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# **The Dynamics and Status of India's Economic Reforms\***

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## **Abstract**

This paper considers the status of economic reform in India, to understand which further reforms might be desirable, and why they have not been successfully introduced or implemented. Rather than provide a list of reforms that “should” be undertaken, the paper attempts to understand the political economy of the process of economic reform in India, and how that process plays out with respect to different sectors of the economy, or different areas of potential economic reform. The discussion includes the roles of institutions, interest groups and ideas in driving reform.

## **The Dynamics and Status of India's Economic Reforms**

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### **1. Introduction**

India is a large, heterogeneous and complex nation, with 1.2 billion people, and multiple ethnicities, languages and religions. Its size and diversity make it more like a continent than a single country. India stands out among developing countries in its political structures, having sustained a working democracy for almost six decades, even at relatively low levels of income. It also is distinguished by the richness and relative stability of its institutions (Kapur, 2005). These institutions have had an important impact on the evolution of India's economy.

As one of the first colonies to achieve independence in the 20<sup>th</sup> century, India was a pioneer among non-Western nations in trying to forge an explicit development strategy. The centerpiece of India's development strategy was modernization through industrialization. Effort by private industrialists was viewed as inadequate for this task. Underlying this view was a realization that infrastructure has public good aspects that could lead to under provision if left entirely to the private sector. Even non-infrastructure sectors such as steel, chemicals or machine tools may be subject to coordination or linkage issues that require a "big push," further supporting a case for public intervention.<sup>1</sup>

Thus, India's leaders embarked on a program of government occupation of the "commanding heights" of the economy, including the creation of public enterprises in key sectors of the economy, regulation of existing private businesses, and some

nationalization. Analytical arguments for growth promotion were combined with concerns about inequalities that are inherent in capitalism, and more sociologically or philosophically based concerns about the role of business in society. This program was implemented, however, in the context of a pluralistic constitutional democracy with multiple tiers of government.

The evolution of the pattern of state control of the market contributed to increasing problems in maintaining or accelerating economic growth, and eventually led to various attempts to reverse this pattern of control. The reversal in policy direction was given impetus by a balance of payments crisis in 1991, and has been known as “economic reform.”<sup>2</sup> Key initial steps of reform were liberalization of international trade and investment, and of controls on the level and pattern of private domestic industrial investment and operations. Numerous other institutional reforms have followed, including the conduct of monetary policy, and the operation of financial markets. Other reforms have been more difficult to achieve, even when it seemed that a consensus had been built up.

The goal of this paper is to consider the status of economic reform in India, to understand which further reforms might be desirable, and why they have not been successfully introduced or implemented. Rather than provide a list of reforms that “should” be undertaken, the attempt will be to understand the political economy of the process of economic reform in India, and how that process plays out with respect to different sectors of the economy, or different areas of potential economic reform. Some familiarity with

the Indian economy and polity will be assumed. In particular, the paper seeks to explain the dynamics of past and future reforms in terms of the nature of interest groups and their influence. It also highlights the role of ideas and individuals in the reform process: India has a process of debate and change implementation that is quite understandable. Several other themes also run through the paper: the difficulty of reforming governance, because of the reflexive nature of the exercise; the increasing alignment of government and business, making some reforms easier; and the inherent differences in difficulty of reform across different sectors or economic issues.

Accordingly, Section 2 provides a conceptual framework, which is intertwined with some of the historical evolution of India's economy. Sections 3-5 consider governance structures, taxes and public service delivery, which have encompassed some of the greatest change and also some of the greatest difficulties in change. Sections 6 through 9 discuss issues of labor markets, privatization, corporate governance, competition policy, and bankruptcy laws. All of these together have important implications for the growth of the industrial sector, itself an important component of economic growth and development. Sections 10 and 11 consider agriculture and land markets, while Sections 12 and 13 examine investment in physical infrastructure and human capital, the latter referring to the education sector, of course. Section 14 is a summary conclusion.

Several of these issues, especially labor and education, are addressed in other pieces in this volume, but are treated here in the context of a particular view on the dynamics of reform. However, this paper does not tackle monetary and financial sector reforms or the

external sector, which are also covered elsewhere in this volume. These areas have actually seen the some of the most significant reforms, and a brief comment on the differences from other sectors will be offered in the conclusion

## **2. History and Concepts**

Using the colonial period as a benchmark, India certainly did well after independence. Its GDP growth and improvements in human development indicators were both well above the earlier era. This progress was accompanied by the development of a rich set of governance and private sector institutions for delivering food, health, shelter and education to a much greater proportion of the population than ever before in the region's history. Infrastructure investment was greater than before, industries were developed in support of modernization goals, and higher education, in particular, grew dramatically.<sup>3</sup>

On the other hand, as early as the 1960s, several East Asian countries began to outstrip India's economic performance, relying on export-led growth.<sup>4</sup> However, in India this period was marked by political impulses that restrained economic policy changes that would have moved in this direction. By the 1980s, India's relative lack of success became obvious, with the cumulative impacts of decades of higher growth in East and Southeast Asia. Along with the crisis, China's embrace of capitalism, and its growth record helped favor economic reform. Nevertheless, the economic path of the previous decades created certain barriers to change.

India's particular implementation of a strategy of state-led industrialization led to three related sets of problems (Singh, 2008). First, often the policy measures used in practice were inferior ways of achieving avowed goals, with over-reliance on quantitative and discretionary controls. Second, the system of discretionary bureaucratic control created classic 'vested interests' that prevented reform. Third, the short-run political logic of governing India led to transfers and subsidies that also created interest groups. The second and third of these factors continue to influence the path of economic reform in India.

Once policies were in place that created distortions in markets through controls, there were beneficiaries of these distortions, through the economic rents created.<sup>5</sup> Customs officers and income tax officials became notorious for extracting payments in return for ignoring punitive restrictions or tax rates, but all government bureaucrats were put in positions where they had the potential to profit from the lawful or unlawful exercise of their discretionary control. Politicians often became eager collaborators in, or drivers of this process, to claim their share of the rents. Policy restrictions and entry barriers also created rents for private economic actors such as industrial license holders, middlemen in agricultural markets, and import license holders. These groups also developed interests in preserving the status quo. Indeed, there was a long period in which economic controls steadily increased, as more and more groups and organizations sought to create rent-seeking opportunities.

India's size and diversity required considerable attention to creating winning political coalitions. A system in which the government occupied the commanding heights became a natural tool for seeking political advantage through the spread of all kinds of subsidies, especially to numerically important rural voters. The nationalization of banks in 1969 was designed to create a populist image and electoral appeal for then-Prime Minister Indira Gandhi as she sought to consolidate political power. These exercises in competitive populism were driven not by economic logic, however imperfectly applied, but by political imperatives. Once new beneficiaries of transfers or subsidies were created, they became interest groups protecting those economic rents.

The general idea that interest groups affect resource allocation and block reform is a well-worn one. Murphy, Shleifer and Vishny (1993) provide theoretical reasons why rent-seeking is particularly costly for growth. Rajan and Zingales (2006) model the primacy of interest groups over institutions in acting as a barrier to reform.<sup>6</sup> Bardhan (1984) provided a class-based analysis of a politico-economic equilibrium with "multiple vetoes," to explain India's slow growth.<sup>7</sup> It has also been suggested, by political scientists, that India's economic reforms have been a project of the elite, not involving the masses, and therefore subject to being blocked in a mass democracy. The ironic term "reform by stealth," (Jenkins, 1999) used to describe India's process of economic reform, has a similar conceptual flavor. Economists (Rao and Singh, 2005; Singh and Srinivasan, 2005) and political scientists (Saez, 2002; Sinha, 2005) have emphasized India's regional politics and federal governance structures. All of these perspectives can be useful in understanding why welfare-improving reforms may be difficult to undertake or complete.

Interest groups and institutions are amenable to formal modeling, and provide a standard conceptual framework in examining the status and dynamics of India's economic reforms. It is harder to pin down the role of ideas. The introduction mentioned the role of East Asia, and particularly of China, as a benchmark for Indian thinking on economic policy.<sup>8</sup> Much earlier, the USSR's experience, as then understood, was a source of ideas for economic development policy. Academics have also shaped policy thinking, from the "big push" to the "bottom of the pyramid," and how to measure true "human development." Non-economic ideas with respect to culture and nationhood (the "idea of India") also affect economic policy. The evolution, or stasis, of ideas therefore also matters for understanding the reform process and prospects. Individual leaders embody these ideas as well as representing underlying group interests, and therefore individuals matter in a way that is hard to capture in formal models. Keeping these issues in mind, the paper turns to examining specific aspects of a possible economic reform agenda for India, as it goes into the future.

### **3. Governance Structures**

India has an explicitly federal governance structure, with multiple layers of elected governments, each with its own assignments of authority. The constitution initially laid out the areas of responsibility of the central and state governments, with respect to expenditure authority, revenue raising instruments, and legislation needed to implement either. Expenditure responsibilities are specified in separate Union and State Lists, with a Concurrent List covering areas of joint authority. Tax powers of these two levels of

government are specified in various individual articles. Legislative procedures for each level, particularly with respect to budgets and appropriations, are spelled out in detail, and are similar to parliamentary democracies elsewhere.

As with any constitution, there is considerable leeway in terms of the actual division of powers between center and states, and economic reform has *de facto* included greater flexibility for the states in conducting economic policy. In some cases, such as sales tax breaks to attract investment to individual states, leading to a feared race to the bottom, the center has worked with the states as a group to jointly constrain such policies. A key structural feature of the constitution through its assignment of tax and expenditure authorities, as well as the political economy of the states' own governance (in particular their failure to tax agricultural income at all), has been a vertical imbalance: the states' expenditure responsibilities outstrip their fiscal capacities. The constitution made provisions for tax sharing, governed by quinquennial Finance Commissions. In addition, the central government makes transfers through various other, more discretionary channels.

A considerable simplification of the tax sharing rules was achieved through a constitutional amendment in 2000, based on recommendations of the 10<sup>th</sup> Finance Commission (FC-X) in 1994. This affected what revenues were split between the center and states, though not the division among states, where the methods are largely governed by precedent. Based on considerations of marginal incentives for revenue-raising by individual states (Weingast, 1993), it has been argued (Singh and Srinivasan, 2008) that

changing the methodology of determining center-state transfers, as well as the assignment of tax authorities (reducing the states' reliance on transfers) would improve fiscal performance at the state level. However, this would be a major reform that currently appears to be unlikely to come to the front of political agendas, despite its theoretical appeal.

Similar issues arise with respect to local governments. Initially, local governments functioned entirely at the whim of their respective state governments, with little direct democratic representation. Constitutional amendments in 1993 changed this situation, giving them a more solid existence, with regular electoral mandates required. Local government responsibilities were also more explicitly defined. However, local governments remain constitutionally under the authority of the states, particularly with respect to revenue authority, and this has limited their effectiveness. They rely heavily on state-local transfers, which can be meager or uncertain. Successive Finance Commissions have earmarked center-state transfers for local governments (direct center-local transfers not being constitutionally allowed), as well as using direct central spending in areas such as urban development. There has been a gradual improvement in flows of funds to local governments, and their political functioning has become more routine.<sup>9</sup>

Again, it is unlikely that major reassignments of tax authority will be undertaken. Instead, there is a possibility of progress in improving budgeting, accounting and other operational procedures of local governments. There is also scope to improve their incentives for own-revenue collection, particularly in the case of larger urban

governments. The FC-XIII report (Finance Commission, 2010, Chapter 10) provides a comprehensive perspective on the state of local government finances, and detailed recommendations for reform.

Aside from the kinds of fiscal and electoral reforms discussed above, there has been little progress in broader governance reforms. These include reforms of parliamentary and legislative procedures (Kapur and Mehta, 2006), judicial reforms (Mookherjee, 2004) and civil service reforms (Second Administrative Reforms Commission, 2008). In each case, there is at least some qualitative evidence that the level of functioning of these institutions is below realistic feasible benchmarks. The problems include quality of decision-making, delays and corruption, and there are numerous specific recommendations that have been made for reform (e.g., Singh, 2004, 2010 and references therein). However, the difficulty of detailed organizational reform within the government is a natural consequence of the desire to protect economic rents, as discussed in the previous section. The difficulty is compounded by the reflexivity of the issue, when the reformers are the subjects of reform (Singh, 2002).

Reforms in governance structures are often not perceived as part of the economic reform process in India. Certainly, the impetus for changing the basis for tax-sharing, or introducing democratically-elected local governments, did not come from the same conceptual source as the removal of restrictions on private industrial and trade activities. Nevertheless, there is a theoretical unity between these seemingly disparate policy reforms, which comes from the idea that behavioral incentives must be considered in

designing policies and institutions.<sup>10</sup> This idea cuts across economics and politics. Furthermore, some of the issues of organizational reform of government in India are reflective of a wider worldwide reconsideration of the functioning of government, and not just the particularities of the Indian case.

#### **4. Taxes**

Tax assignments were alluded to in the foregoing discussion of governance structures. Within the existing system of assignments, there is greater room for maneuver, and considerable progress has been made. Again, Indian tax reform somewhat rode a global wave, which brought down marginal direct tax rates in the 1980s, from considerations of efficiency and incentives. In 1991, a committee chaired by Raja Chelliah detailed a comprehensive program for tax reform, and its principles have continued to guide subsequent policy changes.

Fortuitously, the tax reform committee's report coincided with the initial trade and industrial liberalization in response to the balance of payments crisis and the structural adjustment it triggered. Marginal tax rates on personal and corporate incomes were very quickly brought down by the central government, which has authority over direct taxes. Subsequently, aided by improvements in information technology, as well as changes in approach, tax administration has also improved in quality and efficiency. From a political economy perspective, corporations and individuals gained from the reforms, through greater simplicity and lower rates, while the government was able to garner increased direct tax revenue. Only a small group of income tax officials may have lost, through

reduced opportunities for corruption, though it should also be noted that the vast majority of the population are outside the coverage of the direct tax system – that tax base remains narrow. Throughout the process, the underlying legislation remained archaic, and a major push is now underway to create a new Direct Tax Code, which will systematize and refine tax reform.

Greater challenges have been faced in reforming indirect taxes. Sales taxes have been the main revenue source for the states, but there are also various central excises and other levies. The indirect tax system through the 1990s was characterized by a multitude of rates, cascading (different taxes on top of each other), and inefficient tax competition. It was well recognized that the system grossly violated economic principles of efficiency and equity in designing indirect taxes. Initial steps towards improving efficiency by adopting value added principles came earlier, in the 1980s, but only by 2005 was there a significant implementation of a value added tax (VAT) across the country, with coordination between the center and the states. The center essentially worked to provide an effective guarantee to the states that they would not suffer revenue losses.

The VAT, by reducing cascading, reduces marginal distortions. The nature of the VAT, which provides an incentive for those at each stage in the value chain to honestly report upstream transactions (so that they are only taxed on the value added), tends to reduce costs of ensuring compliance. On both counts, the marginal cost of public funds is reduced.

The next major reform is the creation of a comprehensive national Goods and Services Tax, which is also a VAT system. The GST further broadens the tax base, improving efficiency and potentially allowing greater revenue capacity at a time of fiscal stress. As in the case of the initial VAT, information systems and administrative and organizational capacities have to be developed for the GST. Businesses that effectively act as tax collectors for indirect taxes also have to be gotten up to speed. There are bound to be political economy issues of how the changes will affect states' fiscal positions, but the (relatively) successful introduction of the VAT system for goods has increased confidence that tax revenues will not be disrupted. As in the case of direct taxes, information technology is playing a key role in improving tax administration, and greatly increasing capacities for tracking and monitoring the requisite financial information (needed in addition to the self-compliance properties of the VAT).

## **5. Public Service Delivery**

As measured by outcomes, public service delivery in India has fallen short of expectations. Basic indicators of well-being, especially various dimensions of health and educational attainment, are below the benchmark of low-income country averages. Ideally, a comprehensive approach to reform of public expenditures to promote better delivery of public goods and services would include structural and organizational changes to enhance accountability and incentives for governmental providers. There is some evidence (surveyed in Singh, 2007) that decentralization to electorally accountable local governments has improved matters. However, as noted in previous sections, lack of fiscal capacity at that level hampers local government effectiveness, while broader reform

of bureaucratic functioning has not made much progress. Many basic public goods are constitutionally state subjects, and the states have also tended to devote revenues to meeting salary obligations, or constrained revenues through generous subsidy provision.

However, some states have done better than others in improving their functioning as providers of public goods, even without structural reforms. Rajasthan, Madhya Pradesh and now even Bihar, all traditionally among the worst performers in human development, have shown some gains. These gains can perhaps be attributed to better policy formulation and implementation, rather than strong national growth, since Uttar Pradesh has not displayed the same level of improvement. At the same time, reliance on specific political leaders or senior civil servants means that improvement may not be sustained, unless the electoral process provides a positive feedback loop.

At the national level, the government has recognized that human development outcomes in India leave much to be desired. This recognition is perhaps not new, but has been given urgency by increasing inequality and evidence of social conflict as outcomes of rapid growth. The national government has increased spending in areas such as education (Sarva Shiksha Abhiyan – translated as “education for all movement,” but a government program) and health (the National Rural Health Mission), also trying to partially bypass state bureaucracies or political leaders in doing so. For example, in the NRHM, societies have been set up to spend central government funds, with senior bureaucrats heavily involved in leadership roles, but with new hybrid committees involving local

governments and non-governmental organizations (NGOs) as well. Thus, there is an attempt at organizational innovation outside the core of state government.

One way of conceptualizing the national schemes and other organizational innovations is as part of a larger framework of public-private partnerships (PPPs). PPPs are typically discussed in the context of large infrastructure projects, where private partners can bring in expertise, financing, or both, while having superior incentives for performance, while the government structures partnership contracts to meet social goals that diverge from pure profit motives. Infrastructure, which can include public as well as private goods, is discussed in a subsequent section, but here one can note that PPPs for service delivery in areas such as health and education involve more complex partnerships of the public sector, for-profit private providers, and NGOs.

One example of PPPs is hospitals given public land on lease, in exchange for agreeing to meet goals for serving low-income patients, either through direct or indirect subsidies (the latter through revenue-sharing and a government-managed fund for subsidies).

Another is the empanelling of private doctors to provide institutional childbirth deliveries for poor patients, with the government paying. A third is government hospitals or clinics, with private providers being contracted for specific services, which could range from cleaning to high-end specializations. As is the case for governance structures, these kinds of innovations are part of a broader rethinking of state-market boundaries and India is in some ways at the frontier of experimentation.

From the perspective of “economic reforms,” therefore, public service delivery represents an important area for potential progress in the immediate future. The underlying political economy forces can be seen in terms of a shift from a dominance of rent-seeking (patronage, subsidies and transfer payments as the main role of government) to one of value creation, through more efficient production and distribution of public goods and services. In the context of democratic politics, demonstrating that the latter is a feasible route to electoral success may facilitate this important shift, since it provides some fruits of economic growth to larger numbers of voters.

## **6. Labor Markets and Privatization**

The discussion of labor market reform in India pertains only to a very small fraction of the workforce, which is engaged in the so-called organized (as opposed to informal) sector. In fact, the small size of the organized industrial sector is partly attributed to restrictive labor laws. Public sector industrial enterprises, including telecoms and electricity firms, are also large employers in the organized sector, and this fact probably serves as the major political barrier to privatization, motivating the combination of these two issues in a single section.

There is some empirical work that supports the argument that restrictive labor laws have had deleterious impacts on growth (Besley and Burgess, 2004), though academic opinion is not unanimous on the robustness of these empirical results. It is also plausible that the problem of lack of robust manufacturing growth in India is also due to problems with corporate law, land use regulations, and infrastructure, which are all discussed in later

sections of the paper. The Besley-Burgess analysis exploits cross-state variation as well as variation over time, but the translation of a complex mix of policies, enforcement and environment into simple indices can be tricky.

Labor laws in India are designed to provide standard kinds of protections to workers in areas such as health and safety of working conditions, and also with respect to issues such as arbitrary dismissal and wage conditions. However, the formulation of legislation has effectively provided extreme protection for a specific subset of industrial workers in firms above a certain size. The problem is compounded by lack of efficient judicial procedures for dealing with disagreements. It is plausible that capacity expansion, innovation and hiring are all adversely affected by the costs of rigidity imposed by the current laws.

With respect to public sector enterprises, the political constraints are exacerbated by additional protections afforded to government employees in general. Privatization (or disinvestment, which can mean less than full privatization) threatens job security, and that has been a significant factor behind opposition to privatization, though not the only one. Privatization can also be resisted because it reduces the power, prestige and rent-seeking opportunities of bureaucrats and politicians. There may also be concerns about security, stability or the distribution of economic power that are associated with privatization. These issues are all recognized by policy makers (e.g., Ahluwalia, 2002), and are quite different from more technical economic discussions of privatization, which

focus on information, uncertainty and market structures (e.g., Husain and Sahay, 1992; Glaeser and Scheinkman, 1996).

There has been little explicit progress in labor market reform. What has happened is a chipping away at coverage, by allowing contract workers who may not be afforded the same level of protection. Firms are able to retain flexibility in this manner, and several states have achieved “reform” by expanding the legal room for firms to use contract labor, without altering the core legal situation. Firms also have an incentive to use more skilled, salaried workers, who also will fall outside the coverage of existing laws. This is consistent with the observed skill-bias of India’s growth (Kochhar et al., 2006).

Given the small size of the unions that represent workers who are covered by labor laws, the question is why reform has not been possible. Plausible factors which may come into play include a suspicion of business (reinforced by adversarial reactions of business to the unions), somewhat extreme ideals of social insurance (reinforced by the traditionally extreme cost of losing one’s job in a low-income, slow-growing economy with large amounts of surplus labor), and simply a disproportionate power of small organized groups such as unions (Olson, 1965). The last of these factors is almost universal across nations, India being somewhat of an anomaly in having created such a strong interest group through extreme social protection at low levels of income.

Reform of labor laws may involve the evolution of alternative forms of social insurance, particularly unemployment insurance, a more enlightened approach by businesses, which

may benefit in the long run by offering pools of private insurance for workers, and creative approaches to legislative reform such as grandfather clauses that protect existing workers while allowing new hiring to be covered by different rules. This last approach is different from the use of contract workers, since the latter must be prevented from falling in or transitioning to a protected category. It is unclear whether any of this reform will be achieved in the short run, since it does not appear to be explicitly on the policy agenda. An important political economy feature here is the salient role of state governments in the detailed implementation of labor laws, including state-level legislations – hence reform will also require action at this level. State-level issues have also been important in the case of privatization of some firms (e.g., BALCO – see Ahluwalia, 2002), and especially the State Electricity Boards.

## **7. Corporate Governance**

Traditionally, Indian business has been dominated by family firms, and by British corporations operating through Indian subsidiaries or managing agencies (Reed, 2002). In either case, corporate governance was not characterized by modern standards of transparency and disclosure, and contributed to the often negative perception of business in society at large. In some ways, there have been dramatic changes in governance standards, but much remains on the reform agenda.

This section will not consider the special case of financial firms, nor the role of financial markets in influencing corporate governance in practice, since the volume contains a separate consideration of financial sector reform. However, it is noteworthy that the

recommendations of the Kumar Mangalam Birla Committee on corporate governance, submitted in 2000, were quickly implemented by a key additional clause (number 49) of the listing agreement for publicly traded companies (Chakrabarti, Megginson and Yadav, 2008; Khanna, 2009). Hence, an important step in reforming corporate governance was taken by the financial market regulator, the Securities and Exchange Board of India (SEBI). A refinement of Clause 49 was implemented after the report of another SEBI committee, headed by Narayana Murthy in 2004.

SEBI's regulatory requirements went well ahead of amendments to the 1956 Companies Act, which had been passed in the 1990s. Hence, the legislative underpinnings of corporate governance remained somewhat limited. In particular, the coverage of Clause 49 only extended to listed companies. Moreover, enforcement was weak, especially in the face of complex cross-holdings of family-owned conglomerates with layers of subsidiaries, which allowed manipulation of profits at the expense of minority shareholders. This is a policy concern on grounds of equity as well as efficiency and India's performance in various international benchmarks of corporate governance remained mixed (Balasubramanian, Black and Khanna, 2008; Chakrabarti et al., 2008).

The Ministry of Finance constituted committees on Corporate Audit and Governance and on Corporate Law (headed respectively by Naresh Chandra and J. J. Irani), which submitted reports in 2002 and 2005. Together with the earlier SEBI committees, these formed the basis of a Companies Bill, which undertakes a major overhaul of the Companies Act. The Bill was introduced in Parliament in 2008, but lapsed with its

dissolution in 2009, and was reintroduced in 2010. Meanwhile the Satyam scandal erupted, in which weaknesses in board practices, auditing and other facets of corporate governance were exposed, and the new bill adds stronger provisions.

In some respects, the new legislation will reduce discretionary government control, but in many ways it raises standards for private companies, including accounting, disclosure, shareholder protections and checks and balances in governance. Specific provisions include new standards for composition and performance of boards of directors, as well as key managerial personnel. Access of shareholders to information and to voting will be increased, and class action suits will be allowed for the first time. Accounting and auditing standards will be tightened. Significantly, penalties for violations will be raised significantly – one of the concerns about the recent regime has been with enforcement, with respect to the frequency as well as severity of punishment for breaking the rules.<sup>11</sup> The new bill will also modernize and streamline several other provisions pertaining to mergers, joint ventures, and asset valuations.

The relatively rapid and comprehensive reform of company law and corporate governance in India (assuming that the current bill passes) is in contrast to the difficulties of other kinds of reforms. Certainly, the reforms will not extend meaningfully to India's many smaller firms, and not all the reforms will be to the liking of business owners, but larger firms probably see improved corporate governance as important for their global growth and long-run profitability. One can perhaps view the relative alignment of business and government in this area as a development of the system of "embedded

autonomy” characterized earlier by Peter Evans (1995) for South Korea.<sup>12</sup> This provides a sociological perspective on business-government relations, but one can argue that the ultimate driver is a shift in the relative costs and benefits of rent-seeking versus value creation for business.

## **8. Competition Policy**

India’s 1969 Monopolies and Restrictive Trade Practices (MRTP) Act complemented the extant industrial licensing regime, by placing severe limits on entry and growth, based on a presumption that size would lead to market dominance. With liberalization of domestic industry in 1991, the MRTP Act was amended the same year, to remove provisions for discretionary control of entry, mergers and growth. It was recognized that the legislation needed a complete overhaul, and this was accomplished with the passage of the Competition Act of 2003.

The MRTP Act had been ostensibly based on international approaches to monopolies, anti-competitive behavior and restrictive trade practices with respect to pricing and exclusion. In practice, its detailed provisions and implementation made it much more draconian. The new act focused more explicitly on anti-competitive behavior, and attempted to lay the groundwork for an approach more based on economic considerations of efficiency. It also attempted to deal with the gap left by the 1991 amendments, introducing provisions for assessing anti-competitive effects of mergers. A new Competition Commission of India (CCI) replaced the old MRTP Commission.

Unusually, the new Competition Act was phased in very slowly, and its provisions were fully implemented only by May 2009, though a major amendment in 2007 created an appeals tribunal. Hence, the CCI has yet to establish itself as an entity with a clear track record with respect to dealing with anti-competitive behavior. The new law also did not give the CCI powers over retail consumer protections covered under the MRTP Act, which instead have devolved to consumer protection councils created by a 1986 Consumer Protection Act (since amended several times). This act provides a much broader framework of consumer protection, including health and safety concerns, as well as quality standards and pricing practices, but seems mainly to be designed to handle individual consumer-initiated complaints. It also extended consumer protections to dealings with public sector undertakings, which might be exempt from other kinds of legislation against anti-competitive behavior.

Given this background, the current reform agenda concerns the creation of a National Competition Policy (NCP). The idea of the NCP seems to have its roots in similar developments in countries such as Australia. However, the rhetoric in India seems to be somewhat broad and unfocused. In particular, competitiveness and competition are mingled together in discussions of the NCP (Planning Commission, 2008, Chapter 11). Nevertheless, there are some specific issues that arise from a more comprehensive view of competition policy.

The 11<sup>th</sup> Plan document draws a distinction between competition law, narrowly focused on anti-competitive business practices, and competition policy, which provides a broader

framework extending across the economy. In practice, this seems to boil down to regulatory and legal frameworks within which private firms in regulated sectors such as telecommunications or power operate, as well as the conduct of public sector enterprises and government agencies themselves. International trade and disinvestment of public sector enterprises also are to be looked at from the lens of competition.

National goals of creating a “level playing field” for all business enterprises, whether public or private, in regulated and unregulated sectors; promoting transparent, fair and non-discretionary regulation; and furthering competitiveness by enhancing competition are all appealing objectives. The real issue is how conflicting goals are to be resolved, and how detailed implementations will be worked out. To some extent, an NCP, perhaps overseen by a suggested Competition Policy Council (CPC), seems like a replacement for the Planning Commission and its planning exercises, reflecting an essential shift in philosophy with respect to economic governance that is taking place with “economic reform.” However, it is unlikely that such a dramatic change in the status quo would take place.

## **9. Bankruptcy**

Bankruptcy law has specific practical implications for competition policy, since entry and exit are crucial to the dynamic efficiency of competition among firms. The Planning Commission’s discussion of competition policy makes a single reference to lowering entry and exit barriers. In fact, exit barriers have been one of the greatest weaknesses of India’s business environment, and India has consistently ranked at the bottom of the

measure of time to close a business, in the World Bank's Ease of Doing Business rankings. The rules for handling insolvency, restructuring or liquidation are also a facet of corporate governance, and are now being addressed in the latest Companies Bill. However, the starkness of Indian policy's failure to tackle exit effectively up to now makes it a topic of special importance.

The initial attempt to deal with exit in an environment of industrial licensing and detailed controls over industry came with the Sick Industrial Companies Act (SICA) of 1985. In that environment, manufacturers found it undesirable, prohibitively costly or even forbidden to shut down, especially since labor laws effectively prohibited worker terminations. SICA attempted to provide a mechanism for winding down or reviving troubled companies, by referral to a Board for Industrial and Financial Reconstruction (BIFR). Registration with the BIFR provided temporary protection from creditors. In practice, there were no well-established procedures for restructuring or liquidation, and delays in the BIFR went from long to longer, with liquidations a ten-year process on average.

Debt Recovery Tribunals (DRTs) were introduced in the 1990s to speed up the process of giving creditors relief in the face of defaulting borrowers, and the awkwardly named Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, passed in 2002, gave banks the option of seizing debtors' assets, or moving nonperforming assets off their balance sheets through Asset Reconstruction Companies. In practice, the continued existence of DRTs and other

appeals channels perpetuated delays in resolving disputes, and SARFAESI was of limited value, though banks were able to improve their balance sheets through a variety of other means. Meanwhile, SICA was also repealed.

Ultimately, a comprehensive bankruptcy reform was needed, and it has been incorporated in the new Companies Bill, being considered as of this writing. Two detailed sections of the Bill outline a complete set of bankruptcy procedures, including restructuring and liquidation. Interestingly, the language clings to the philosophy of past efforts to preserve the status quo, linguistically treating firms as delicate organisms to be “rehabilitated”, “revived” or, in extreme circumstances, “wound up.” Despite this hangover from the past, the provisions of the new legislation represent a major and significant potential reform of exit policy. As necessary, they include requirements for specific new judicial tribunals, and go as far as to impose specific time limits on different processes and stages.

Without downplaying the importance of corporate governance reforms, operating firms, if listed, are subject to market discipline, which can provide incentives for good governance beyond the scope of laws. No such thick, standardized market exists for firms that are in trouble. Hence, well-defined efficient procedures for exit are of supreme importance for creating a dynamic, competitive business environment. In this respect, the new bankruptcy policy represents a major leap in ideas of how Indian business should work, and what should be done when a business does not work.

## 10. Agriculture

Agriculture provides well over half of India's employment, though closer to a quarter of its GDP. In the long run, India has to shift labor from agriculture to manufacturing and services, in order to grow. Technically, this could be achieved without increases in agricultural productivity, if the outputs of that sector are replaced by imports. In practice, that is unlikely to happen, due to strategic concerns about food security. Therefore agricultural productivity increases will be necessary.<sup>13</sup>

Soon after the initial liberalization of trade and industry, the reform agenda for agriculture was already well articulated (Pursell and Gulati, 1993) in parallel with industrial sector reforms. A case could be made for careful liberalization of international trade in agricultural products, bearing in mind impacts on domestic prices; liberalizing fertilizer imports; liberalizing procurement policies and pricing; and removing subsidies on water, electric power and credit. Others emphasized the importance of increasing rural investment generally, and in agriculture in particular. Pursell and Gulati made a case for deregulating food processing, and improving the targeting of the public food distribution system.

A decade and more later, many of the same points were still being made (e.g., Ahluwalia, 2002; Singh and Srinivasan, 2005). Singh and Srinivasan also noted the ability of states to restrict inter-state trade of agricultural products, and their detailed controls on procurement and private stock-holding. They emphasized the difficulties inherent in agriculture being a state subject, in the context of federal divisions of powers. To this one

can add that the reason this is a problem is that the current system of controls is a significant vestige of the former rent-seeking regime, but at the level of individual states. Factors which have led to some industrial dynamism and appropriate policy responses in industry have not had a chance to operate in agriculture, so that the political economy equilibrium has been relatively undisturbed. As a result, little reform has taken place in agriculture. An illustration comes from the contrast between Punjab and Haryana: where the former is completely locked into a rent-seeking equilibrium based on green revolution agriculture gone haywire (so that free water and power support the growth of crops that are both low value-added and unsuitable for that agro-climatic region), while the latter has been more receptive to change because of its proximity to Delhi and the rise of Gurgaon as an outsourcing hub.

Given the barriers to reform at the state level, the national government has tried to increase investment in rural India, in infrastructure (Bharat Nirman, which is an umbrella for many infrastructure components, including water, housing and rural roads – the latter covered more specifically under the Pradhan Mantri Gram Sadak Yojana), health and education (NRHM and SSA respectively, discussed in section 5). It has also increased the provision of welfare payments, through efforts such as the National Rural Employment Guarantee Scheme. The latter efforts have had the effect of providing short-run demand stimuli in rural India – their long run impact on the efficiency of agriculture remains to be seen. Attempts to reduce input subsidies or improve the workings of institutions for agricultural procurement or distribution do not really seem to have made a dent, though

another attempt is being made, as of this writing, to reduce and rationalize fertilizer subsidies.

The central government did form two National Commissions, on Sustainable Agriculture and on Farmers. These have led to a National Mission on Sustainable Agriculture and a National Policy for Farmers, but aside from stating goals such as creating a national market, and improving access to new technologies, better infrastructure and more credit, specific progress has been slow. It is possible that improved communication technologies will bring down costs of access to finance, to insurance and to markets, but often the problem is one of lack of basic roads and information in rural areas. Bharat Nirman, the PMGSY and a National e-Governance Plan are all designed to overcome these gaps, but it is not clear how effective they will be in the absence of reforms of governance and public service delivery, as discussed in sections 3 and 5.

Improvements in rural infrastructure are, in a sense, more in line with the original intent of India's development strategy, rather than a part of economic reform, per se. As noted earlier, reform in agriculture would include allowing markets to function more effectively, by delinking income support and insurance for poor farmers from policies that heavily distort market functioning or restrict competition. In fact, institutionally, rural India is still subject to the power of intermediaries that face little competition and have close ties to government. The political economy equilibrium at the level of individual states will have to change for reform of market structures to take place in any meaningful manner.

## 11. Land Markets

At independence, India's primarily agricultural economy was characterized by social and economic inequality. Inclusive growth at that time was conceived of as being achieved through policies such as land reform. Legislation was passed, but implementation was limited, and the distribution of rural land remained quite unequal, much more so than in China, for example (Bardhan, 2009a), or other East Asian economies. Land reform took a back seat to other agricultural policies such as input subsidies and support prices.

Agricultural land markets have been relatively inoperative, because land remains a core rural asset, not to be given up easily. Land transfers are also made difficult by a lack of complete records. Computerization of land records, which makes checking existing records easier, has been underway for some time at the state level, supported by central government initiatives, but does not solve the problem of uncertain ownership or incomplete transfer histories.

A new problem has arisen with industrial expansion and growth. Agricultural land, forests and mineral rights have increased in value with the potential for exploitation in new ways, and this has led to new conflicts. In particular, some agricultural land is attractive for industrial expansion. Recently an attempt to acquire land for the construction of a Tata automobile factory in West Bengal led to violence and deaths of protesting villagers.

The national government has attempted to create new legislation to govern the process of land acquisition for economic development. In the past, the government has exercised its rights of eminent domain for various projects, especially dams, and there have been problems with adequate compensation and resettlement. The involvement of the private sector only increases the complexity of the situation. A bill is currently (2010) before Parliament for consideration. It allows states to use eminent domain for 30 percent of an acquisition when a company has gotten agreement on 70 percent through the market, and shifts from judicial review to tribunals for appeals over disputes. The goal is to achieve streamlining of the process while protecting existing small landowners' rights.

Many politicians are unhappy with the new proposal, as are some businesses. Bardhan (2009b) suggests that the procedures in the legislation will not provide adequate protection for small rural landholders, and proposes that firms that specialize in land acquisition be required to create an annuity fund, so that landowners receive a stream of payments over time as insurance, in addition to lump-sum transfers. He also points out the impact of land transfers on tenants and landless agricultural workers, and suggests they also be included in such annuity payments. Finally, he recommends that government purchases be buffered by an independent agency, to avoid political manipulation. These are all ways of preserving the streamlining objective, while doing more to correct the imbalance in bargaining power between buyers and sellers in such cases.

The Bardhan suggestions are not only important for land acquisition, but also more generally for thinking about reform. In the context of the issues discussed in the initial

sections of the paper, reform creates losers as well as winners, and there need to be mechanisms for winners to adequately compensate losers. Furthermore, Bardhan's approach addresses problems of intertemporal transfers and uncertainties. The use of trust funds and annuity payments is a natural mechanism for other reforms, where the less well off are being asked to transfer their jobs rather than land.

## **12. Infrastructure**

Infrastructure is recognized as an area where India has lagged. Infrastructure spending has been lower than planned, and it has not always been clear that the capacity existed to implement large infrastructure projects, even with financing available. Another issue was the participation of the private sector in building or maintaining infrastructure that had earlier been the exclusive purview of the government.

The past few years have seen some progress, with toll roads, a large national highway project, new airports in Delhi, Mumbai and Bangalore, and a metro in the capital city. Expertise is therefore gradually developing in project selection and management, as well as in structuring finances and contracts. The agenda for infrastructure investment remains lengthy, and includes railways and urban infrastructure as well. Investment plans for the railways include new logistics hubs, two new freight corridors (eastern and western) and a premium freight service for high value goods. Funding is being sought from the World Bank.

Urban infrastructure is receiving attention for metro-rail systems, rapid transit bus systems, new water infrastructure, and low income housing on the agenda for investment. Urbanization is seen as a major challenge, and it is planned to build capacity through new institutes for studying urban infrastructure project design and implementation.<sup>14</sup> In this context, the development of municipal bond finance remains an important area where progress has been slow (Singh, 2007).

The electric power sector has been one of the greatest problems for India, despite its importance for growth (Singh, 2006). Lack of adequate capacity and capacity expansion has meant that power shortages are chronic, and firms' reliance on generators or small captive power plants pushes up production costs. Past reforms unbundled some generation, transmission and distribution, and allowed privatization and private entrants, but the resulting record of performance has been mixed (Bhattacharya and Patel, 2008). Bhattacharya and Patel outline the various reform efforts made, culminating in the Electricity Act of 2003, which provided guidelines for individual states to follow in their own reforms. As the authors show, there has been an increasing disparity across states in the performance of the power sector, and implementation of reform has been imperfect. One issue that remains unresolved is whether competition without privatization is sufficient for a commercially viable power sector with adequate capacity growth.

More recently, in October 2009, the central Cabinet approved streamlined and relaxed procedures for setting up large new power plants. The US-India nuclear deal is also an important component of a strategy to address constraints in the power sector. Investments

in renewable energy sources such as solar and wind are also slated to increase, including foreign collaborations, but this is almost all exclusively on the drawing board.

The power sector illustrates once more the political economy of Indian reforms. The existence of government electricity providers with large payrolls (as noted in section 6), and the split of responsibilities between the center and states meant that reaching agreement on how to allow for new private entrants was problematic. Lack of expertise in assessing projects and in contracting also played a role. The problems of the Dabhol power plant project in Maharashtra, one of the earliest new infrastructure projects, included perceptions of corruption and incompetence, resulting in increasing political barriers to subsequent projects.

It has required time, successes in other infrastructure projects, and gradual managerial capacity building for barriers to start coming down. The finance and financial deal-making ability for large infrastructure projects has also improved in the last decade. Of course, telecommunications is an area where tremendous growth has been achieved, and firms that have bought spectrum rights have aggressively built infrastructure for wireless communications. In contrast to the power sector, these private entrants did not have to contend too much with inefficient state incumbents, and were able to grow their market by offering new services to an increasing number of consumers. In other words, their revenue model was inherently more supportive of growth and expansion than that available to other kinds of infrastructure providers.

### 13. Education

Returning to international comparisons, education has been one of the factors distinguishing high-performing East Asian economies from Latin America, for example (Birdsall, Ross and Sabot, 1995). While India's public investments in higher education enabled the creation of a high-skilled upper middle class, primary education lagged behind. India still falls well short of universal literacy, with access to and quality of basic schooling leaving much to be desired. There is extensive research and documentation of teacher absence, low student attendance, and low levels of achievement in government schools. Recently, the government has legislated a right to education, and increased resources for primary education (in particular, through the SSA, alluded to in section 5), but institutional reform has been minimal, since teachers in government schools are effectively civil servants with no incentive to perform their jobs. There has been some discussion of and trials of programs like school vouchers, to give parents choice and thereby improve teacher incentives, but these are small experiments for now, at best. Private sector entry into provision of primary and secondary education has demonstrated latent demand, but the government has not yet succeeded in creating a model of effective regulation of private provision. In many respects, the education sector illustrates the political economy problems discussed in section 3, 5 and 6, where an existing interest group strives to preserve its economic rents in a highly inefficient equilibrium.

Higher education has been subject to the same problems as primary and secondary education, with opposition from existing faculty, administrators, bureaucrats and politicians to changes in the incentive system, funding model or increased competition

from private providers, despite evidence of breakdown of the publicly funded system.<sup>15</sup> Nevertheless, higher education provides an opportunity for more significant reform, since it is not as much of a merit good as is primary education. The current system is dominated by government providers, and while some private colleges and universities have been permitted, there are uneven standards, and most of all, inadequate information for prospective students. After a long period of opposition to change within the Ministry of Human Resource Development, a reform agenda is now being articulated, which will increase the contribution of private providers and foreign providers of tertiary education.<sup>16</sup>

One conceptual flaw that still creeps into policy thinking is the assumption that regulation needs to be in the form of detailed dos and don'ts, rather than enforcing minimum standards and disclosure, and allowing choice and competition to do more of the work of achieving efficiency. Education reform in India illustrates the limited reach that ideas about the proper working of markets and the role of incentives have. In this respect, the Chinese approach to higher education reform has been quicker and bolder. However, the current situation is a sea change from previous attitudes, and demonstrates that ideas do matter. The political leadership is now willing to apply economic principles to the provision of higher education, whereas earlier perspectives emphasized cultural nationalism and a belief that education is so special in nature that even domestic providers could not be trusted to provide quality.

In the entire post-secondary education sector, mechanisms for employer participation in educational design and delivery could be an important reform. For example, information technology firms have led the way in developing training programs for their own employees to make sure that skills sets are adequate and upgraded appropriately over time. Taking such models further, in another possible expression of embedded autonomy, a variety of public-private collaborations could possibly become part of higher education reform.

## **14. Conclusions**

This paper has provided a rather broad overview of several areas of the Indian economy, where ongoing reforms are important for future growth. It has attempted to highlight where reforms are needed, while providing the context of past achievements. The conceptual underpinning of the discussion has been the idea that reform creates losers as well as winners, especially in a situation where the status quo involves rents for well-defined groups in the economy. Rather than just make normative judgments on where reforms would have the greatest social benefits, the paper has attempted to explain the dynamics of past and future reforms in terms of the nature of interest groups and their influence.

At various points, the paper also highlights the role of ideas and individuals. India actually has a process of debate and change implementation that is quite understandable. Academic ideas are often a starting point, or experiences gleaned from past mistakes or benchmarking against other countries. The government has a systematic process for

identifying important issues, setting up expert committees, and obtaining inputs from academics, bureaucrats, and interest groups. There are also systematic avenues for political bargaining – in some cases, these are supplemented by committees of politicians (e.g., state finance ministers) to reach agreement. The political process also has formal steps of legislation, formulation of new rules, and even constitutional amendments.

It is also true that some recommendations of expert committees do not translate into action. This paper has tried to explain the difference between cases of forward progress and those of lack of movement in terms of different political economy equilibria. This is very much in the spirit of Bardhan's (1984) classic work on the political economy of development in India. However, the departure here is that rather than considering the nation as a whole, or economic reform as a unified process, the discussion has considered different sectors and cases. It is at least partially possible to understand why tax reform is easier to accomplish than civil service reform, even though it may be technically more complex.

Despite the wide range of topics considered, there have also been a smaller number of themes in the discussion of Indian economic reforms, beside the overarching one of political-economic equilibrium and dynamics. One is the difficulty of reforming governance, because of the reflexive nature of the effort required. In this context, positive changes in governance structures and public service delivery have proved difficult to achieve, though progress has not been zero.

Another theme is the increasing alignment of government and business, in a more systematic and transparent manner, as opposed to the backroom connections of the old discretionary control regime (though those will always persist in some form). One can particularly see this development in the progress being made in areas such as reforming corporate governance, bankruptcy provisions, and corporate policy. Even when standards are being raised for businesses, or regulatory requirements being added, there is a sense of being in it together, even if it is still not as tight a relationship as Japan, Inc. or Korea, Inc.

A third theme is that certain areas of reform are inherently more challenging. Agriculture, land, labor, education and infrastructure all have special characteristics, either in terms of numbers, positions in the income hierarchy, complexity, expertise, or diversity of interests, that make progress more difficult. It is also the case that reform which involves reconstituting laws, regulations or governance institutions is inherently more challenging than liberalization or decontrol. In that sense, trade and industrial licensing were easier to tackle than many subsequent policy changes. In the case of monetary policy reform, the changes were at the level of a centralized institution and small numbers of decision makers, without any obvious interest group to oppose them. Financial sector reforms have been mixed in pace and character, but again have often been politically “easy,” with the modernization of the stock market being a prime example.

Often, discussions of reform in India list an ideal set of reforms, but do not analyze how such changes may be operationalized in a politically feasible manner, where such

feasibility includes considerations of impacts on political support, or simply intrinsic social values of policy makers (in favor of fairness or equity, for example). Recognizing these factors and incorporating them into policy design for reforms can be more productive than articulating ideal end points without any pathway for reaching them. While time will overtake much of the specific description of the status of particular reforms in this piece, the analytical principles articulated here should be of more long-lasting value.

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## Endnotes

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<sup>1</sup> The “big push” idea can be traced back at least to Paul Rosenstein-Rodan. Modern formulations of this and related ideas can be found in Murphy, Shleifer and Vishny (1989), Matsuyama (1995), Basu (1997) and Ray (1998).

<sup>2</sup> There is an ongoing debate on when “economic reform” began in India. As indicated here, there were reform attempts before 1991. However, these were relatively piecemeal, and were unsustainable in their

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macroeconomic implications. The 1991 reforms marked a “big bang” effort at removing government controls in key areas. See Panagariya (2008) for an analysis and detailed references. Ahluwalia (2002) is also an important reference on the nature and pace of India’s economic reforms.

<sup>3</sup> The role of policies and public sector investment in creating preconditions for future growth has often been argued in the Indian context. A quantitative investigation that brings out the positive impacts of earlier policies is Sen (2007).

<sup>4</sup> It should be noted that these East Asian economies typically also began with import-substituting industrial policies not dissimilar in nature from India’s: however, for various reasons, including size and political economy differences, their policy paths diverged beginning in the 1960s. Several of these economies also differed from India in terms of their levels of social or economic inequality, and their implementation of policies such as agricultural land reform. I am grateful to an anonymous reviewer for reminding me of these points.

<sup>5</sup> India was one of the cases that led to the coining of the term ‘rent-seeking society’ (Krueger, 1974).

<sup>6</sup> In a different theoretical approach, Rodrik and Fernandez (1991) modeled ex ante individual uncertainty as a source of status quo bias when welfare-improving reforms are being considered. Individuals in their model could also be interpreted as interest groups or classes.

<sup>7</sup> Ahluwalia (2002) in his defense of “gradualism” in India’s reform process, effectively highlights the need for political consensus as shaping the pace and sequence of reforms. There is also a related literature on sequencing of reforms, beginning at least with Little, Scitovsky and Scott (1970), and reviewed in Edwards (1990), which includes political economy considerations driven by adjustment costs and uncertainties. This literature focuses on the sequence of trade reform, domestic financial reform, and financial openness.

India’s approach to these has adhered quite well to the analytical prescriptions of the literature. In any case, these areas are outside this chapter’s scope.

<sup>8</sup> This parallel should only be interpreted in the broadest possible terms, with respect to the relative role of markets and the state. The details of China’s political economy and its reform process differ substantially from India. It is beyond the scope of this paper to make a comparison, but a brief discussion is provided in Singh (2007a).

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<sup>9</sup> Singh (2007) provides a detailed review and assessment of the evidence on the progress and impacts of this decentralization process in India.

<sup>10</sup> This point can be illustrated with a quote from Basu (2010), in the context of food grain management policy, “It would be wonderful if people were innately honest and self-monitored their behavior; and government ought to educate the citizenry to develop these qualities. But to *assume* that they have these qualities when they do not is to risk designing a flawed mechanism that will be pilfered and adulterated, as indeed happens widely in our food distribution system.”

<sup>11</sup> Judicial delays also are a barrier to enforcement, since delays reduce the effective penalty, even when it is eventually imposed (Singh, 2004; Khanna, 2009).

<sup>12</sup> The promotion of the Finance Ministry’s Department of Corporate Affairs to an independent ministry can be viewed as a manifestation of this development on the government side. The idea is that embedded autonomy leads to more cooperatively determined “rules of the game.” In contrast, the old regime began with adversarial rules, which made room for ex post, inefficient cooperation through collusive rent-seeking.

<sup>13</sup> Of course, there are linkages from agricultural growth to growth in the rest of the economy, through demand channels for final and intermediate goods (Kalirajan and Sankar, 2001), as well as distributional concerns and transition costs if agriculture were to shrink rapidly.

<sup>14</sup> Rural infrastructure represents a different category, and has been treated along with agriculture in section 10. Essential differences include density and scale, the former being greater and the latter smaller in rural infrastructure versus national-level or urban infrastructure.

<sup>15</sup> A more pessimistic analysis, which emphasizes the distortion of the ideas as well as the institutions governing higher education, is in Kapur and Mehta (2008).

<sup>16</sup> Aside from the need to greatly expand the capacity of degree-awarding colleges and universities, India also has a strong need to increase the quality and quantity of post-secondary vocational training. Government-run institutes are underfunded and poorly run. The government has been increasing spending allocations for such institutes, but fundamental problems of incentives in service delivery remain.