for liberalisation of policies has been widely accepted, but this does not apply to all aspects of integration of the Indian economy into the 'globalised' economy.

By adopting a flexible and compromising strategy, by slowing down the reform process and postponing (or giving up?) some of the most unpopular policies, the government has so far managed to build sufficient support for continuing the reform process. There is a widespread consensus regarding the necessity to promote private - Indian as well as foreign - investment. Major trade unions, representatives of farmer interests, and most key decision makers at both central and State levels have accepted this necessity. But the

values and ideologies still prevailing among large segments of the (articulate) Indian population embody strong reservations.

The outcome is likely to be determined primarily by the capability of Indian business house to compete with foreign companies in the domestic market - and the net advantages they are able to obtain from combining competition with strategic alliances with transnational corporations. If they fail, they are likely to give much more emphasis to 'Swadeshi' - self-reliance, economic nationalism and inward-oriented and protectionist economic policies. What will happen then, considering to what extent the Indian economy has already been integrated into the regional and global processes governed by the new rules of the game established by the WTO and other international institutions? That is a crucial question the answer to which will reveal much about the fundamental balance of power and the relative importance of external influences on the shaping of India's industrial and other economic policies.

John Degnbol-Martinussen

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