

## 深受過去經發策略拖累的印度出口表現

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### 中文摘要

本文主旨在檢驗印度從封閉而管理嚴密的經濟到以出口為導向的市場經濟的演進過程，尤其集中在探討其獨立以來之貿易政策，剖析其貿易政策變遷之背景，並點出其延續與變化之所在。

作者認為今日印度的貿易政策仍深受過去尼赫魯（Nehru）與馬哈拉諾比斯（Mahalanobis）經濟發展策略之影響。尼馬（NM）經發模式強調在相當封閉的經濟體制下透過工業化追求自給自足的經濟成長。在他們眼裡，出口的唯一功能是為了支付進口。此一發展模式植基於高成本的經濟基礎之上，嚴重阻礙出口之發展。而由於此一經發模式的失敗導致印度必須開放經濟。儘管如此，此一模式本身以及其缺點時而迫使印度政府採取一些不利出口努力的措施。而這些措施的實施卻意外地創造出印度經發擘劃者所始料未及的有利資訊工業（IT）繁榮的機構。



不過，目前印度的出口卻出現瓶頸，若不根除這些殘存的不利因素，並投資基礎架構，否則出口成長將無法持續。但是，因為這些政策措施所衍生出來的既得利益使改革困難。結果，雖然改革的需要剛一開始極為明顯，但是在許多情況下改革被迫拖延至最後關頭。紡織業和成衣業就是最佳的例子。基礎設施亟需投資但是政府此刻卻無能為力。80年代起的財政動蕩導致資本密集高的產業被迫改革、「企業化」並隨後接受市場的考驗。然而，若是以政府在權力改革推行的速度和結果不確定性來作為將來改革的標準，印度要成功地推動出口仍將極受限制。



# **India's Trade Policy A Hostage of Ghosts Past**

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## **Introduction**

It is commonly held that the year 1991 marks the turn-around in India's policy making; from that year India finally broke with the dirigiste Nehru-Mahalanobis economic model and gave the market the pride of place in economic decision-making. It also marks the era where a relatively closed economy that had viewed international trade sceptically, embraced the

concept of export-led growth enthusiastically. Although the above is not entirely false it masks the fact that Indian planning had been slowly but surely relaxing the stranglehold of the state over economic decision-making throughout the eighties. In similar vein the policy-makers had also been promoting exports for quite sometime even before the final decisive break of 1991<sup>1</sup>.

This paper examines the evolution of India from a closed tightly regulated economy pursuing a policy of self-sufficient growth through industrialisation, into an economy that is clearly evolving into market driven economy where the primary impulse of growth is arguably external in nature, driven by export demand. It seeks to examine India's trade policies since independence to explain continuity and change in such policies as they have evolved.

The contention of this paper is the following: India's Trade policies are hostage to circumstances created by policies followed during the 'plan period', i.e. the Nehru-Mahalanobis (NM) strategy. We will argue that although the Nehru-Mahalanobis model envisaged industrial growth within the confines of a relatively closed economy (where the sole role of exports were to pay for its imports), it paradoxically contained the seeds of its dissolution as well as one that would lead to a policy of export promotion. At the same time N-M model inhibited export promotion by laying foundations of a high cost economy. Although India discarded the NM and *de facto* went in for export-led growth, the NM's final bequest to India's trade policy would be features that limit the manoeuvring space of Indian exporters even in the face the constraints they actually face.

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<sup>1</sup> Agarwal, Manmohan & Dipankar Sengupta, 'Financial Markets in India: Reforms in India from the BOP Crisis to the East Asian Crisis' in 'Beyond the Rhetoric: The Economics of India's Look East Policy' vol 2 (eds) Frederic Grare & Amitabh Mattoo, Manohar, New Delhi 2003

We will conclude with policy prescriptions that seek to enhance India's export performance given opportunities that are likely to arise in the future, the constraints that India faces and the competition that awaits it in the future.

This paper is divided into the following sections. In the first section we discuss the Import Substituting Industrialisation (ISI) policies followed by the government, rationale for such a policy, instruments that were used to implement such policies as well as the impact of such policies. In the second section we discuss the trade policy adopted by the State. In the third section we talk about the developments in the economy and its impact on policy-making including trade policy. In the fourth section we talk about the policies pursued in the eighties, their unsustainability and the consequent BOP crisis of 1991. In the last section we talk of the reforms that have followed, their initial successes and tapering off and the reasons for the slowing of the economy and how these are related the policies of the fifties. We also discuss the appropriate policy changes that are required if India's trade performance is to pick up and regain the growth rate it exhibited during its initial spurt immediately after reforms.

## **Section I The Nehru-Mahalanobis Model**

There were a number of reasons why India chose industrialisation over all strategies. Firstly, the political leadership that assumed power during independence had witnessed that during the freedom struggle, how the USSR, which was in ruins after the First World War, the Bolshevik Revolution and the Civil War rapidly transformed itself into an industrial economy by the eve of the Second World War. Moreover this transformation was carried out at a time when western capitalist economies stagnated due to prolonged recession. This was buttressed by the arguments of economists, most notably Prebisch<sup>2</sup> who cautioned against relying on primary market production and their exports arguing that this would not to development. Expansion of Export volumes would lead to a decline in the terms of trade

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<sup>2</sup> Prebisch, R & H. Singer,

and so export earnings would increase relatively slowly. At the same time imports of capital goods would increase rapidly as investment would have to accelerate if GDP were to grow rapidly. Rapid growth in imports combined with sluggish export growth would result in a BoP deficits which would force the state to cut down investment and consequently growth. Thus theoretically too, the case for industrialisation and against primary output based growth strategies was strong.

Industrialisation however could be export oriented or import substituting. However following Nurksian arguments<sup>3</sup>, that investment in Less Developed Countries (LDCs) were constrained by a lack of demand and protection of the domestic market (via high tariffs to discourage imports) would make the home market more profitable, made ISI the preferred option. Additionally, the intellectual mood of the period was one of 'export pessimism'<sup>4</sup>, based on the experience of the inter-war period and fears that labour-intensive exports from LDCs in general would face significant trade barriers. For the export of more sophisticated goods, it was felt that India needed time to create/develop a industrial structure and a labour force that could produce such goods competitively in the labour market. All this made the arguments in favour of ISI even more attractive and this was the model ultimately adopted.

Specifically, in keeping with the original Soviet model, the aim of the Indian planners was to achieve a industrial structure in the minimum possible time. It was not to maximise national income at any point in time. Such an objective called for the concentration of investment in the (capital-intensive) capital good industry in the initial stages of the planning period with resources being transferred to the

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<sup>3</sup> Nurkse, Ragnar, 'Some International Aspects of the Problem of Economic Development' in *The Economics of Under-development* (eds) AN Agarwal and SP Singh, Oxford University Press, New York, 1963

(labour-intensive) consumer goods industry in the later stages of the plan period.

### **The Tools for implementation of the NM model**

A programme of ISI could be implemented in a number of alternative ways. One way would be through a system of tariffs, taxes and subsidies, that would make the domestic market more attractive(via tariffs), investment in the desired sector of the economy (in this case the capital goods sector) more attractive(via subsidies/tax breaks) and discourage investment in consumption goods (via taxes). Indeed economic theory would suggest this course of action.

However India did not rely on these instruments that affected price signals to stick to the planned investment programme. India went in for a regime of quantitative restrictions (QRs) consisting of quotas, licenses and permits (as exemplified by the Industrial Development Regulations Act 1955) to regulate investment. Additionally, although ISI models are ownership neutral, Indian policy makers decided to make state owned public sector units (PSUs) the prime actors in the industrial growth process.

One reason as to why QRs were chosen over more conventional tools was because the former was believed to provide more certain signals to prospective investors in the protected sectors than the latter. The impact of tariffs was more uncertain because low prices (caused by business cycles) could neutralise the impact of tariffs. But QRs like licenses also had another purpose; they were used to marginalise/curb the private sector to the benefit of the state-owned Public Sector Units<sup>5</sup>. The economic argument was that private sector units did not possess the capital or expertise to go into heavy industry. This is clearly an unsatisfactory explanation. If indeed the Indian private sector was unable due to lack of capital or expertise to invest in an

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<sup>5</sup> Nayyar, Baldev Raj, 'Globalisation and Nationalism: The Changing Balance in India's Economic Policy 1950-2000, New Delhi: Sage Publications, 2001.

area, they would not do so in their own interest<sup>6</sup>! They did not have to be prevented by a system of licenses. Secondly even before independence, Indian private capital had invested in heavy industry profitably and with distinction e.g. Steel and automobiles and there was a sizeable presence of British-owned Engineering companies in India.

The main objective of the QR regime was usher in a 'socialistic pattern of society' where PSUs would have an increasingly large role to play and Indian private capital slowly but surely marginalised.

#### The Impact of the NM model and the Genesis of the High Cost Economy

There were a few conceptual problems with ISI strategy. Given the fact that LDCs (and indeed India) were poorly endowed with capital, how would they be able to finance a full scale industrialisation programme which called for large scale investments across a large number of industries? Secondly, since these investments (most likely capital goods) would necessarily have to be imported where would the necessary foreign exchange come from since exports were not especially emphasized upon?

Indian planners pinned their hopes to two factors:

1. The sterling balances that India had accumulated during the second world war
2. Foreign Aid from the USA, USSR and other Developed Countries.

While there was something paradoxical about pursuing the goal of self-reliance with the help of foreign aid, India embarked on the goal of industrialisation via the Nehru-Mahalanobis model in 1957 with the second 5-year plan.

Given the fact that India decided to invest in a range of industries at the same time, it meant that India sacrificed economies of scale in favour of a diversified industrial structure. This of course gave rise to the high cost

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<sup>6</sup> Nayyar, Balder Raj, *op cit*



economy as inputs from in-optimal scale industries were of necessity priced steeply as costs were high. Secondly, when state-owned public sector units turned out to be inefficient and failed to supply essential inputs like steel and cement shortages did not lead to an automatic increase of supply from the private sector on account of the licence-permit regime. This only reinforced the high cost economy. Thus even efficiently run plants in so far as they had to buy industrial inputs would be at a disadvantage were they to compete in global markets. Nor could these in-optimal scale industries 'grow' into optimally scaled factories unlike List's infant industries as even expansion of capacity was controlled by the state and the procedures were extremely cumbersome. Thus the official policy of neglecting the export sector was now compounded by the creation of a high cost economy a necessary outcome of the NM model and the tools utilised to implement it.

Surely enough the NM model ran into Balance of Payments problems as Foreign Aid and India's exports (then composed of traditional items like jute products and tea) could not support the import requirements. More importantly, the model (or at least the planners) had not given India's largely rain-fed agriculture the importance that it required, unrealistically relying on good monsoons to continue so that food requirements were met. In the mid-sixties, the monsoons failed and there was a large fall in agriculture production. India could not meet her food requirements. India would have to import food. Thus engaging the global economy at least to buy food had become a must. In the mean time, to stave off starvation, India depended on grain from the USA given to India on credit and then converted into a gift in 1976.

The problem was that by this time India had positioned itself into a corner from where it had little manoeuvring room. India could not divert part of its industrial production to pay for its imports as it had become a high cost economy; its products too costly to be competitive in the market. It was then that India then very much a quantity-rationed economy went in for a textbook solution. In 1965, it devalued its currency by a third to make it good competitive and boost exports.

The devaluation failed. This was not surprising. It must be pointed out that the sufficient conditions for a successful devaluation i.e. the Marshall Lerner conditions (sum of the demand elasticities of exports and imports be greater than 1 and the supply elasticity of exportables be infinitely elastic) were probably not met. This is because Indian exports in the 1960s were dominated by items like jute and tea (see **Table 1**) the demand elasticity for which were likely to be low. Moreover given the quantity restrictions that prevailed certainly ensured the violation of the second assumption.

**Table 1: Profile of Indian Exports<sup>7</sup>**

Goods	1960-61	1970-71	1980-81	1990-91	1999-2000
Figures in million dollars, percentage in parenthesis					
<b>1 Agriculture</b>	<b>596</b> <b>(44.2)</b>	<b>644</b> <b>(31.7)</b>	<b>2601</b> <b>(30.6)</b>	<b>3354</b>	<b>5671</b> <b>(15.1)</b>
(of which tea)	(8)	(6.2)	(2)	(3.2)	(1.8)
<b>2 Ores and Minerals</b>	<b>109</b> <b>(8.1)</b>	<b>217</b> <b>(10.7)</b>	<b>523</b> <b>(6.2)</b>	<b>969</b>	<b>687</b> <b>(1.8)</b>
<b>3 Manufactured goods</b>	<b>610</b> <b>(45.3)</b>	<b>1021</b> <b>(50.3)</b>	<b>4758</b> <b>(55.8)</b>	<b>12996</b>	<b>29153</b> <b>(77.5)</b>
(of which ready made garments)	(0.1)	(1.9)	(8.2)	(12.3)	(12.8)
(of which jute manufactures)	(21)	(12.4)	(4.9)	(1)	(0.3)
(of which leather goods)	(4.4)	(5.2)	(5.8)	(8)	(4)
(of which gems and jewellery)	(0.1)	(2.9)	(9.2)	(16.1)	(20.3)

<sup>7</sup> Taken from the *Economic Survey*, 2001 Government of India and the *Handbook of Statistics of the Indian Economy*, Reserve Bank of India, 2002-2003

(of which chemical goods)	(1.1)	(1.9)	(3.3)	(7)	(10.1)
(of which engineering goods)	(3.4)	(12.9)	(12.3)	(12.4)	(13.1)
<b>Others</b>	<b>32(2.4)</b>	<b>149 (7.3)</b>	<b>624 (7.4)</b>	<b>825</b>	<b>2088 (5.5)</b>
<b>Total</b>	<b>1346 (100)</b>	<b>2031 (100)</b>	<b>8486 (100)</b>	<b>18145 (100)</b>	<b>37599 (100)</b>

Thus while exports did not rise, imports did not fall either. This is because imports largely comprised of food and raw materials (66% of total imports) were maintenance imports vital to the functioning the economy. The devaluation fed the inflationary pressures already existing on account of failed monsoons.

Thus by the late 1960s, India was faced with a food shortage, a Balance of payments problem, stagnant Industrial and overall economic growth and double-digit inflation. Ironically, India had been doing reasonably well on these fronts before it implemented the NM model.

It became clear to policy makers that agriculture could not be neglected any longer and required special attention. Additionally the policy makers decided to diversify India's export basket to make it more income and price elastic. As the NM model given its capital-intensive nature did not create much by way of employment, the government also undertook some policy changes to remedy this shortcoming. As we will argue, policy changes taken to tackle separate areas would affect India's competitiveness years later.

In the field of agriculture, a 'Green Revolution' was ushered in whereby High Yield Variety (HVY) seeds were utilised to boost agricultural production. This technology required among other things regular and steady supply of water and fertilisers. Thus farmers had to be given fertilisers and

electricity at subsidised rates (and subsequently in some states free of cost) if the cost of food production had to be kept down.

From the point of view of employment, the state decided to reserve the manufacture of some commodities (the list of which grew from 47 in 1967 to 675 in 2003) for the Small Scale Industries (SSIs) which it was thought would be labour-intensive and would employ more labour. Some of the items reserved for SSIs were labour-intensive items any way and normally where India would have had a comparative advantage (textile products including hosiery etc.). Others were not. However the slew of laws enacted to keep big business out of this sector (which included caps on turnover and assets) also ensured that these units would never achieve economies of scale in almost none of these sectors. However as the economy remained closed, the high cost nature of these industries was not a great matter of concern. It would be after 1991.

### **Export Policy in the 1970s**

Indian policy makers had by this time realised that there was a need to boost exports if only to pay for imports and not necessarily as a strategy for export led growth. To this end the policy makers gave up the policy of relying on goods where India possessed merely geographical advantage like tea and jute and started to promote labour-intensive manufactures where India's comparative advantage was likely to lay as well as other slightly more capital-intensive engineering goods. This was done by relaxing some of the controls that existed in the economy for these sectors; there was no change in the regime of licences and permits. Given the high cost nature of Indian industry these firms had to be given subsidies to overcome cost disadvantages. The Cash Compensatory Scheme (CCS) that had been abolished after the devaluation had already been reinstated. Engineering items that commanded premium price and could be manufactured even in India's high cost milieu were encouraged (eg pump-sets etc). There was an effort to reduce the Nominal Effective Exchange Rate (NEER) of the rupee which given the fact that inflation in India was lower than world inflation caused the Real Effective Exchange Rate (REER) to go down. Other

extraneous factors also helped. There was an increase in the prices of primary products which meant that the revenue received for a unit of primary product rose. The Gulf economies became another market for Indian goods given the oil boom. There was also a general rise in the demand for Indian goods that propelled exports<sup>8</sup>.

But there was no attempt to do away with the system of licenses altogether and processes of setting up businesses remained as cumbersome as ever. India was unresponsive to the attractions of Foreign Direct Investment and making the economy the site for export oriented FDI in spite of an abundance of cheap unemployed labour.

In spite of the limited nature of India's policies, they did pay off. Exports grew from \$ 2 billion in 1970 to approximately \$ 8.5 billion in 1980 (in current dollars) (ref: Table 1) although in constant dollars (1995) it grew from \$ 6 billion in 1970 to \$ 11 billion dollars<sup>9</sup>. This growth came none too earlier as this era also saw oil prices rising from a dollar a barrel in 1970 to over \$ 30 per barrel in the early eighties. India's enhanced export performance and remittances of her workers from the newly enriched oil states enabled her to meet her rising petroleum bill without serious dislocation. There were however other developments. The Indian Patents Act of 1970 which did away with product patents in medicine providing for only process patents gave rise to domestic players in this field. Pharmaceutical exports almost non-existent in 1970 were over a billion dollars in 2000. The foundations of exports of chemicals too was laid in the seventies. All this added up to pretty diversified export structure with manufactures getting an increasingly higher share of exports than before.

But overall economic growth could not breach the notorious Hindu rate of growth of 2.5 % per annum. It must be noted that through out this period,

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<sup>8</sup> Nayar, Deepak, 'India's Export Performance, 1970-85' in Indian Economy: Recent Development and Future Prospects (eds) Robert EB Lucas & Gustav Papanek, Oxford University Press, New Delhi, 1988

<sup>9</sup> WDI 2003 CD-ROM Query database

exports were never seen as an avenue for growth. The source of growth remained domestic largely via public investment in a largely controlled economy. *Such a strategy required imports and thus the economy exported merely to pay for its imports*<sup>10</sup>. Growth, constrained as it was by the regime of permits and licences, was further constrained by agriculture and exports whichever was more constraining. Thus a bad drought or an oil shock that kept on occurring from time to time would bring forth inflation and a slowdown in the economy.

By and large this paradigm of low growth was sustainable given the export performance and growth of agriculture. However, Indian policy makers were no longer satisfied with an economy with a Hindu rate of growth plagued by pervasive shortages in the case of items like cement and steel as well as occasional shortages in the case of foodstuffs. They wanted to grow faster.

### **Indian Exports in the 1980s**

Indian Policy makers did not effect any fundamental change in the economy especially when it came to the policy of dirigisme. While maintaining the regime of licences and controls they became more liberal with the licenses. Additionally, the central government started to run higher and higher deficits. In the seventies, the central government had for most part enjoyed a surplus on the current account (i.e. its revenues were always greater than government consumption); the government had only borrowed to supplement this surplus to finance capital expenditure. In the eighties the government threw fiscal prudence to the winds increasing expenditure to such an extent that it had to borrow even to finance consumption. This no doubt had an expansionary effect on the economy. Coupled with the current generosity in the issuing of licences there was also a supply effect. The 1980s saw shortages in sectors like steel and cement become a thing of the

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<sup>10</sup> This view would ironically find sympathy with Milton Friedman, see Friedman, Milton & Rose Friedman, 'The Case for Free Trade', <http://www.cato.org/special/symposium/essays/friedman.html>.

past. Goods like two-wheelers and cars and a host of electronic items that had long been the preserve of protected of Indian manufacturers were opened to a few more industrialists who procured foreign collaborators.

The latter had an adverse impact on the balance of payments. This is because in the initial stages these industries were little better than 'screw-driver' industries with the greater proportion of their components being imported from the seller of the new technology and the domestic partner merely assembling it for the home market. This surge of imports (**Table 2**) more than compensated for the drop in oil prices witnessed in the eighties. Moreover remittances from the Gulf no longer grew as it had in the seventies precisely because of the fall in oil prices that affected this region. (\$2.8 bill to \$ 1.874 bill) as compared to 291 mill to)

To boost exports to match the growing import intensity of Indian industry the policy makers introduced a new element in its policies. Apart from the subsidies to exporters and the special schemes/privileges enabling exporters to buy imports that continued, a policy of creeping devaluation of the rupee was introduced where the rupee was gradually fell from Rs 8 to the dollar (in 1980) to Rs 18.57 to the dollar (in 1990) over a ten year period. There were of course elements in the policy that encouraged technological up-gradation, achievement of optimal scales as well freer imports (made necessary given the change in industrial sector). Indian exports responded quite well to this policy growing at a faster clip than imports. Manufactures occupied an increasing share in the exports and share of primary goods in exports fell even further(ref: Table 1). But as the absolute amount of imports was very high, even with the faster growth of exports this policy itself was not sustainable. The Current Account Balance sank to almost -\$ 6 billion in 1990 from -\$4.6 billion the previous year.

### **Table 2: Profile of Imports<sup>11</sup>**

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<sup>11</sup> Economic Survey...*op cit*, Handbook of Statistics...(*op cit*)

Total Imports (in millions of dollars, percentage in parenthesis) Commodities		1960-61	1970-71	1980-81	1990-91	1999- 2000
		2353	2162	15869	24072	49670
1	<b>Food</b>	449(19)	321 (14.8)	481(3)	556(2)	2416(5)
2	<b>Raw Material</b>	1105 (47)	1176 (54)	12341 (71)	14422 (61.3)	26348 (53)
	Of which Oil	(6.1)	(8.3)	(41.9)	(25)	(25)
3	<b>Capital Goods Machinery and Transport Eq.</b>	747 (31.7)	534 (24.7)	2416 (15.2)	5385 (22.2)	8965 (18)
4	<b>Others</b>	52(2.2)	131(6.1)	631(4)	3709 (15)	11941 (24)

While in the 1970s, Institutional finance at concessional rates of interest had been available to cover this gap, the 1980s saw India taking recourse increasingly to commercial short-term finance which kept on being rolled over as lenders had faith in India's ability to pay. Apart from this were accounts held by Non-Resident Indian (NRIs) who were encouraged to put their money in accounts/schemes that offered them a higher rate of interest than available in the international market.

However, this paradigm of import-intensive high growth financed by deficits proved to be unsustainable. The immediate trigger was the political instability that was created when Prime Minister Vishwanath Pratap Singh implemented the recommendations of a commission that had looked into the reservation of government jobs for members belonging to the backward



classes. This and the Babri Masjid- Ram Janmabhoomi issue followed by the fall of two governments created instability at the centre. This in the background of fiscally irresponsible steps like waiving of loans to farmers led the NRIs to withdraw their money from their accounts at an alarming rate.

When the Indian National Congress (INC) was returned to power in the mid-term elections of 1991 it was clear that something drastic had to be done about the Indian economy.

### **The Liberalisation of the Indian Economy**

The PV Narasimha Rao government that assumed power in mid-1991 did not have a majority in the Lok Sabha, the lower house of parliament. It had the support of Leftist formations who wished to keep the Bharatiya Janata Party (BJP) out of power. While the Left admitted that emergency measures were required to stave off a collapse they argued that it was the state that had lived beyond its means and a reform of public finances were necessary; the state had to raise resources to become solvent. They held that it was not the fiscal deficit but the revenue deficit that had to be curbed.

The International Monetary Fund (IMF) on the other hand concentrated on the reduction of fiscal deficit. This meant that even part-financing of infrastructural projects with borrowings was unadvisable. Given the limits on the state's ability to raise taxes, this obviously meant that given the financial condition of the Indian state, it would have to relinquish its position as the main driver of aggregate demand.

The Narasimha Rao Government decided to go with the IMF whose financial assistance was required to supplement India's almost depleted foreign exchange reserves. At the same time it also decided to go in for structural reforms to transform the Indian economy and integrate with the rest of the world economy. In short, the Narasimha Rao government jettisoned the NM model. It used a financial crisis to not only put government finances into order, but to carry out structural reforms. From now on it would be exports

would be the engine of Indian economic growth and not merely an instrument to pay for imports.

To this end the government sharply devalued the Indian rupee in two stages by 22% dismantled the regime of permits and controls. At the same time effective Government Expenditure (consumption + capital expenditure - interest rate payments) came down. (14.11% to below 11% of GDP)<sup>12</sup>. The rupee was partially floated and then made fully convertible on trade account. The entire paraphernalia of controls that governed imports were dismantled. Quantity controls were cut done sharply and the tariff-structure rationalised and generally reduced. Imports were gradually de-canalised (private sector allowed to imports a larger variety of goods).

The effect of these measures was quite dramatic. While the economy contracted in 1991 due to the compression measures taken by the Chandrashekhar Government and the Rao government, it grew moderately the following year by a modest 3 percent the following two years. The last three years of the Rao government saw an average rate of growth of 7% per annum. The spurt in growth was caused by the surge in exports in these years (averaging about 20% per annum) validating the 'J curve' theory of devaluation that predicted a lagged surge of exports following a devaluation. The value of the rupee, which was now floating, remained remarkably stable. India was finally experiencing export-led growth.

The shift in the source of growth was all the more remarkable when it is seen that this happened even as government purchase of goods and services (as a proportion of GDP) declined by over 10%.

The composition of exports exhibited the same trends that had been set in motion during the seventies and was accentuated by market forces and comparative advantage in the 1980s and 1990s. Thus primary goods exhibited a secular decline in the share of exports while items like chemicals

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<sup>12</sup> Authors Calculations using *WDI 2003 CD-ROM Query database*

grew throughout the 1980s and 1990s to almost a sixth of India's exports. Gems and Jewellery that had doubled its share in the 1980s held its position in the 1990s. Resource intensive items like iron and steel and capital-intensive items like machinery stagnated in these two decades. All in all the theories of comparative advantage had been vindicated. At the same time theories of export pessimism had not.

The increasing importance of market forces in India's Geographical composition in trade can also be evidenced by the fact that the share of exports to the USSR dropped from 15.7% to 2% (see table 3.) showing the decline of managed trade.

**Table 3: Geographic Destination of India's Exports (shares)<sup>13</sup>**

	1980	1990	2000
European Union	27.4	29.1	25
USSR	15.2	15.7	2
NAFTA	13	16.9	22.4
Japan	10.9	10.2	4.6
ANZ*	1.9	1.3	1.2
Asian NIE <sup>1</sup>	3.1	4.6	6.8
Asian NIE <sup>2</sup>	1.6	3.6	3.4
SAARC/Oceania	3.5	3.3	4.3
Sub-Saharan Africa	4.2	1.7	5
Rest of the World	19.1	13.7	25.3

Australia and New Zealand, <sup>1</sup> refers to Hong Kong, Singapore, South Korea, Taiwan, <sup>2</sup> refers to Malaysia, Thailand, Phillipines

A surge in trade with NAFTA and the richer NIEs showed the aggression with which new markets were being sought. Trade with the EU

<sup>13</sup> Chauvin, S & Françoise Lemoine, 'India in the World Economy: Traditional Specialisations and Technology Niches' Working paper 2003-09 August, CEPPII, Paris, 2003

countries also declined from the 1985 peak of 45%. At the same time a decline in trade with Japan showed how India was losing share to other trading nations and that Japan did not use India as a production site.

Export growth started to taper off around the time of the East Asian Crisis and would not recover till this year (growth expected to exceed 20%). Expectedly overall economic growth which was now linked inextricably to the global economy too faltered as global economy tapered off. Growth stagnated at 5% per annum which although higher than the Hindu rate belied expectations that now wanted more. Moreover the Chinese experience of maintaining a much higher export growth rate (and thus a higher overall growth rate) had been achieved over a much longer period of time regardless of global conditions raised questions as to why India could not achieve the same.

### **The Hostage of Ghosts Past**

It can of course be argued that China has grown faster than India because it saves and invests a greater proportion of its income than India. While saving and investment rates in India hovers around 20% on an average, in China this figure is close to 40%.

However this vile a valid explanation is also an incomplete one. It is known that India and China compete in certain markets like textiles that constitute 30% of India's exports. Indian exporters find it difficult to match the Chinese for price and have chosen to cater to the upper niches of the market by upgrading quality. While this is a rational tactic this state of affairs has to be explained<sup>14</sup>.

We have already mentioned that certain items were reserved from 1967 onwards for the small-scale sector as a measure to compensate for the NM model's lack of job creation. This policy measure survives to this day.

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<sup>14</sup>Agarwal, Manmohan & Dipankar Sengupta, 'Comparing Transition Economies: India and China' in China Report, 36, 1, 2000

Textile items are included in the list of items reserved for the SSIs. Given the cap on turnover and assets, Indian exporters find themselves unable to reap economies of scale and thus are stuck with high average costs. The PRC firms operate under no such compulsion and thus enjoy lower costs.

Secondly, we have mentioned how agriculturists in India are often given subsidised electricity. In some states they have even been given electricity free of cost. This means that these State Electricity Boards (SEBs) carry out cross-subsidisation charging industrialists a higher tariff for electricity. This adds to the cost of Indian industry. However even this policy of cross-subsidisation does not suffice to compensate for the losses incurred by the SEBs as a result of subsidies to farmers, households and the theft of electricity that occurs. Thus SEBs very often do not have the resources to invest in additional generation capacity to meet rising demand (and very often even maintenance of existing assets sometimes proves difficult.) Thus electricity shortages are rife. Industry generally meets this shortage by installing captive generation which adds to costs.

It may be noted that installed generation capacity in China is almost thrice as much as India's<sup>15</sup>. Here too the Chinese firm is at an advantage.

This cost-disadvantage forced Indian firms, especially garment manufacturers, to go up the demand ladder and create niches for quality products where premium prices can be had for products sold.

Here a parallel may be drawn with the Italian experience<sup>16</sup>. Capital abundant Italy's entrepreneurs has had to go into labour-intensive products that commanded a premium because of features like quality, and design as the supporting institutions and labour laws were not conducive to large scale capital intensive operations. In India the laws and the infrastructure inhibit optimally sized labour intensive operations. Thus both Italian and Indian

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<sup>15</sup> WDI 2002 CD-ROM Query database, World Bank

<sup>16</sup> Porter, Michael, 'Competitive Advantage of Nations' Macmillan, New York, 1990

Businessmen cater to upper niches of the market to compensate for higher costs. Here the similarity ends.

Italians have been extremely good at establishing a brand name for their products. Production clusters have successfully project item associated with themselves to be premium products. Indian clusters have failed to do so. Thus they do not receive the price they might have received had they been as successful. In this case it is the importer that gets most of the mark up<sup>17</sup>.

Additionally, India has no counterpart to the Chinese overseas business community and their intricate links that have enables the Non-resident Chinese (NRCs) to invest in China and use it as a production site and market the products through existing marketing channels.

All this has inhibited FDI in labour intensive commodities as contrasted to China where FDI flows are several times as much of India and much of it comes from NRCs.

In any case all these go to explain why Indian exports are so dependent on the global economy unlike Chinese exports which grew even when the global economy did not.

It may be asked as to why these ghosts from the past cannot be exorcised. It must be realised that the SSIs today is quite a strong lobby and resists all moves the reform and de-reservation. Similarly raising electricity tariffs is difficult given the political clout of rich farmers. However, the Electricity Act of 2003 attempts to shift the burden of subsidy from the SEBs to the budgets of the State Governments. If this is successful, investment in power may increase leading to lowering of costs for the entire industrial sector including exporters.

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<sup>17</sup> Sengupta, Dipankar, 'Exporting through E-commerce' Working paper, Centre de Sciences Humaines de New Delhi, 2003

### **Export of Services: An Unplanned Success**

While growth in the export of goods stagnated with the tapering off of the global economy, there had been all this while a secular rise in the growth of exports of services, especially Information Technology (IT) and Information Technology-enabled services (ITES). Export of Indian IT Software and Services Exports has grown from \$ 1.76 billion in 1997-8 to \$7.6 in 2001-2 and is projected to be \$9.9 billion in 2002-3<sup>18</sup>. This again is paradoxical; how could India, which has the largest number of illiterate persons in the world, be such a spectacular player in this sector that represents the latest technology? The answer is again lies with the NM model (although the NM model did not plan for this) as well as India's colonial heritage that bequeathed the knowledge of English as well as the tradition of learning the language to a sufficiently large number of Indians.

The first point requires explanation. The NM model required for its successful implementation a large body of trained technical personnel aimed as it was to the development of a successful industrial sector. To this end a large number of technical institutes (some of which were of the highest quality) were set up. The medium of English was English. At the same time college level education was generally increased through out the country and commerce as a subject (where accountancy is taught) became quite common. Like the economic policy, education policy was also non-universal and pitched at a high level.

As the NM model ran into difficulties and industrial growth stagnated from the mid-sixties onwards the supply of engineers started to exceed demand. It was then a large number of technically qualified personnel started to go to the USA for employment. The initial successes in IT exports were mainly in the form of 'body-shopping' where Indian companies sent 'cheaper' Indian IT professionals to replace more expensive American employees. However as Indians started to relocate in India part of the work

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<sup>18</sup> The IT Industry in India , NASSCOM Strategic Review , 2003

that they did in the USA could now be done here<sup>19</sup>. US companies having employed and tested Indian employees had faith in subcontracting work to the firms owned by ex-employees. Projects like Y2K and the adoption of the Euro not only boosted software exports but also established the capability of Indian software firms. This must be contrasted to the mixed experiences of the first generation of NRIs who returned to invest. Procedural and infrastructural problems hobbled many of these investors. The IT sector in contrast was not overtly dependent on these factors. Nor did congested ports or poor roads matter as the product could be safely sent across the net. In this respect their success is not unlike Taiwanese professionals who after a stint in the USA returned to Taiwan to set up enterprises on their own<sup>20</sup>.

There is now evidence that Indian firms who had initially been entrusted with the lower end of software operations are moving up the value chain and firms are also becoming larger<sup>21</sup>. This is a welcome development as earlier research had indicated that Research and Development undertaken by Indian software firms were negatively related to the share of exports in their total turnover<sup>22</sup>. This was on account of the fact that such firms catered to the lower end of software development raising fears of being able to move up the value chain<sup>23</sup>.

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<sup>19</sup> Bomsel, Pierre & Joel Ruet and others 'Digital India' Report on the IT industry, CERNA, Centre d'economie industrielle, Ecole National Suprieure des Mines de Paris, 2001

<sup>20</sup> Saxenian, Annalee, 'The Silicon Valley Connection: Transnational Networks and Regional Development in Taiwan, China and India' in Science, Technology and Society 7:1, 2002

<sup>21</sup> Arora, A & S. Athreye, 'The Software Industry and Indian Economic Development' WIDER Discussion Paper, 20 2001/20. 2001

<sup>22</sup> Parthasarathi, Ashok and K J Joseph, 'Limits to Innovation with Strong Export Orientation: The Case of Indian's and Information Communication Technologies Sector' in Science, Technology and Society 7:1, 2002

<sup>23</sup> D'Costa, Anthony P, 'Export Growth and Path Dependence: The Locking-in of Innovations in the Software Industry' in Science, Technology and Society 7:1, 2002



Even as sales of software has not risen as fast as was once projected, the exports of ITES (contributing \$1.49 billion out of \$7.65 billion in 2001-2<sup>24</sup>) has exhibited unexpected growth leading many competitors to believe that it is this sector that will drive future export and thus overall growth. The potential of certain segments of the Business Processes Outsourcing (BPO) is now visible to most observers. This activity refers to critical yet non-core operations of a firm that can be farmed out to other specialised firms especially when such services can be rendered elsewhere and transferred over the net. Services like payroll management, data management, segments of customer relations like call centres etc lend themselves to outsourcing. Indian accountants who are substantially cheaper can replace expensive ones in the USA. Bills and financial documents can be scanned and sent over the net for processing and financial statements prepared and transmitted over the net to the US client. Data entry and call centre operations are also cheaper. The former example is that of skill-intensive operation; the latter is not. India has an advantage in both. A peculiarity in this field is that while Indian firms have a substantial presence in the production of software, foreign multinationals dominate the lower-technology BPO business.

This reflects the manner this field has developed. Technological giants like GE Corp that have a global presence realised the economies of using Indian accountants for their global operations as communications became cheaper and more sophisticated capable of handling more data. Soon what they could do for themselves, they could do for others. Their size and record has lent them credibility that enables/encourages other firms in the USA to off-shore some business processes. For a new Indian firm to get a share of this market is difficult. While there have been successes, they have played second fiddle. To a great extent this is also in part due to government regulations that limit the size of auditing firms putting a bar on the number of partners as well as restricting their activities.

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<sup>24</sup> Review of the IT Industry ....(op cit)

But all in all this is one sector where Exports have grown in spite of a recessionary global market and possibly because of it. Some industry watchers insist that recession has put pressure on industry abroad to cut costs, which has forced them to pass on certain operations to Indian companies who can do it at fraction of the cost. While costs to the US firm has declined, software exports have risen.

### **India's Constraints and its Positions at the WTO**

India held positions at the WTO negotiations can be summarised (albeit crudely as follows).

1. India wants special and differential market access where agricultural goods are concerned.
2. Protests notwithstanding, India likely to give in on one Singapore Issue, that of trade facilitation. The reasons for this are that implementation of this clause is largely in India's interests. There are indications that India might give some ground on the issue of government if it be required.
3. India pushes for the movement of natural persons in all fields but is willing to settle for a few sectors especially cross-border services.

The boldness of the stance on industrial goods contrasts with the ill-disguised timidity on agricultural products. India wants the Developed countries to cut down on subsidies given to its farmers and open its markets to third world agriculture produce while asking for time for it to cut down on subsidies. This is because in the aftermath of the Green Revolution, Indian agriculture has become quite high cost. In the absence of public investment in this field costs to farmers have grown. Even subsidies compound this problem. Free electricity has led farmers to deplete ground water sources to cultivate water-intensive crops like rice. Subsequently the farmers have to invest more in drilling deeper and in more powerful pump sets. All these have added to costs. The absence of comprehensive water-shed management schemes have led farmers to make their own arrangements for water adding to their costs.

India, a labour abundant country pushes for the movement of natural persons for obvious reasons. The right of IT professionals to avail of the maximum mobility possible is of critical importance to future of Indian software exporting firms especially if they are access the market for on-site services in Developed countries. However, the surge in BPO related exports made possible by the IT revolution means that services exported are created in India and made available to consumers abroad through modern communications systems. This does not need labour to be relocated in importing countries. This rise in cross-border services whose future potential looks undimmed has led to the softening of its earlier rigid stance on the movement of natural persons.

### **An agenda for Reform**

The policies geared towards increasing the competitiveness and boosting exports can be divided into two categories:

- a) Those that are geared for boosting the economy in general.
- b) Those are specific to the exports.

The former refer to steps aimed at increasing investment in power and transport. The Electricity Act of 2003 that aims to shift the burden of subsidy from the SEBs to the respective state governments is one such move. Should this lead to the improvement of the financial health of the SEBs then investment in this sector will rise leading to the 'crowding in' of investment in the economy. From the point of view of the exporter, enhanced and regular supply reduces capitals well as running costs. Moreover labour-intensive operations like assembling TV sets and computers also become less expensive thus making FDI in these fields feasible.

Investments in agriculture and irrigation and appropriate crop selection also can help to lower costs making agriculture competitive. Similarly investment in transport and ports also lowers costs enhancing profitability and competitiveness. Indeed, the much touted 'Golden Quadrilateral' Project, i.e. a highway project that seeks to connect all the four major metropolitan cities of India, Delhi, Mumbai, Kolkata and Madras as well as India's IT hub Bangalore is a step in that direction. The project envisages the construction

of 4-6 lane highways connecting the afore-mentioned cities and by mid-June 2004, 2801 km of the total planned 5846 km had been completed. In the same vein the central government has announced the NorthSouthEastWest Corridor of 7300 km of which 596 km had been completed and 467 kms are under implementation<sup>25</sup>. While the above are not specifically related to boosting export competitiveness directly and will help export promotion by a general lowering of transport costs, there is also an element of the road construction programme that is specifically export related. Port connectivity roads of 356 kms have been announced of which 56 kms have been completed and 242 kms are under implementation.

By and large investment in infrastructure is geared towards aiding the entire economy, not just the export sector. But in so far as costs are reduced export competitiveness is given a boost. It has to be borne in mind that investment in infrastructure is capital intensive and has to be shouldered largely by the government. Given the state of public finances, where the public sector is mired in debt and the State borrows to meet its consumption expenditure, there is serious need to involve private sector participation in these projects. With the Electricity Act of 2003, the private sector may be encouraged to invest in the Power Sector. However with a new government in place there are calls for a review of this act. Populism in the form of free power to farmers have reared its head in some of the states most notably Andhra Pradesh where the newly government decided to make concessions to farmers. This does not augur well for economic reforms.

In the Highways sector, private sector participation is yet limited with Build-operate-transfer models accounting for only 857 km of the 5486 km of the Highways planned under the Golden Quadrilateral project.

However, if we take infrastructure related specifically to international trade, India lags behind competitors like China. For example, where ports are concerned the table below sets out how backward India is:

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<sup>25</sup> See the website of the National Highways Authority of India, <http://www.nhai.org>

**Typical Cargo Dwell Time in the port of Mumbai<sup>26</sup>**

Transaction	Location	International Norm
Containerized Sea Freight	Mumbai	
Ship Waiting Time	3-5 days	Less than 6 hours
Export Dwell Time	3-5 days	Less than 18 hours
Import Dwell Time	7-14 days	Less than 24 hours

Given this state of affairs that seriously inhibit India's export efforts, India's readiness to discuss Trade Facilitation at the WTO is understandable. The draft maritime policy seeks to redress the above situation by changing the rules of the game by increasing competition among the various players and by optimising port use. The state monopoly that had hitherto existed was already gradually ended in the nineties. But the thrust of the reforms even today is the reorganisation needed for the ports to function better and raise resources on a self-sustaining basis<sup>27</sup>. Indeed, there is a feeling that the 2004 budget that was supposed to give a boost to infrastructure has not done enough<sup>28</sup>. This is in keeping with past experience whereby effective steps are taken only at the last moment as the discussion of the steps taken to boost garment and textiles sector will be discussed.

Policy measures specific to the export sector would include the abolition of reservations for the small-scale sector. This would enable exporters to reap economies of scale, grow organisationally and be able to absorb and develop new technologies. The state should encourage industry associations

<sup>26</sup> taken from Roy, Jayanta, 'Towards International Norms for Indirect Taxes and Trade Facilitation in India', Paper prepared for the Task Force on Indirect Taxes, Government of India, 2002.

<sup>27</sup> Manoj, P, 'Draft Maritime Policy-Rowing Towards Reforms' Businessline , 16/8/2004

<sup>28</sup> Sahoo, P., & Nataraj, G., 'Budget: 'Core Weakness not Addressed' Businessline , 27/7/2004

to develop new markets and create a brand name to impart a degree of monopoly power over their market and thus get a higher price for their product. Alliances should be sought on the basis of synergies. Thus Indian garment makers could align with exporters who cater to higher niche helping them to move up while taking their help and marketing links and brand name to serve the present niche. Indian software firms should form alliances with those who have an advantage in hardware and brand-name owners to market their wares. If we limit our discussion to garments and textiles (given its centrality in India's export basket) we find that this in fact is being done. However the pace of change has been very gradual. Indeed while it became known in 1994 that the Multi-fibre Agreement would come to an end in 2004, India started to implement a plan for this eventuality only from 2000 onwards.

Taking cognisance of the fact that Indian garment as well as the textile industry was heavily fragmented with the present structure of incentives both financial and legal militating against economies of scale and technology, the government slowly started to reform this sector. Reforms had to be slow as previous policies had created a large lobby in these sectors that were not technologically dynamic and had in-optimal scales of operation. They survived because state policies and a substantial portion of the 35 million people employed by this sector comes from this uncompetitive niche. A policy that suddenly put to risk so many people to the uncertainty of unemployment was not politically possible. In this sense the government was a hostage of ghosts past, ghosts that it had created. However, the recent efforts of the government has been towards doing away of the various niches that are not market created but policy created. Thus the bias against the cost-efficient capital intensive sophisticated mill sector that turned yarn to fibre has been done away with. Similarly there are indications that the bias that still exist against man-made fibre (which constitutes 70% of the market) will also be ended. Garment manufacturing has also been de-reserved. The market seems to have received these reforms well; textile shares have outperformed the Bombay Stock Exchange sensitivity index (sensex) this

year even leading it<sup>29</sup>. The fact that India is expected to be a major beneficiary of the phasing out of the MFA coupled with government policy has gone down well with the market with the sector actually on course to raising the finances it planned to raise this financial year<sup>30</sup>. Only time will tell how this story unfolds.

There are signs that Indian industry is waking up to challenges. The old fears about an influx of Chinese goods have been replaced with an awareness of complementarities. Indeed, there are observers who believe that China is vastly overrated when it comes to the textile industry. They point to the continuous losses made by the Chinese textile industry from 1993 to 1998. They point to the closing of the quarter of the state-owned mills and decline in installed capacities and the outmoded technology used by many Chinese mills. Indeed the old charge of subsidies is also levelled and it is pointed out that her entry into WTO will eliminate this particular advantage<sup>31</sup>. Be that as it may, Indian industry is not as diffident as it was with markets are being sought to be opened up and even non-traditional markets being wooed. But these are recent developments.

In the IT sector there are signals that India will be seriously challenged by China. China's infrastructure and wider spread of education combined with its position in IT hardware is likely to give it synergies that will enable her to catch up with India within five to ten years. Indian IT majors concede that the only areas where China lags behind is her limited resources of people who know English (which is growing fast) and her limited skills in

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<sup>29</sup> Textile shares weave gains as Sensex spins 8/6/2004,  
<http://www.indiaonline.com/news/news.asp?dat=44508>

<sup>30</sup> conveyed to the author by a senior government official in the Ministry of Textiles, Government of India.

<sup>31</sup> Rao, J.V. ' *Indian Textile Industry beyond 2004* ' presented at the workshop on "Challenges and Opportunities for the Indian Textile and Clothing Industry in the Post-Agreement on Textiles and Clothing (ATC) Regime" 4/9/2004, New Delhi, organised by Amity Institute of Global Legal Education and Research

project management (which is being neutralised by experience)<sup>32</sup>. At the same time the government is cutting back on higher education which does little for maintaining a competitive edge. The consequence of this policy coupled with the furious growth of the industry is expected to give rise to a shortfall of a half-million IT professionals by the year 2005<sup>33</sup>. The wider spread of PCs in China also ensure that IT professionals in India are more likely to come into contact with a PC for the first time when he starts to get trained in software development. It is likely that quality wise, Chinese IT professionals will dominate their Indian counterparts in the not too distant future<sup>34</sup>.

That is why it is not IT exports but IT enabled services which is touted as the India's ace.

### **Conclusion**

The story of India's exports is inextricably linked to the NM model. Although this model was a closed model designed to implement a model of import-substituting industrialisation, by its very failure it made opening up of the Indian economy necessary. However, the model itself and its shortcomings from time to time forced the state to take certain steps which made India's export efforts difficult. At the same time, its implementation necessitated the creation of institutions that have led to and sustained the IT boom which was not envisaged by India's planners.

However, Indian exports have grown difficulties notwithstanding although there are now signs that this growth may not continue unless the

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<sup>32</sup> China inching closer to India in IT: Murthy, Times of India, 8/9/2004

<sup>33</sup> India's Software Firms to Receive Outsourcing Windfall, [http://www.itmatter.com.ph/news\\_05102002b.html](http://www.itmatter.com.ph/news_05102002b.html)

<sup>34</sup> Sengupta, D., 'Exporting Through E-commerce-How Indian Exporters have Harnessed the IT Revolution' CSH Occasional Paper No 9, 2004



remnants of dirigisme are discarded and investments made in infrastructure. However, the vested interests that have been built up by these very policy measures make reforms (that will do away with the same interests) very difficult. Consequently, reforms in many cases are put off till the very last moment although the need for such reforms is apparent from the very beginning. The case of the textiles and garment sector is a case in point.

The infrastructure demands investment that the government at this point in time cannot make. The fiscal profligacy from 1980s onwards has deprived the government of elbow room with the result being that this capital-intensive high gestation period sector has to be reformed, 'enterprised'<sup>35</sup> and then exposed to the market. However if the speed with which the government has moved with regard to power reform in this respect and the uncertainty that surrounds the finality of even that reform is a gauge to future intentions, India's success in boosting exports will be highly circumscribed.

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<sup>35</sup> i.e structured into firms that look at cost efficiency without external and discretionary power, see Ruet, J, 'Winners and Losers of the Indian State Electricity Board Reforms: An Organisational Analysis' CSH Occasional Paper No 1 2001,