

**SIZE-DISTRIBUTION OF FACTORY
ENTERPRISES:
AN ANALYSIS OF THE 90s**

Dissertation submitted to Jawaharlal Nehru University in partial fulfilment of the requirements for the award of the degree of Master of Philosophy

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CERTIFICATE

This is to certify that this dissertation entitled "SIZE-DISTRIBUTION OF FACTORY ENTERPRISES : AN ANALYSIS OF THE 90s" submitted by DEVAJYOTI RAY in partial fulfilment of the requirements for the award of degree of Master of Philosophy (M.Phil) of this University, is his original work and has not been submitted for any other degree or diploma.

We recommend that this dissertation be placed before the examiners for evaluation.

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CHAPTER 1
INTRODUCTION AND REVIEW

1.1 INTRODUCTION

Since 1991-92, the Indian economic policies have seen a paradigm shift. It is well known that the country had faced a severe external debt crisis in the year 1991. It took India close to default in international payments obligations and brought into existence a fear of unmanageable inflation. The situation though not as severe, was in character quite similar to the debt crisis that several of the developing countries in Latin America and Sub-Saharan Africa had faced in the mid 1980s. Like the governments of these countries, our own government of the day also approached the international lender of the last resort, the IMF for some kind of temporary arrangement. The loan however did not come free and the country had to undertake a temporary stabilisation programme under the guidance of the IMF.

It was however also realised at the same time that this crisis that India had got into was not because of any sudden economic shock [Nayyar and Bhaduri,1996] beyond its control or understanding but was due to its own fiscal mismanagement that continued over the entire decade of 80s. The decade saw a profligate increase in public expenditure which could not be

financed by internal resource mobilisation as government's efforts towards either expanding the tax-net or raising the rate of taxation on those who could pay remained lax [Nayyar, 1995]. The fiscal deficit surged up as a percentage of GDP and government came to rely on public debt to finance its deficits. Such financing was easy as government was virtually under no restrictions in this regard. This increased the burden of public debt and its repayment. Such a fiscal regime was not sustainable and started showing its vulnerability in late 1980s and finally in 1991.

Economists and policy-makers now started questioning the very paradigm of our Economic development [Bhagwati and Desai, 1970]. The paradigm shift that we witnessed since 1991 was a result of this new thinking [Ministry of Finance, 1993]. However it can not be said that the policies that came up since then were in response to the opinion of majority of Economists. A. Bhaduri and D. Nayyar mentions in their authoritative book, "The Intelligent Man's guide to liberalization" that both the Stabilization and the Structural Adjustment programmes were drawn up with the IMF and the World Bank respectively. Therefore the change was more in line with what the World Bank and like-minded institutions and individuals had been professing for quite some time for the developing countries in general. This strategy was however "...flaunted as India's strategy of development" [1996]. The new dogma that we embraced aimed at 'reforming' the whole of Indian economic set-up over the medium term and from 1999, we are supposed to start the second phase of this process [Annual Financial Statement, 1999].

The Structural Adjustment programme seeks to improve resource utilization by increasing the degree of openness in the economy, allowing a freer hand to the private sector, reducing government interventions and dismantling the public sector [Nanjandappa, 1995]. It also professes a gradual opening up of the economy to the world at large. The basic assumption seems to be that since the crisis in 1991 was mostly due to fiscal mismanagement by government, the new system should allow a limited role to the government in matter of economics. The mixed economy with significant government intervention

in resource allocation was inefficient in many respects and these mistakes were now to be rectified by offering a larger role to the market forces and the government is only to act as a facilitator if not a mute spectator in this process. The idea of developing our own industrial base to cater to our domestic needs by protecting our industrial sector from external competition was also found to be faulty and the focus today has shifted from import-substitution to export promotion. This new shift is supposed to bring into the country valuable foreign exchange and also improved technology, which will develop our industries. The government controls over foreign trade is to be reduced and this will also make Indian enterprises feel the international competition. Such competition, the policy makers feel will improve the quality of Indian products.

Thus massive virtue has been located in the competitive forces, both internal and external and any form of government control is being seen as detrimental to growth and development. How far this new mantra has succeeded in achieving our long cherished goals in various sectors of the economy is certainly beyond the scope of the narrow confines of this dissertation. But before we go on to what is being termed as the 'Second phase of reforms' the necessity of understanding the impact of the first phase is immense. This dissertation aims an attempt to analyze the impact of some of these policy decisions on a part of the economy.

What were the features that were obtaining in our economy that raised doubt in the ability of our earlier economic model of growth and development? How far the new paradigm, which is being flaunted as 'Reforms', can dissipate these features? What are the new problems that have emerged as a result of this new process? How can we get rid of these new problems as we move on our new road to economic 'Moksha'?

As we know that this new paradigm was professed most enthusiastically by the World Bank, it is imperative that we look at what the Bank had been saying since the mid-1980s about our economy to influence our thinking pattern. Among the vast majority of such literature our concern would lie in a two-volume document prepared by the Industry Department of the Bank titled,

“India : Industrial Regulatory Policy Study” [1986]: This report focuses on a particular kind of deformity that had been observed in the industrial structure of India since the mid 70s. The Bank is of the view that the deformity was the result of various Industrial policy-decisions that we had taken since independence. And finally at the end it once again suggests the adoption of the a reform-process that we have now adopted.

Our study will mention briefly the Bank’s viewpoint in the second section of this chapter followed by a review of related literature. In the fourth section of this chapter we will define the objective of our study. In chapter 2 we will look at the policy decisions that had been taken since 1991-92 that conforms to what the Bank desired, and on the basis of these we will explain the methodology we will adopt. In chapter 3 we will analyze the impact of these policy-decisions on industrial structure of India and see how these changes had conformed to the goals, the new policies were designed for. In chapter 4, we will conclude our study.

1.2 WORLD BANK VIEW

The World Bank report begins with a set of observations, that boils down to three basic points that,

- a) the rate of growth of industrial value added since mid-1960s had been falling
- b) the technological progress had been very slow in the Indian market. This was reflected in the delay in introduction of new techniques in India and persistent use of obsolete technology.
- c) Growth in total factor productivity was very slow over the two decades beginning in 1970s.

All this according to the Bank had reduced the competitiveness of India in the world capitalist market. Why has Indian industrial sector suffered this fate? The Report finds the causes in the Industrial Regulatory policies that existed in India

till the mid 1980s. the report focuses on 5 aspects of the Regulatory policies of that time.

First, the system of Industrial licensing,.

1. The licenses granted were often linked to the demand generated for products in the market. The Bank argues that the business houses had a tendency to apply and obtain licenses with out any plan to set of units of production. Thus though licensed capacity was linked to total demand in the market, the actual capacity created often remained lower that the demand. This practice helped the business houses to restrict entry into their areas of productions and thus abled them to charge monopolistic prices.
2. The regulatory framework involved a lot of scrutiny and this introduced considerable delays in the fruition of the investment project that rendered initial calculations meaningless and, therefore, deterred entry of those who had the potential and growth of those who had applied for licenses.

Second, the measures aimed at controlling the growth of big business, so as to pre-empt concentration of assets.

1. Since the MRTP act came into existence, the companies that fell under it were denied licenses to enter certain in order to prevent concentration of capital. But according to the Bank, such a policy often did not allow the MRTP companies to enter even those areas where the small or medium sized firms did not have the potential. Thus such sectors continued to be served by inefficient firms whose efficiency also did not increase due to lack of competition.
2. The policies to prevent concentration of capital imposed severe restrictions on the expansions on the existing units. This meant that often enterprises established new units without expanding the old units. Such policies thus discouraged economic scales of production in areas where large scale leads to fall in average costs of productions.

Third, the measures that reserved items of industrial production for the small-scale sector.

1. The reservation of 870 items for small-scale sector production also acted as a disincentive for the small-scale units to expand and thereby lose the incentives that were offered to the small units. This according to the Bank's report had curtailed growth as well lead to high costs and poor quality. There was no inducement to improve quality, update technology, or reduce costs. The small-scale sector also enjoyed certain other incentives like flexibility regarding number of workers employed and closure of units.
2. The incentives to small-scale sector particularly regarding closure of units and number of workers employed were not available to medium sized firms or large firms. So according to the bank many larger enterprises were tempted to open units within small-scale sectors.

Fourthly, the policies that aimed at preventing the closure of 'sick industries.

1. The exit barriers in Indian industrial sector were always very high making most entrepreneurs risk-averse in their investment plans, foregoing growth opportunities that in a more relaxed environment might have lead to more capacity creation. Thus exit barriers served as yet another form of entry barriers.

Finally, the policies that aimed at reducing the influence of foreign capital in Indian industrial market

1. The Indian policies always aimed at indigenisation of production of capital goods and of technology generation activities. Indian firms had to seek special permissions whenever they had to purchase technology from abroad or whenever they seeked foreign technical collaboration or financial collaboration. This was more so since the inception of the Foreign Exchange & Regulation Act[FERA]. Such restrictions restricted competition and entry of improved technology into India.

Thus the industrial policies in India imposed differential barriers to entry, growth and exit for different size classes of firms. They have been high for large and medium units and comparatively much less for the small units. As a result the small units often had more incentives to stay small rather than expand into medium range units. The large enterprises did not have freedom

to enter middle range. Thus in the middle sector the investment was much less than potentially possible. This feature has been termed a “Empty Middle” by the Bank’s report. It has been argued that this composition as a whole also holds good at the subsector level.

Having established the existence of this feature, the Bank’s report says that “cross country and Indian experience indicates that medium size firms often enjoy better labour relations and higher labour productivity than larger firms, and respond more quickly to technological and market requirements. Their policy-induced absence has added an element of rigidity and contributed to the slowness of technological progress and structural change in Indian industry.”

This empty-middle is however not a purely Indian phenomenon as it is exhibited by most newly industrialized nations particularly in South Asia. The report takes into consideration five developing countries and shows in terms of the following table that percentage distribution of size classes in total is lowest for the middle-level units employing between 189 to 243 workers for all these countries.

Firm Size [workers]	JAPAN	S.KOREA	INDIA	CHINA	YUGOSLAVIA
5-33	80.2	70.2	51.7	59.2	6.6
33-75	10.7	14.4	35.3	19.5	15.8
75-189	6.1	9.2	7.8	12.2	32.2
189-243	0.8	1.5	0.8	8.5	12.0
243+	2.1	4.3	4.4	0.6	33.5

SOURCE: World Bank report

But even though the “empty middle” exists in the industrial structure of most late industrialisers, the Bank report says that this does not make India comparable to other such countries. For India this “empty-middle” poses a more serious problem.

This is because according to the Bank's report the Indian industry is characterised by two additional features,

- a) insufficient degree of specialisation.
- b) Weak subcontractural relations between large and small firms. This is reflected according to the report in the nature of growth of small-scale sector in India, which involved the replication of many production activities typical of large units. The report takes the example of three particular industries where there had been a proliferation of small units. These are the cement, paper and sugar industries.

Due to this weak subcontractural relations between large and small units which often leads to proliferation of non-economic units and due to insufficient degree of specialisation the concentration of capital is much higher than is reflected in the above table. Thus according to the Bank the regulatory policies in India had lead to a high concentration of capital in Indian industrial sector.

After this analysis the Bank takes a critical look at the industrial regulatory policy reform that took place in the 1980s. Though these reforms were in the desired directions as they aimed at reducing licensing requirements in certain areas, and reducing bureaucratic delays, etc, these reform measures were much less than desired according to the Bank. The Bank says that the limited nature of these reforms had acted as constraints against the industry to respond favourably to the new industrial policy framework.

At the end the report makes some sweeping proposals regarding the industrial policies in India, which according to the Bank would lead to a faster growth of Indian industries and dissipation of the "empty-middle". These recommendations include,

- a) immediate removal of licensing barriers to capacity growth,
- b) considerably narrowing the number of industries subject to capacity licensing
- c) reducing the role of public sector in provision of goods and services
- d) simplifying the procedures for technology transfer and foreign investment
- e) reducing restrictions on individual firm size

- f) as far as controlling the monopolistic and restrictive trade practices are concerned there should be checks only on the trade practices
- g) shifting away from reservation of products for small scale units towards modernisation of these units
- h) relaxed exit policy coupled with stricter lending guidelines and fully implemented government commitment to avoid taking over “sick units”.

However according to the report these above mentioned policy reforms would not alone suffice to bring the desired change in industrial structure and its performance. There is the possibility new distortions emerging out of the new set of policies. In order to minimise to reduce these new distortions, changes in regulatory policies need to be co-ordinated to simultaneous changes in the trade policies in India. This is because according to the bank, the behind high trade barriers, relative prices are such that that financial incentives do not coincide with economic costs. The lowest economic costs can be realised only with import liberalization.

1.3 REVIEW OF RELATED LITERATURE

Before we go on to our own study of the Indian industrial structure, we would first take up a brief survey of related literature. R.K. Hazari had come up with a study titled, “The Structure of the Corporate Private Sector : A Study of Corporate Ownership and Control”. According to Hazari the representative unit of decision making in the Indian Corporate sector was never the competitive firm. This was so even after we got independence. The ‘typical unit’ representing the majority of industrial sector was always a business house or a business group, which controlled a number of companies in several branches of business through a common, central decision making authority. Again the business houses had high degree of co-ordination between them and the firms under them operated in oligopolistic markets.

Hazari divided the Indian business set up as it existed in 1958 into 22 rudimentary categories. Out of these TATAs were found to be present in 21 categories, Birlas in 15, Bangurs in 19, Thapars in 15, JK in 18 and so on. Thus a small set of houses were present in all the categories enjoying differential market share in different markets. Given the extremely diversified technologically integrated structure of the business group, a few houses tended to monopolise most areas through firms under their control. Firms outside these groups were few and had very little market share.

This view is also supported by the observation of the Monopolies Enquiry Commission set up in 1964. It had reported that [Monopoly Inquiry Commission Report , 1969],

- a) excepting for food products, cotton textiles and jute textiles, almost the whole of Indian industry was characterised by monopoly, duopoly and oligopoly
- b) upto 1964, out of a total of total of 1298 products studied by the Commission, 87.7% were produced by oligopolists, monopolists and duopolists
- c) of these 37% (i.e. 437 in total) of the products were monopoly products, i.e. only one firm operated in each of these markets
- d) 17% (i.e. 229 in total) of the products were duopoly products, i.e. only two firms operated in each of these markets.

Thus we see that concentration was a defining feature of the Indian industrial sector right from the start. This is also true for most late industrialisers. Thus we can probably argue that the World Bank's Report stating that the Regulatory policies in India had lead to concentration in Indian industry had failed to take into account the existence of such concentration even before the regulatory policies came into existence.

Criticising the World Bank view, C.P. Chandrasekhar raised a number of points in his "Regulatory Policy and Industrial Growth : The World Bank View". Firstly Chandrasekhar explains why almost all late industrialising countries have high degrees of concentration in the industrial sector. This is because none of these countries had seen the classical path of industrialisation, which involved gradual movement from handicraft to manufacture

and finally to factory system as had happened in the west. In most developing countries like India industrialisation involved import of technology from the developed countries. Though these technologies were appropriate for large scales of production, the developing countries had few people who had the capability of investing in such large scales. So industrial sector was naturally dominated by a few oligopolists. The markets for manufactures were also small and this too discouraged the entry of smaller firms. Thus Chandrasekhar established that concentration of capital in the industrial sector is a consequence of the historical process at work and not the regulatory policies that came up after independence.

Secondly Chandrasekhar points out that the government policies of reserving items for small-scale sector production can not be said to have brought in a distorted market structure that would not have resulted otherwise. He argued that there are certain areas where some technological advantages given the nature of products. Secondly, given the diversified character of operations of big business houses, its attitude to any area of industrial activity is determined by relative profitability of all other avenues that are open at any point of time. These business houses according to Chandrasekhar had treated a number of areas not so lucrative from investment point of view. Yet in these areas the business houses had the ability of pre-empting licenses without undertaking investment. The reservation of areas of production has helped in creating space for space for small-scale firms and thereby ensuring significant investment.

Aurobindo Ghosh [1974] also expresses similar views in his study of investment behaviour of Monopoly Houses in India. Ghosh too opines that the licensing policies were required to restrict the pre-emptive motives of the big industrial houses. It is however true that the regulatory policies had failed to a large extent in achieving its objectives but this was probably not because of the government policy per se, but because of the nature of control mechanism adopted.

According to Bhagwati and Desai [1970], the private sector often had the capability of circumventing control. In case of licensing, the most important way of doing this was pre-emption. Given the wide interests and

their financial strength and ability to bear costs of obtaining information, the large business houses always had an edge over other entrepreneurs in a system where capacity was licensed to achieve planned target. But large business houses often obtained licenses without ultimately establishing capacity. Thus the whole process not only defeated the purpose for which was licensing was adopted. To this extent the view of the World Bank Report is acceptable, but the whether the solution to this problem lied in abolishing the detailed regulatory mechanism or to replace it by a more effective one has been debated extensively [Nayyar, D. IIS, 1993].

Lal in his article published in 1990 has contended that industrial competitiveness in developing countries always requires sufficient control by government. The type of control may however be determined according to the country concerned. For example in case of licensing in India what we needed was a system of penalties on defaulters who obtained licenses but failed to utilise them for capacity creation and production.

1.4 THE OBJECTIVE OF THIS DISSERTATION

Notwithstanding the objections raised by various sections against the World Bank professed changes, the Government of India has since 1991-92 undertaken a large number measures with an aim to restructure the Indian economy and the industrial structure in particular. These measures have transformed the entire regulatory frame-work of industrial policies in India. As we will see in the first section of the next chapter, these new changes are quite in line with what the World Bank had desired. These changes aimed at,

1. reducing bureaucratic interference in industrial sector
2. reducing government's role as a regulator and introducing the role of a facilitator

3. downsizing the public sector
4. corporatizing and privatizing the public sector
5. reducing protection given to various sectors of the industry
6. modernizing the small scale sector
7. allowing more freedom to the market by reducing the entry and exit barriers
8. reducing interference in credit allocations
9. allowing foreign investments and technologies to enter Indian markets
10. liberalising the import regime
11. Encouraging exports.

Thus we see that these policies aimed at introducing all the three forms of competitions that the World Bank had asked for, i.e., internal competition, import competition and export rivalry.

Since 1991-92, close to eight years has passed and these policy changes have now started now showing results. The budget of 1999-2000 has in fact said to have initiated the second phase of these reforms. This dissertation aims at analysing the impact of the policy changes that have been initiated since 1991-92. However it's scope is rather limited as we would only look at the changes that have taken place since 1991 in the industrial structure of India. How far these changes are different from those that were taking place before 1991? Our data sources however allow us to confine our investigation of changes that have taken place till 1995. Without claim to certainty we can say that the changes after 1995 might have been in the same directions.

CHAPTER 2
REVIEW OF GOVERNMENT POLICIES

2.1 INDUSTRIAL POLICY CHANGES

SINCE 1991

Since 1991, Indian industrial policies had undergone drastic changes shackling institutions that we had built up since independence. The New Industrial Policy Resolution of 1991 announced that its new aim was to unshackle the Industrial economy from the cobwebs of unnecessary bureaucratic control, to introduce liberalization with a view to integrate the Indian economy with the world economy, to remove restrictions on foreign direct investment as also to free the domestic entrepreneurs from restrictions of MRTP Act. The policy also aimed at shedding the load of public enterprises which have shown a very a low rate of return or incurring losses over the years. All these initiatives taken to change the entire regulatory framework were taken at much faster pace and on a much broader scale as compared to those that were taken in the 80s. We will here look at the various policy measures under the following heads, as these were the directions of change that the World Bank professed.

- i) Industrial licensing
- j) Public Sector Policy
- k) Foreign Investment

- l) Foreign Technology
- m) MRTP Acts
- n) Small Scale Industries
- o) Exit policy.

Industrial licensing

The World Bank suggestions regarding the Industrial licensing were two fold,

- a) immediate removal of licensing barriers to capacity growth,
- b) considerably narrowing the number of industries subject to capacity licensing.

The New Industrial Policy of 1991 brought the following changes,

1. Industrial licensing was abolished for all projects except for a small list of 18 industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons and items of elitist consumption (list as in Annex II of the Policy Document).

Further in 1993, the items of elitist consumption's were also freed from the likening requirements, thereby reducing the list of 18 industries to 15, by excluding motor cars, white goods(including refrigerators, washing machines air conditioners, etc).

2. The location requirements as far as granting of licenses is concerned, was to a large extent reduced. In locations other than cities of more than 1 million populations, there will be no requirement of obtaining industrial approvals from the Central government except for industries subject to compulsory licensing. Only in respect of cities with population greater than 1 million, non-polluting industries, such as electronics, computer software and printing were now to be located outside 25 kms of the periphery
3. All substantial expansions of existing units were allowed exemptions from any form of licensing.
4. Earlier projects that required imported capital goods special licenses were to be obtained. But now such projects obtained automatic approval if the value of imported capital goods was less than 25% of the total value of plant and equipment, subject to the maximum value of Rs2 crores.

Projects requiring imported capital goods also was to obtain automatic approval if the foreign exchange availability was met through foreign equity.

In other cases imports required various permissions. But the projects as such did not require approvals or licenses.

Thus industrial licensing was virtually abolished.

Public sector policy

The Bank's report had suggested the reduction of the role of public sector in provision of goods and services. The New Industrial Policy of 1991 lifted all restrictions on entry of private enterprises into the public sector except for 8 areas related to strategic and security concerns of the country. These 8 areas were mentioned in Annex I of the policy document. A part of equity of public sector companies was now to be disinvested and efforts were to be made to involve more of participation through corporatisation process.

In 1992-93 the reserved list for public sector was further reduced to 6 industries.

Foreign Investment

The World Bank had urged for a more friendly atmosphere for foreign investment. The government had over the years have increased concessions to foreign investment. The New Industrial Policy had introduced the following changes in this regard,

1. automatic approval would be available for direct foreign investment upto as much as 51% in 34 high priority industries, mentioned in Annex III of the policy document, provided foreign equity covers the foreign exchange requirement for imported capital

2. those foreign equity proposals which do not meet the above criteria would though require prior clearances, here too the trading companies engaged in export activities have been exempted.
3. During 1992-93 several other measures were undertaken to encourage direct foreign investment, NRI investment, etc as follows,
 - a) the dividend balancing conditions earlier applicable to foreign investment upto 51% was abolished except for consumer goods
 - b) NRIs and OCBs owned by them have been permitted to hold upto 100% equity in high priority industries. The capital and income can also be repatriated in these cases. In non-priority areas such as trading houses, hospitals, EOUs, hotels and tourism related industries NRIs and OCBs owned by them have been allowed to hold equity upto 100% but without the right of repatriation.
4. FERA provisions have been liberalized as a result of which companies with 405 of equity are also treated at par with fully Indian-owned companies
5. Foreign companies have been allowed to use their trade marks on domestic sales.
6. Finally in 1992 India also signed the Multilateral Investment Guarantee Agency Protocol for protection of foreign investors.

Foreign technology

In order to encourage entry of improved foreign technology into Indian markets the new policy followed the Bank's philosophy and introduced the following changes in policy,

1. Automatic permission have been given for foreign technology agreements in high priority industries mentioned in Annex III, upto lumpsum payment of Rs 1crore, 5% royalty for domestic sales and 8% for exports, subject to a total payments of sales over a 10 year period from date of agreement or 7 years from date of commencement of production.

2. In case of other industries not mentioned in Annex III, automatic permission would also be given but only if no free foreign exchange is required for any payments.
3. No permission will be required for hiring foreign technicians, foreign testing of indigenously developed technology.

MRTP Act

The New Industrial Policy of 1991 stated that,

1. The pre-entry scrutiny of investment decisions of the erstwhile MRTP companies will no longer be required
2. The emphasis will be on controlling and regulating restrictive trade practices rather than making it necessary for MRTP companies to obtain prior approval of central government for establishment, expansions, mergers, amalgamations, takeovers of certain directors.
3. The new MRTP commission will have the power only to initiate investigations *suo moto*, i.e., on complaints received from individual consumers or classes of consumers in regard to monopolistic, restrictive and unfair trade practices.

On the whole it is said the MRTP Act as it stands today has taken almost all the powers of the MRTP commission.

Small Scale Industries

As far as small scale industries is concerned the government has not till date accepted the World Bank view whole heartedly. A committee was set up to look into the issue of dereserving the products meant for small scale industries under Abid Hussain. On the recommendation some changes were brought in the government policies towards this sector, but these had taken place after 1994-95, which falls outside our study period. Does that mean the small scale sector continued to enjoy the protection till 1994-95? The answer is “No”.

The protection enjoyed by the small scale sector had started deteriorating since the mid 1980s. According to Research Team of 'Economic & Political Weekly' [EPW] of India due to the increasing liberalization of India's import policy. Since the early 1980s, according to the team more and more number import products were brought under OGL. Many of these products whose imports were brought under OGL in mid 1980s were produced earlier exclusively by the small scale sector. These include textile machinery like air-jets, water-jet looms, rubber cushions, man-made fibres, woolen rags, polysterene films, etc.

A large part of small scale sector's output was earlier used as intermediate goods by large and medium scale industries. Allowing the entry of foreign technology has cut into the markets for the corresponding small-scale products. According to EPW's research team, "production capacities once built on imported technologies and imported capital goods have to be sustained by imported raw materials, spare parts. Therefore import of capital is destined to grow continuously". This has certainly the domestic small scale sector over the years.

On top of this more and more items were brought under OGL particularly after 1991 and thus the protection enjoyed by the sector in terms of reservation of products was largely nullified after 1991-92 and the small scale sector has been exposed to external competition. As far as internal competition is concerned we have seen in Chandrasekhar's study that the large and medium sector had never been very interested to invest in these areas. So we can probably say that the small scale sector has been exposed to a very unprotected atmosphere over the years, particularly after 1991-92.

Exit Policy

India does not have a proper exit policy as such, but a number of policy changes have been introduced since 1991-92 which have made the exit of industries suffering from chronic sickness easier. In public sector industrial

sickness is higher than in the private sector. To take care of this the government have come up with a set of policy measures since 1991-92. Public and private enterprises which are chronically sick and which are unlikely to turn around are now referred to BIFR which recommends either its rehabilitation. The workers to be affected by any retrenchment move are to be suitably provided some rehabilitation. Government attitude towards sick units in the public sector have also changed since 1991-92 and now the government encourages the takeover of sick units in public sector by private players, provided suitable compensation is provided to the affected workers. A NRF was to be established to support compensation packages to the workers.

How far the NRF or the rehabilitation packages have helped either in compensating the sick industries or how far they have revived the reemergence of the sick units is beyond the scope of this dissertation. We would just take note of the fact that the exit of sick units has become easier than before.

Thus we see that most of the regulatory changes that according to the World Bank was required to remove the discrepancies in the Indian industrial structure were brought about through a host of new policy measures during the years 1991-92 to 1993-94. These changes are said to have brought an entire paradigm shift in the industrial regulatory framework of India. Through the next parts of this dissertation we would look at the impact of this changes on the industrial structure of India.

**CHAPTER 3
PLAN OF STUDY**



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3.1 QUESTIONS REGARDING **METHODOLOGY**

As was done in the World Bank report, we would also classify the whole of industrial sector into 3 classes, those of large scale units, middle scale units and small scale units. The classification as adopted by World Bank had taken the total number of workers in an unit as the standard of classification. The Bank's report takes the ranges of 5-33, 33-75, 75-189, 189-243 and 243&above as the 5 size classes. Of these the emptiness of industrial sector as defined by the Bank seems to be operating in the size class employing 189-243 workers. This, therefore, according to the bank is the middle sector, while the units employing upto 189 workers fall within the small scale sector. The units employing more than 243 workers are included in the large scale sector.

In India the industrial units are classified as small scale, medium scale or large scale on the basis of the value of plants and machinery, i.e., value of fixed capital. Since the report deals with the impact of the government's regulatory policy on the structure of Indian industrial sector, it is probably imperative that the study should take such a classification as adopted by the government. The government policies like protection to small-scale sector,

MRTTP Act, licensing requirements, locational restrictions, etc are also based on such a classification.

The reason why the Bank had used total number of workers employed in an unit as the standard of classification is probably that the Bank needed a standard of classification that could be applicable to all the countries which it included in its study, i.e., Japan, Yugoslavia, South Korea, China and India. Even in such a case the Bank could probably have used the criteria of investment in plant and machinery for defining the scales of industrial units across the various countries. Therefore, the Bank's classification is acceptable only if we can assume that in all these countries absolute number of workers in a unit varies directly with the absolute value of capital-size, i.e., units in large scale sector employ highest number of workers followed by middle scale units and small scale units.

But this correlation between capital size and number workers employed is not mentioned anywhere in the Bank's report. The report only classifies the industrial units into 5 size-classes in terms of the total number workers without ever mentioning the corresponding capital sizes. Thus it seems that the idea of a positive correlation between absolute capital size and absolute number of employed workers enters the study as an implicit assumption.

Though this assumption may not be questionable entirely, it probably raises the following questions that, if it is always the case that all units in the small scale sector employ lesser number of workers than the middle scale sector and all units of the later employ lesser number workers than large scale sector?

The most comprehensive industrial data is produced in India by the Central Statistical Organisation in the form of Annual Survey of industries. According to these surveys upto 1985-86 many units in the smallest industrial sector with per factory capital size less than Rs 10 lakhs employed upto 2000 at least. The units in the range of capital size of 10-20 lakhs, which also falls in the category of small scale sector employed again in the range of 1-2000 (and above in few years) workers. Again many of the middle sector units with capital sizes more than Rs 60 lakhs employed less than 4 workers. In large scale sectors like

those where per factory capital sizes had been more than Rs 10 crores there had been units employing less than 4 workers. Many of these were sick units but they continued to exist in the industrial sector. Thus we see that it cannot be said without qualification that all units in the small scale sector employed lesser number of workers than those in the large scale units.

In fact sickness inflicts some units in all sectors in all countries and such units would always employ less number of workers than the sector average. However when we classify the units according to number of workers this creates a problem of inclusion of wrong units in a class. Large-scale units with very little work-force may get included in the class of small units when classified this way. Again some units in all size classes will be over employed in comparison to the class average. This too creates the problem of wrong inclusion. In this case small-units with a more than average number of workers may get included in the class of larger units.

How has the Bank's report then classified the industrial units without involving the problem of wrong inclusion? One possibility is that the report has taken the average range of workers that a size class employed. In case of India, as per ASI statistics, in the small-scale sector where per unit Fixed Capital is in the range of Rs 0-10 lakhs, the average number of workers employed remained around 23 for the entire decade of 1980s. In the sector where per unit Fixed Capital is in the range of Rs 10-20 lakhs, the average number of workers employed remained around 29. Both these size-classes, therefore, can be included in the class of small-scale units employing workers in the range of 5-33 as defined by the Bank. But there is no mention in the report, as why the Bank had chosen the values of 5 and 33 as the outer limits of the range.

Secondly as per the Bank's definition of middle sector employing between 75-189 workers per unit, we can include only those units which had Fixed Capital in the range of Rs 50 lakhs-5 crores. These units employed on an average in the range of 99 to 172 workers for the entire decade of 1980s. But the Bank's report never mentions as why this range of Fixed Capital per unit should be called appropriate for the middle-scale sector.

Also once again there is no mention as why the Bank had chosen the values of 75 and 189 as the outer limits of the range.

There also probably emerges another question, if the ranges taken by the report is universally applicable to all the countries. Here too probably the bank's report has not given a very clear answer.

Thus we see that by taking the number of employed workers as a basis for classification of industrial units we encounter a few problems, which probably the report has neither triumphed over nor mentioned explicitly.

As we have mentioned before, in India the industrial units are classified as small scale, medium scale or large scale on the basis of the value of plants and machinery, i.e., value of fixed capital. Since the report deals with the impact of the government's regulatory policy on the structure of Indian industrial sector, in our study we would be using the classification based on capital size as adopted by the government of India.

3.2 METHODOLOGY ADOPTED

We will base our analysis on the Annual Survey of Industries [ASI] data produced by the Central Statistical organisation [CSO]. One advantage of this data source is that ASI classifies the industrial units on the basis of size of fixed capital and then within a range of fixed capital it distributes the units into groups based on employment size. As we have seen earlier that it is not possible to classify industrial units into small-scale, medium-scale and large-scale on the basis of employment size as there is no regular correlation between size of capital and size of employment, we will, therefore classify industrial units on the basis of size of fixed capital.

But the ASI is available only for the period upto 1994-95. Hence our analysis of the impact of the policy changes that occurred since 1991 on industrial structure of India is confined upto 1994-95. Our analysis will be for a period of ten years from 1985-1995 and we will divide the period into two phases, 1985-89 and 1989-95. In the first half of the next chapter we will analyse the impact of the policy changes since 1991 on the industrial structure of India. In the next half we will compare these changes with the trends prior to 1989-90.

Upto 1990, the small-scale sector included only those units where investment in fixed capital was less than or equal to Rs 35 lakhs. From 1991 this limit was raised to Rs 60 lakhs. For ancillary units the earlier limit was Rs 45 lakhs and the new limit was set at Rs 75 lakhs. However these ancillary units could enjoy the benefits offered government only if they exported 30% of their products within the next three years. Thus for these units the limit was raised to Rs 75 lakhs effectively from 1994. Thus what concerns us is the limit of Rs 60 lakhs for small-scale sector and Rs 45 lakhs for the ancillary sector. The ASI however classifies the industrial units into unequal ranges of fixed capital as follows,

Rs 0-10 lakhs, Rs 10-20 lakhs, Rs 20-50 lakhs, Rs 50 lakhs-1crores, Rs 1crores-2crores, Rs 2crores-5crores, Rs 5crores-10crores, Rs 10crores-20crores, Rs 20crores-50crores, Rs 50-100crores, and finally Rs 100crores and above.

Of these, upto the second group, i.e., upto Rs 50 lakhs roughly corresponds to the small-scale sector including the ancillary units. Only a few non ancillary units with a capital range between Rs50-60 lakhs will be outside this range. Thus in our analysis the SET, which corresponds to the small-scale sector will include units with fixed capital in the range of 0-Rs50 lakhs.

How are we to define large-scale sector? While the government policies are based clear definition of small-scale sector, they are not so for large-scale sector. However as the World Bank says that the regulatory framework as it existed before 1991 imposed a lot of restrictions on the large units to enter middle sector, we would look at the size of fixed capital beyond

which these restrictions were the highest, in our effort to define the large-scale sector.

Now beyond the limit of Rs 50 lakhs the industrial units had been regulated by a host of policy measures till 1991, like licensing requirements, locational requirements, phased manufacturing system, etc as we have discussed earlier. These regulatory measures were gradually relaxed since mid 1980s. However the restrictions on the bigger units with fixed capital above Rs 10crores were still very high. The licensing requirements were relaxed for such units in 1987-88, but only when they fulfilled certain locational requirements. In 1986-87 a new concept of encouraging Venture Capital was introduced. Bigger companies could establish smaller units under this schemes but again the minimum limit for Venture Capital had to be Rs 10crores. Below this the licensing requirements continued to be stringent. Thus it is imperative that the units with fixed capital above Rs 10crores be called large-scale units. The largest among them are the MRTTP companies with fixed capital above Rs 100crores.

Thus the classification of industrial units in this dissertation has been planned as follows,

<i>small-scale sector</i> [SET1]	0-Rs10 lakhs
	Rs10-20 lakhs
	Rs20-50 lakhs
<i>Middle-scale sector</i> [SET2]	Rs50 lakhs- Rs1crore
	Rs1-2 crores
	Rs 2-5crores
<i>Large-scale sector</i> [SET3]	Rs 5-10 crores
	Rs10-20 crores
	Rs20-50 crores
	Rs50-100crores
	Rs100crores and above

3.3 LOOKING AT INDUSTRIAL **STRUCTURE**

When we look at the industrial structure of India we would concentrate on three aspects. The first is of course the concentration of capital in the three sets. By concentration we would mean the value of Fixed Capital invested in a set as a percentage of total. This would tell us how the “empty middle” has changed over the periods from 1989 to 1995. But the changes in the concentration of capital may occur due to many factors,

- a) entry of new units into a set,
- b) exit of some units from a set
- c) expansion of existing units in a set,
- d) shrinking of the capital base of certain units in a set.

As our aim is to find the causes behind the changes in concentration of capital, we would therefore have to look at the number of units in a particular set and how these numbers have changed over the years. More importantly, we should look at the number of units in a set as a percentage of total number of units and the changes in them. To find out if expansions or contractions of capital base of individual units in a particular set had been responsible for the changes in concentration of capital for the set as a whole we would also look at the changes in the Fixed Capital per unit in the three sets and these have changed over the period under consideration.

Next we would attempt to analyse these changes on the basis of various probable factors that might affect the growth of industrial units in a sector. The most important factor in this regard is the profitability of the units under consideration. We would therefore try to gauge the rates of return on fixed capital enjoyed by the various sets. The rates of return are not given by the ASI

data that we are using. The ASI provides information under the following heads for each class of industrial units [classified in terms of fixed capital],

Employment range

No of factories

Fixed capital

Productive capital

Invested capital

No of workers

No of employees

Wages to workers

Total emolument

Gross output

Depreciation

Net value added

Here the ASI defines the Net Value added as “the increment to the value of goods and services that is contributed by the factory and is obtained by deducting the value of total inputs and depreciation from value of output.”

Total input is again defined as that which comprises of “total value of fuels, materials consumed as well as expenditures such as (a) cost of contract and commission work done by others on materials supplied by the factory, (b) cost of materials consumed for repairs and maintenance work done by others to the factory’s fixed assets, (c) inward freight charges and transport charges; rates and taxes excluding income taxes; postage, telephone and telephone expences; insurance charges, banking charges; and cost of printing and stationery, etc.”

To arrive at the value of absolute profits we have to deduct the wages [W] paid to the workers. Finally to arrive at gross rate of returns [R] accruing to the units we have used the following formula,

$$R = \frac{\text{NVA-W}}{\text{PC}} * 100$$

Where PC= Productive Capital

Productive Capital includes both working capital and Fixed Capital and hence is a measure of the total capital invested on which profits are realised.

CHAPTER 4

ANALYSIS OF DATA

4.1 CONCENTRATION OF CAPITAL

Our first aim would be to look at the changes in concentration of capital across the various sets. Table 1 shows that concentration of capital as measured in terms of Fixed Capital [FC] invested in a set as a percentage of total Fixed Capital in the industry as a whole. It clearly reveals that capital had always been concentrated in the most in SET3 followed by SET2 and SET1. This is quite in line with what the World Bank report says. However as per the prediction of the Bank's report the concentration of capital in the large-scale sector is supposed to reduce once the regulatory policies are relaxed. This probably has not taken place. As we can see, concentrations in large scale sector i.e., in SET 3 has not reduced over the period 1989-95. In fact the concentration of capital in SET3 has increased rather than reducing and the concentration of capital in SET2 and SET1 have reduced rather than increasing.

Thus we can probably say that capital has got more concentrated in the large-scale sector since 1989-90. However this trend does not necessarily imply a deteriorating position for the small or middle-scale sector. In absolute terms both small and middle-scale sectors have experienced increase in capital. But relative to increase in capital base of the entire industry,

the increase in capital in small-scale and middle-scale sector had been very modest.

As we have said in the previous chapter that, changes in the concentration of capital may occur due to many factors, like,

- e) entry of new units into a set,
- f) exit of some units from a set
- g) expansion of existing units in a set,
- h) shrinking of the capital base of certain units in a set.

Table 2, 3 and 4 show respectively the number of units, the numbers as percentage of total and Fixed Capital [FC] per unit in the various SETs. As we can see that while the number of units increased at very high rate, FC per unit has registered a rather modest growth in the large-scale sector. While the number of units in this sector has increased by over 119%, FC per factory increased by only about 2%. Concentration of capital has, therefore, increased as a percentage of total mostly because of increase in the number of units and not so much because of the expansion of the existing units.

The small-scale sector shows just the opposite trend when compared to the large-scale sector. Here we see that the number of units has registered a modest increase of around 9% in. But unlike the large-scale sector, it has achieved a good increase of about 102% in FC per factory. Therefore we can probably say that whatever increase in investment in capital has been achieved in this sector it has been largely due to the expansions of the existing units as entry of new units has remained modest.

However in spite of such growths, concentration of capital in this sector as a percentage of total has shown negative growth. This is because the increases in FC per unit have not been commensurate to the increase in the capital base of the industry as a whole. Most of the increase in capital came from the large-scale sector.

The middle-scale sector shows a modest growth of only 30% in FC per unit. However number of units in this sector has increased at a high rate of 85%, though it is still lower than the corresponding figure for large-

scale sector. Thus in this sector it is the entry of new units which is mostly responsible for the increase in investment in FC.

We can thus make the following observations,

- a) even though all the three sectors have experienced positive growths in FC and number of units, in relative terms, capital as a proportion of total reduced in the small and medium sectors.
- b) The large-scale sector experienced phenomenal growth in number of units but not so much growth in FC per unit. The concentration of capital in the large-scale sector has increased mostly because of the entry of new units.
- c) Increase in investment in the small-scale sector has been achieved mostly by expansion of existing units and not so much due to the entry of new units.
- d) Increase in investment in the middle-scale sector has been achieved mostly by entry of new units in the sector and not so much due to expansions of the existing units.

4.2 RATES OF RETURN

Rate of return on capital invested is one of the most important factors affecting investment decisions. However there are other factors too which affect them. Here we will first analyse the rates of return as they behaved over the years. Other factors that probably had affected the various sectors of industries will be brought up subsequently.

As we can see from Table 4 rates of return on fixed capital had always remained the highest for the small-scale sector. Also over the period under consideration the rate of return for this sector has increased by 15%. The middle scale sector enjoyed lower rates of return than the small-scale sector. Here the rates have fallen by about 28% over the period under consideration. On the other hand rates of return though was always the lowest for the large-scale

sector, they have improved positively over the years by about 19%. Thus we can say that profitability in Indian industry is inversely proportional to size of Fixed Capital.

i.e., $R \propto 1/FC$ (1)

But over the period under consideration, profitability of the majority of the middle-scale units has deteriorated whereas those of small and large units have generally improved.

At this point we can raise a few interesting questions,

- a) What are the factors then that led to the positive increase in number of units in the large-scale sector? One possible way of explaining the phenomenal increase in number of units in the large-scale sector is that due to continuous rise in rates of return in the large-scale sector, it generated a positive expectation regarding increasing rates in future too. This has led to entry of new units. This explanation may not fully suffice but such factors do affect investment decisions.
- b) But if this is so, then positive improvement in rates of return as observed for the small-scale sector's size-classes must also lead to high growth rate in number of units. But growth in number of units for this sector as a whole has remained the modest. In the next section we would look at this phenomenon more closely.

4.3 SMALL-SCALE SECTOR

We would now look at the small, large and middle-scale sectors separately. In the small-scale sector, we can observe the following features of change,

- a) The rates of return have remained the highest in all the years.

And also $R > 0$

- b) As size of FC increases, rate of return (R) falls. This is true for the whole industry.

i.e., $R \propto 1/FC$.

- c) The rates of return also improved but at modest rates.
d) The reduction in R has been more for bigger size-classes.

$$\text{i.e., } \Delta R \propto 1/FC \quad (2)$$

- e) FC per unit has increased for all the size-classes within the sector. Here increase in FC per unit has been maximum for the largest size class, but the change in FC per unit has been lower for the middle size-class than that for the lowest size-class.

$$\Delta[FC/N]_{0-10} > \Delta[FC/N]_{10-20} \quad (4)$$

$$\Delta[FC/N]_{10-20} < \Delta[FC/N]_{20-50}$$

- f) Number of units increased more in larger size classes,

$$\text{i.e., } \Delta N \propto FC \quad (5)$$

$$\text{i.e., } \Delta N_{0-10} < \Delta N_{10-20} < \Delta N_{20-50} < \Delta N_{50-100} \quad (6)$$

where, 'n' represents the number of units in a size-class, the subscripts 0-10, 10-20 and 20-50 respectively represent the size-classes of 0-Rs 10 lakhs, Rs 10-20 lakhs, Rs20-50 lakhs, and Rs50 lakhs-1 crores.

Let us now try to explain these changes. As R is inversely proportional to FC it is probably an imperative that the maximum investments would take place in the smallest units followed by larger units. However as we can see from (4) above that maximum expansion in terms of FC has been registered in the largest size-class. This is because expansions of industrial units may not necessarily lead to expansion of capital base for that sector as a whole. With expansion of an industrial unit a particular unit may become large enough to be included in the next higher size-class. Thus even though the units in the smallest size-class expanded at a high rate, many of them must have entered the next higher size class. If this is so, then the number of units in the next size-class must increase as has happened.

Similarly the units in the size class of Rs 10 –20 lakhs must have also expanded and some must have left the size-class for the next higher size-class. This explains both (5) and (6). In fact some units must have entered the middle-scale sector which explains the high growth in numbers of units in the size-class of 'Rs 50 lakhs to Rs 1 crore'.

Thus overall there had been positive growth of the existing units in the small-scale sector. The smallest units expanded at a faster rate than the rest because of higher rates of return enjoyed by these units. However we can see that there had been a fall in number of units in the smallest Size-class. Part of this must have been because of the exit of units from this class and their entry into a higher class. But it is also probably true that there had not been any significant entry of new units.

4.4 LARGE SCALE SECTOR

As mentioned before, in the large-scale sector we see the following features,

- a) The rates of return have remained the lowest in all the years.
- b) As size of FC increases, rate of return (R) falls. This is true for the whole industry.

i.e., $R \propto 1/FC$.

- c) FC per unit has increased for all the size-classes within the sector. However contrary to the small-scale sector here FC per unit has increased more for the smaller units.
- d) Number of units generally increased more in larger size classes than the smaller units as in the small-scale sector.[only the size class of Rs 50-100crores is a small exception]

As rates of return for the smallest size-class has always remained the highest in this sector too, it is therefore, understandable that maximum expansion of units took place in this size-class or Rs10 –20 crores. The range of this size class is also very large and so any unit would have to expand very drastically in order to enter the next higher size-class. This can not be expected to happen for most of the industrial units. Therefore, not only FC per unit increased in this size-class but also exit of units from this class can not be expected to have happened very widely. Similarly entry of units from previous

class can not be expected to be large enough due to similar reasons. How do we then explain the tremendous increase in number of units in the size-class? The only possible explanation seems to be that in this size-class there had been a huge increase in number of new units.

Similar logic also holds for the other size-classes in the large-scale sector. Not only so, we also see that while the size-class of Rs10-20 crores witnessed a sharp increase in FC per unit, it has not happened in case of the other size-classes. In these classes only the numbers increased. This is therefore possible only due to entry of fresh units into the sector.

Thus contrary to the small-scale sector the expansion of capital base in the large-scale sector has been mostly because of the entry of new units in the sector. What are the causes of this high growth of new entrants into the sector? As explained earlier, the new units are guided more by future expectations than the existing rates of return. As long as the rates of return are increasing the expectations remain high and encourage entry of new units into the market. Only in case of large-scale sector the rates of return has increased for all the size-classes except one. This explains partly the above observation.

4.5 MIDDLE SCALE SECTOR

The middle scale sector shows very peculiar trends. These are as follows,

a) The rates of return have remained positive in all the years

$$\text{i.e., } R > 0 \quad (7)$$

b) As size of FC increases, rate of return (R) falls. This is true for the whole industry.

$$\text{i.e., } R \propto 1/FC.$$

c) FC per unit has increased for all the size-classes within the sector

$$\text{i.e., } [\Delta FC/N] > 0 \text{ always}$$

(8)

however the growth in FC per unit has remained modest for all size-classes.

e) Number of units also increased for all size classes,

i.e., $\Delta N > 0$ always. (9)

We can now ask the following question,

As we have explained that entry of new units in any size-class is guided by positive expectations regarding future rates of return. Such positive expectations have been possible in the large-scale sector. and such positive expectations encouraged the entry of new units in that sector. Among all the size-classes in the middle scale sector only one size-class, i.e. that of Rs 5-10crores has experienced increase in R over the years. Thus this size-class certainly encouraged entry of new units. Otherwise in the middle-scale sector, the rates of return has shown decline for most Size classes,

i.e., $\Delta R < 0$ (10)

How can we then explain the sharp increases in the number of units in the size-classes, inspite of falling rates of return?

The answer probably lies in the fact that as rates of return affects investment decisions, like expansion of units or entry of new units, the entry of units or their expansions also affect the rates of return. In the middle-scale sector it is the increase in the number of units that has probably guided the fall in rates of return. In other words in this sector the entry of new units has not been guided by the positive expectations regarding future rates of return. But entry of new units has driven the rates of return down.

Let us now look again at the size-class individually starting with that of Rs10-20 lakhs. Driven by positive rates of return this size-class witnessed an expansion in FC per unit. Some of the units expanded and entered the next size-class of Rs20-50 lakhs. In this size-class too the expansions of the existing continued, as $R > 0$. However the $\Delta R < 0$ in this size class. This is probably because, overcrowding of units led to more competition and thereby a fall in R. This same logic can be extended to the next size-classes too.

However as we move towards larger size-classes the range of FC for a size-class also increases. Therefore even with expansion of

units, their entry into higher size-classes becomes more and more a remote possibility. Therefore, if the number of units increased in the larger size-classes then only part of it can be explained by the logic of expansion of smaller units. In that case we probably can say that there had also been a large increase in new entries. Part of this is certainly because of the increase in R in the size-class of Rs 5-10 crores. But there is something more to note.

Increase in number of units in the smaller size-classes can be explained by the logic of expansion of smaller units as we have done in case of small-scale sector. the increase in number of units in the size-class of Rs5-10crores can be explained by the logic of entry of new units driven by positive expectations. However in the middle-scale sector number of units have increased in the size classes between these two extremes. How can we explain this?

As we had mentioned before that among other factors, present rates of return affect the expectations regarding the future rates of growth. Whatever these other factors are, they probably have played a major role in encouraging entry of new units in the middle-sector, particularly because the neither the actual rates of return nor the changes in them seem to explain the changes observed in the middle-scale sector. Secondly since we have taken the trends in rates of return only for a period of five years, such trends may have affected the investment decisions only marginally. Thirdly as we mentioned in the second chapter, the reforms in the industrial sector over the period under consideration have been quite drastic. These probably encouraged private and to a limited extent foreign operators to enter the markets guided by calculations not entirely based on actual rates of return. In fact the policy changes have been so drastic that they created a different situation from the past and therefore past ways of calculating risks could not be applied fully. This is probably also true for the large-scale sector though it is more apparent in case of the middle-scale sector. We have seen that after 1995-96, the country's industrial sector headed for a recession. Part of this was because of the setting of unviable units in the

previous years. This dissertation is however based on the period before the recession took place.

4.6 EXPLAINING RATES OF RETURN

Till now we have tried to explain the changes in industrial structure in terms of rates of return. Only in case of the middle-scale sector we have also tried to explain the opposite causation i.e., changes in the rates of return in terms of changes in the industrial structure. But the rates of return are affected by changes in industrial structure in all sectors of the industry. We would now try to explain such changes starting with the small-scale sector.

In the small-scale sector we have seen that there had been no significant entry of new units into the smallest size-class in the sector. As far as the next size-class of Rs10-20 lakhs is concerned, there is no way to know the actual extent of the entry of new units into the size-class. But in the size-class of Rs20-50 lakhs the increase in number of units has been very high. More than that FC per unit increased by a dramatic 182%. We can probably say that in this class some new units may have entered leading to the over crowding that lead to the fall in rate of return over the years. This we can probably say in the light of the fact that the FC-limit of small-scale sector was raised to Rs 60 lakhs from the earlier limit of Rs 35 lakhs only in the year 1990. The expansion of existing units alone by 182% is probably not possible.

Most existing units with pre-existing plant and machinery would probably not be in a position to expand so dramatically and that too within a period of five years. However new units may be set up more easily with initial capital-base below Rs60 lakhs particularly when there is now lesser restrictions on who is investing. As we have seen that a significant number of units in the small-scale sector are actually set up by larger enterprises under various guise, the new entries, therefore, probably been set up mostly by this class of enterprises.

Thus there might have been entry of new units into the largest size-class in the small-scale sector along with expansion of existing units, leading to a fall in rates of return.

As far as the large-scale sector is concerned we see falling rates of return only in case of the size-class of Rs10-20 crores. For this class we can probably say unambiguously that as a consequence of over crowding of units the rates of return have fallen. The argument that the entry of new units has been guided largely by factors other than trend in rates of return is also applicable for this size-class. But these other factors must also be applicable for the other size-classes in the large-scale sector. As we have seen before the regulatory policies imposed on the large-scale sector have been greatly reduced since 1990-91. Here we would like to take note of the fact that the erstwhile MRTP Act was applicable only to the last size-class of 'Rs 100 crores and above'. As MRTP Act has virtually been repealed as we have mentioned before, this size-class has been facing a totally different environment than before. The large business houses that were earlier under the MRTP regulations are now allowed to set up units of any size in other size-classes too. Other than the rates of return, such policy changes must have affected the investment decisions in the large-scale sector.

What are the impacts that these changes brought on the rates of return? There is no direct way to assess them. But we can probably say two things. Firstly, the changes in industrial policies must have benefited the large-scale sector as the rates of return have been rising. But we have also seen that FC per unit in most size classes in this sector increased very modestly. Infact the growths in FC per units have been so modest that it is possible for the new units alone to cause this growth. It is therefore, possible that this overcrowding of new units may have restricted the growth of existing units. However even if such possibilities are there, they would not be reflected in the changes in R recorded for the size-classes as wholes. The existing units who are incapable of facing the increasing competition would then in all probability either experience depreciation and thereby enter the smaller size-classes. This might explain the over-crowding of

units in the smallest size-class within the large-scale sector. As we can see this size-class is the only one in the large sector which has experienced falling rate of return.

TABLE-1: FC as a % of total FC in the industry

Year Size- class	1989- 90	1990- 91	1991- 92	1992- 93	1993- 94	1994- 95	Change over 89-95 (%)
0-10	2.03	1.67	1.68	1.40	1.53	1.11	-45.48
10_20	1.06	0.96	0.95	0.86	1.05	0.77	-27.06
20-50	2.23	2.17	2.06	1.82	1.93	1.68	-24.84
SET 1	5.33	4.79	4.69	4.09	4.52	3.56	-33.16
50-100	1.88	1.79	1.81	1.72	1.89	1.98	5.65
100-200	2.34	2.12	2.12	2.49	2.30	2.27	-2.81
200-500	5.19	4.46	4.22	5.03	4.24	4.35	-16.25
500-1000	5.17	4.86	5.46	5.43	4.60	4.59	-11.23
SET 2	14.57	13.22	13.61	14.66	13.04	13.19	-9.49
1000-2000	5.93	5.66	5.93	5.74	5.90	5.88	-0.83
2000-5000	9.03	8.93	7.34	7.71	9.11	8.48	-6.14
5000-10000	7.35	4.87	6.73	6.07	5.88	7.07	-3.85
10000-	57.79	62.52	61.70	61.74	61.56	61.83	6.99
SET 3	80.10	81.99	81.71	81.25	82.45	83.25	3.93
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	0.00

TABLE 2 : FC per unit

	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	Δ infc/f 89-95 (%)
0-10	2.89	3.01	3.38	3.47	4.44	4.13	42.53
10_20	12.61	13.04	14.02	14.40	19.86	16.65	32.05
20-50	12.86	31.58	31.49	32.02	36.68	36.36	182.73
SET 1	9.45	15.88	16.30	16.63	20.33	19.04	101.44
50-100	63.42	65.67	67.79	70.97	75.54	85.09	34.18
100-200	114.69	119.09	127.59	156.96	150.38	167.41	45.97
200-500	269.63	273.30	277.14	337.86	323.40	353.38	31.06
500-1000	543.29	547.42	664.60	656.87	659.33	681.25	25.39
SET 2	247.75	251.37	284.28	305.66	302.16	321.78	29.88
1000-2000	1124.42	1147.78	1182.06	1240.39	1309.83	1480.32	31.65
2000-5000	2554.55	2746.50	2457.15	2619.06	2980.29	2671.56	4.58
5000-10000	5123.27	4853.49	5822.50	4791.45	5270.59	5616.77	9.63
10000-	54054.4	51822.5	50463.9	51706.1	52868.3	54608.4	1.02
SET 3	15714.1	15142.5	14981.4	15089.2	15607.2	16094.2	2.42
TOTAL	15971.3	15409.8	15281.9	15411.5	15929.7	16435.1	2.90

TABLE 3 : Number of units

year Size class	1989- 90	1990- 91	1991-92	1992-93	1993-94	1994-95	Change over 89-95(%)
0-10	74908.	77383.	75015.	77959.	77383	74523.	-0.51
10_20	8982.	11871.	10203.	11465.	11871.	12905.	43.68
20-50	8318.	11798.	9923.	10974.	11798.	12803.	53.92
SET 1	92208.	101052	95141.	100398.	101050	100231.	8.70
50-100	3156.	5609.	4039.	4660.	5609.	6463.	104.78
100-200	2176.	3431.	2518.	3051.	3431.	3768.	73.16
200-500	2053.	2939.	2303.	2865.	2939.	3412.	66.20
500-1000	1014.	1565.	1242.	1593.	1565.	1867.	84.12
SET 2	8399.	13544.	10102.	12169.	13544.	15510.	84.66
1000-2000	562.	1010.	759.	891.	1010.	1101.	95.91
2000-5000	377.	685.	452.	567.	685.	880.	133.42
5000-10000	153.	250.	175.	244.	250.	349.	128.10
10000-	114.	261.	185.	230.	261.	314.	175.44
SET 3	1206.	2206.	1571.	1932.	2206.	2644.	119.24
TOTAL	101813	116802	106814.	114499.	116802.	118385.	16.28

TABLE 4 : Rates of return

	1989- 90	1990- 91	1991- 92	1992- 93	1993- 94	1994- 95	% Change 89---95
0-10	47.85	48.11	44.02	40.54	55.83	57.95	21.11
10_20	40.54	45.20	44.33	35.21	53.84	56.96	40.50
20-50	46.74	52.80	49.21	36.81	42.61	39.02	-16.51
SET 1	46.03	49.19	46.01	38.06	50.32	50.12	15.03
50-100	44.18	49.49	43.68	39.86	40.50	43.06	-2.54
100-200	43.84	49.50	42.33	36.44	35.87	37.77	-13.85
200-500	36.18	36.57	29.23	29.37	28.80	34.44	-4.81
500-1000	33.56	39.27	27.00	29.59	34.73	38.11	13.56
SET 2	36.29	44.85	34.38	28.55	27.48	25.94	-28.52
1000-2000	10.94	14.28	10.78	10.47	12.70	13.69	-7.23
2000-5000	25.11	32.77	29.58	29.29	25.10	36.76	46.39
5000- 10000	20.18	19.51	25.79	29.24	24.28	24.63	22.04
10000- SET 3	11.31	15.10	10.52	13.45	20.33	14.99	32.52
	17.70	21.75	17.44	19.28	24.85	21.05	33.65
TOTAL	22.19	25.64	20.85	21.31	26.62	23.84	7.44

CHAPTER 5
ANALYSIS OF TRENDS

5.1 SUMMARISING THE CHANGES

SINCE 1989-90

We would now summarise the observations that we made in the previous section. The observations are broadly as follows,

- A. According to the World Bank's report the concentration of capital in the Indian industrial sector was the highest in the large-scale sector. This has remained so even after 1989-90. Concentration of capital in this sector has infact increased over the years under consideration, i.e., over 1989-95.
- B. The concentration of capital in the large-scale sector has increased mostly because of the entry of new units. But while the large-scale sector experienced phenomenal growth in number of units the growth in FC per unit has been quite modest.
- C. The tremendous increase in number of units is mostly because of the entry of totally new units in the sector.
- D. The entry of new units is partly explainable by the positive expectations generated regarding future rates of return as actual rates of return has been rising continuously over the period under consideration.

- E. But the calculations regarding future prospects has also been affected by the drastic changes that were brought about in the regulatory framework of government policies. This is more apparent for the middle-scale sector but is also probably applicable for the large-scale sector.
- F. The entry of new units in the large-scale sector has lead to increased competition in the large-scale sector , which might have restricted the expansion of existing units in the sector. there is also the possibility that the capital base of these units have also depreciated over the years and thereby figured in the smaller size-classes in subsequent years.
- G. Concentration of capital in the middle-scale sector has reduced in relative terms when compared to the industrial growth as a whole. This is contrary to the World Bank prediction that with the lifting of regulatory policies like 'licensing' the middle-scale sector would experience an increase in concentration of capital.
- H. Whatever increase in investment the middle-scale sector experienced, it has been largely achieved by entry of new units in the sector and not so much due to expansions of the existing units
- I. The increase in number of units in the middle-scale sector is because of two reasons first of which is that the units in the small-scale sector has expanded over the years and entered the middle-sector. This is probably true mostly for the smaller size-classes in the middle-scale sector.
- J. The entry of units in the most other size-classes in the middle sector has been largely because of fresh investments in new units.
- K. The entry of these new units has been guided mostly by factors external to the industry, like changes in government policies.
- L. The tremendous increase in units in the middle-scale sector has increased the competition in the sector leading to a continuous fall in rates of return over the years. This is true for most size-classes in the entire range of capital bases of units between Rs 20 lakhs to Rs 2 crores.
- M. Concentration of capital in relation to the growth of capital base of the industry as a whole in the small-scale sector has also reduced. Increase in

investment in the small-scale sector has been achieved mostly by expansion of existing units and not so much due to the entry of new units.

- N. The expansions of the existing units has been so good that it led a large proportion of units to enter the middle sector.
- O. However the smallest size-class has experienced negligible increase in fresh units. New units have mostly been set up in the larger size-classes of small sector. There is good possibility that a significant proportion of such units have been established by the larger business enterprises.
- P. Such entries of new units in the small sector has probably also reduced the rates of return over the years.

5.2 CHANGES BEFORE 1989-90

We would now look at the changes that were taking place in the Indian industrial structure before 1989-90. This would help us in knowing, how far the changes that have taken place since 1989-90 can be attributed to the 'Reform' process that have been carried out since the 1991.

But in comparing the changes, we are faced with two problems, the first of which relates to how we define the small-scale sector. As we have mentioned before, the upper limit of the small-scale sector was raised in the year 1990 from Rs35 lakhs to Rs 60 lakhs. Thus for the period before 1989-90, we have to take the range of industrial units within the range of Rs 0-35 lakhs as the small-scale sector. the aggregate changes that have taken place in the sector as a whole before and after 1989-90 are, therefore, not comparable.

The second problem is merely technical. The ASI data on which we are basing our analysis does not maintain the same categorising of factories for the period before and after 1989-90. Therefore the data provided by the ASI does not itself allow us to compare the changes across each of the size-

classes. Only the smallest two size-classes are maintained for both the periods. Therefore, direct comparison is possible only for these two classes and for the industry as a whole.

We would in this section regroup the size-classes into two sets, SET 1* and SET 2*. While SET 1* consists of the two size classes of Rs0-10 lakhs and Rs10-20 lakhs, the rest of the industrial units are put into SET 2*. SET 1* thus represents a major portion of the small-scale sector, as only the units with FC between Rs 20-35 lakhs are outside it. However the SET 2* broadly represents the medium and large-scale sector.

Let us now refer to table 5. It shows the changes in the concentration of capital across the two sets. Concentration of capital is again defined as 'total FC in a set as a percentage of total for the industry'. We can see that the concentration of capital in the SET 1* was falling in the period before 1989-90 as well as after 1989-90. Thus the new policy changes have probably not brought any shift in the direction of change as far as concentration of capital is concerned. However the magnitude of the change in concentration has shown some variation before and after the year 1989-90. While concentration of capital deteriorated for the small-scale sector both before and after 1989-90, the rate of this deterioration has increased after 1989-90 than before. However this is in relation to the change in capital-base of the whole industry. In absolute terms FC per unit has improved for the small-scale-sector after 1989-90, as we can see from Table6.

This Table clearly shows that in spite of the reduction of concentration of capital in the small-scale sector FC per unit in the small-scale sector has improved at a faster rate in the period after 1989-90. Not only so, in the period before 1989-90, the size-class of Rs 10-20 lakhs had shown a fall in FC per unit. But in the period after 1989-90, FC per unit in the class improved positively. Thus for the small-scale sector the expansionary activities has been better after 1989-90 than before. Again Table7 shows that the number of units also increased for the small-scale sector after 1989-90 at a faster pace than before.

The concentration of capital in the rest of the industry as represented by the SET 2* has however increased in both the periods, but at a lesser degree after 1989-90. How has the concentration of capital changed in the middle-scale sector or the large-scale sector is however beyond the scope of our understanding. Table 6 and 7 also show that the increase in concentration of capital in the rest of the industrial sector outside the small-scale sector has been mostly because of the increase in number of new units after 1989-90. This we have already explained. But what is probably noteworthy is that the increase in concentration of capital before 1989-90 was mostly because of the expansion in FC per unit or expansion of existing units. Infact before 1989-90, the number of units in the middle and large-scale sector as represented by the SET 2* has infact fallen. On the other hand FC per unit has fallen in the period after 1989-90.

Finally let us look at Table 8 showing the changes in rates of return before and after 1989-90. This table shows very drastic changes over the two periods. As we can see, the rates of return for the small-scale sector as a whole as well as the two size-classes in it were improving at a very high rate before 1989-90. The rates of return after 1989-90 improved too but at a rather lower rate. On the contrary the rate of return for the rest of industry has improved tremendously after 1989-90 when compared to the period before 1989-90.

TABLE 5

SIZE CLASS	% changes in FC as % of total	
	1984--90	1989--95
0-10	-38.04	-45.48
10--20	-34.81	-27.06
SET 1*	-36.97	-39.16
SET 2*	1.9	1.25
TOTAL	0.0	0.0

TABLE 6

SIZE CLASS	% changes in FC per UNIT	
	1984--90	1989--95
0-10	12.76	42.91
10--20	-9.82	31.21
SET 1*	11.99	51.75
SET 2*	349.47	-59.57
TOTAL	168.51	2.90

TABLE 7

SIZE CLASS	% changes in Number of units[N]	
	1984--90	1989--95
0-10	-2.35	-0.51
10--20	29.48	43.68
SET 1*	0.29	4.22
SET 2*	-44.69	72.72
TOTAL	-7.45	16.28

TABLE 8

	% Changes in rates of return[R]	
	1984-90	1989-95
0-10	49.25	21.11
10--20	2.82	40.50
SET 1*	35.14	30.10
SET 2*	3.29	4.45
TOTAL	3.42	9.62

CHAPTER 6
CONCLUDING THE STUDY

6.1 SUMMARY AND CONCLUSION

In 1991 India had faced a serious balance of payments crisis, following which the government of the day had to borrow from the IMF for temporary management of the crisis. It was felt at that time that there was something wrong in the long-standing paradigm of economic development. One line of thinking found the causes of the crisis in the profligate increase throughout the decade of 1980s in public expenditure which could not be financed by adequate internal resource-mobilisation. However another school of thought found the causes in the elaborate regulatory framework that we had devised over the years since independence. It is this view that the international bodies like the World Bank had endorsed and propagated and this view that influenced the government's thinking at that time.

The World Bank had many contentions regarding the policy framework that existed in India, which according to the Bank bred inefficiency. Among the vast majority of such literature our concern lies in a two-volume document prepared by the Bank titled, "India : Industrial Regulatory Policy study."

Among other things this report says that the Indian industrial structure exhibited a kind of deformity since the mid-70s, which the

Bank calls the “Empty Middle”, ie the investment in the middle-scale sector had been much less than potentially possible. This according to the Bank was because of the regulatory framework that we had devised in India since independence. Such policies imposed differential barriers to entry, growth and exit for the different size-classes of firms. For the small-scale sector, there was very little incentive to grow and enter the middle-sector because by remaining small it could enjoy the incentives that were existing for the small-scale units. On the other hand the large-scale enterprises had various restrictions imposed on them against their entry into the middle-sector. The “Empty-Middle” phenomenon was, therefore, policy induced. According to the Bank, throughout the world the middle level firms were always the most efficient and hence their policy-induced absence bred inefficiency in the industrial sector of India.

The Bank, therefore, recommended certain policy measures which would have the impact of liberalising the industrial sector from unnecessary government control. Since 1991-92, the Government of India has undertaken a variety of policy measures with an aim to restructure the Indian economy and the industrial structure in particular. These policy-changes euphemistically called the “Reforms”, were very much in line with the what the World Bank had desired. In our study we have tried to analyse the changes that took place in industrial structure of India in the 1990s since the introduction of the Reform-process.

In our study we classified the the Indian industrial structure into three sets corresponding to the small-scale, middle-scale sector and large-scale sectors. We have concentrated on three aspects of changes in the industrial structure in India, namely, entry and exit of units in the various size-classes and the sets, expansion of capital-base of units within a set, and changes in concentrations of capital in the various sets and size-classes.

As per the World Bank’s report we have seen in our study that the capital was concentrated mostly in the large-scale sector of the Indian industrial sector. But inspite of removal of regulations, over the period under consideration the concentration of capital increased even further in the

large-scale sector instead of reducing. However the increase in concentration of capital in the large-scale sector has been mostly due to the phenomenal increase in the entry of new units in to the sector. While concentration of capital in the large-scale sector had been increasing even before 1989-90, it was mostly due to the expansion of the existing units in the sector. Thus it is a qualitative change and part of this may be because of the large-scale entry MNCs into the industrial sector after 1990-91.

In the small-scale sector in contrast to the large-scale sector the entry of new units has not been very significant. But here whatever increase in concentration of capital had taken place, it has been mostly because of expansion of existing units. However when compared to the period prior to 1989-90, the expansions of existing units has been less after 1989-90 than before. Thus removal of protection given to the small-scale sector probably has not helped in the expansion of units in the small-scale sector contrary to the predictions of the World bank report.

However inspite of the slowing down of expansionary activities in the small-scale sector, some units had expanded well enough to enter the middle-scale sector. Due to increased competition in the large-scale sector due to entry of new units there, it is possible that, many of the existing enterprises has entered the middle-scale sector. Removal of restrictions on the large enterprises also contributed to their entry into the middle-scale sector. Fixed Capital per unit in the middle-scale sector also increased. Thus as per World Bank's prediction the investments in the middle-scale sector has certainly increased after the initiation of the "reform" process. However the phenomenal entry of new units and expansion of existing units has lead to a over-crowding in this sector leading to a fall in rates of return in this sector. We can probably say that, from a situation of "Empty-Middle" we are now moving to a situation of "Crowded Middle" where the rates of return in the middle-scale sector is continuously falling.

The rate of return has been continuously increasing for the large-scale sector. Thus the large-scale sector has benefitted the most after the

initiation of the reform process. The rates of return also kept increasing for the small-scale sector, but at a lesser pace. Thus the benefits accruing to the small-scale sector probably reduced. The middle-scale sector on the other hand experienced an absolute decline in rates of return for most size-classes. If this trend continues then it can probably be said that even though the World Bank report identifies these units as the most efficient, they may face closures in future,

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