

DO CONTROLS HELP ECONOMIC GROWTH?

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By

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Our country today is a land of shortages. Large numbers of people are tragically short of food and short of work. Our industries are short of raw materials, of components and spare parts, and of electric power. Many of us are short of orders for our products and we are all short of finance both in rupees and in foreign exchange.

But there is one thing which we all have in superabundance, and that is Government controls. Nor is there any shortage of Government officials to interpret and apply these controls. There are also plenty of platform speeches which tell us all to tighten our belts for just another two Five Year Plans of "taxi-ing" after which we shall reach the intoxicating stage of the "economica take-off".

Unfortunately those "sunlit plateaux of prosperity" seem to be just as far away from us today as they were ten years ago. In fact the New Delhi session of the United Nations Economic Commission for Asia and the Far East brought home the dismal fact that India's rate of economic growth is almost the lowest in Asia despite fifteen years of detailed centralised planning and massive injections of foreign aid.

Indeed, it is those countries with the least Government controls which appear at the top of the Asian.

Based on a talk delivered under the auspices of the Calcutta centre of the Forum of Free Enterprise in 1966. The author is a former Chairman of the Indian Engineering Association. In view of rethinking on controls, this booklet is topical.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—EUGENE BLACK

economic ladder. The growth rates of the free market economies of Thailand, Hongkong and Taiwan, not to mention the economies of Japan, Australia and New Zealand, are far higher than the rate of our own economic growth. From this it seems plausible to say that our system of detailed Government controls may be more of a barrier to progress than a help. At least it is worthwhile examining this question a little more closely.

In assessing Government controls over the Indian economy it is useful to remember that these controls are of two different kinds. There are firstly the controls which derive from the use of political power, as expressed through legislation and the rules and orders made by the administrative apparatus. In the second place, there are the controls which result from the exercise of economic power, and I wish to place a little more emphasis on this aspect to which relatively little attention has so far been given.

The exercise of great economic power by the State in addition to its political power can be a source of danger to individual freedom and in particular to the operation of a liberal or free market economy. We have heard a great deal about the so-called evils of monopoly and the concentration of economic power, but the criticism has been directed almost exclusively towards private industry. The tremendous problems arising from the combination of political with great economic power have yet to be squarely faced.

On the 31st March 1965, there were 26,653 companies in the corporate sector in India of which 183 were Government-owned. The paid-up capital of the entire corporate sector was estimated to be Rs. 2,636 crores of which Rs. 1,067 crores was held by the Government-owned companies. This is a staggering comparison for it appears that more than 40% of the capital was Government-owned and was concentrated in less than 1% of the companies.

From this, it seems that we have already come far along the road towards the avowed objective of the ruling party of "a dominant Public Sector" in industry. Many of the Private Sector pygmies are indeed struggling for survival under this policy and some have already been eliminated through the arrival of these new Public Sector giants on the scene.

Not that the pygmies are asking for any special protection from the giants. They are asking simply for the right to compete with them fairly and squarely in the economic field. Unfortunately, this basic right to compete on equal terms has still to be established.

There are in fact several ways in which Government controls plus economic power are being used to develop Public Sector industry at the expense of private industry. These methods may be broadly classified in the following four different categories:—

- (i) Controls under the Industries (Development & Regulation) Act empowering the Government to ban all entry or further expansion in particular industries and to delay or deny altogether individual licence applications for other industries.
- (ii) Preference for Government units in the grant of licences/permits to import capital equipment and maintenance supplies (raw materials, spare parts and components) and also to import foreign technical know-how through the approval of foreign collaboration agreements.
- (iii) Preferential treatment for Government units in the supply of land, credit at low interest rates, exemption from labour laws, and so on.
- (iv) Use of the Government's commanding position as a major purchaser to divert business to its own units, even where public tenders are invited

and the tenders submitted by Government units are not competitive.

The first of these controls exercised by the Government of India over industry is the control of industrial licensing. In my view, this is the most questionable control of all, for it is in fact a control over the basic right to produce. At first sight it seems extraordinary in a country so vast, with such huge natural resources, and with such huge resources of unemployed and underemployed people, that any government should consider it necessary to impose fundamental restrictions on production.

The theoretical objective of this control is to channel productive resources into key sectors of the economy. In practice, the harmful effects of this control far outweigh any possible benefit which this control was designed to achieve. This method of stopping movement in one direction in the hope that people will move in another is a very crude and ineffective way of promoting industrial growth.

Let us look at the latest list of industries for which the Government is prepared to sanction further licences and those for which it is not. We find that whereas there are some 90 odd industries on the permitted list, the Government has imposed a general ban on further licensing in about 230 industries. This may well suit those who have previously obtained a licence by some means or other, but it is hardly a situation which will stimulate any unit in the protected or restricted industries to move forward at a fast pace.

There is no single factor in the country today which is more frustrating to economic progress than this power which has been given to the civil servant to tell the business man whether or not he may invest and whether or not he may produce. I need not dwell on the endless possibilities which this power also gives for Government officials to tyrannise over the business community or of the premium which this system puts on political influence

and on the capacity to obtain administrative favours rather than on enterprise and efficiency.

But it is not enough to generalise about a mistaken industrial policy. A good forest keeper is not only concerned with general matters such as the climate, soil conditions and so on, which influence the development of the wood or forest as a whole, but he is vitally interested in the condition of the individual trees. From an aerial survey the forest may still appear green and huge, but all this is illusory if we find on the ground that the trees are weak and undernourished, that their growth is stunted, or that many are being cut down or uprooted or are withering away. And it is only here on the ground, by examining the individual trees, that we can clearly see where the remedies lie.

So the first "industrial tree" which I would like to examine is the compressor industry. Here is a clear case where Government policy is holding back industrial growth and production and is wasting the country's resources of capital, know-how and foreign exchange with the totally misconceived object of protecting a future giant undertaking in the Public Sector.

The following is an extract from a Government letter addressed to the Indian Engineering Association on 17th May 1966:—

... applications from the private sector for the manufacture of large compressors and pumps included in the programme of the proposed public sector unit at Naini cannot be considered, for the present.
.....it is the intention that until the proposed public sector has been established, the expansion of the existing units sector for the manufacture of pumps and compressors of larger sizes included in the programme of this project should not be entertained. Only after the new project at Naini has been set up

and if it is found that there are still certain gaps in capacity which have to be filled up through the licensing of additional capacity, either in the existing units (both public and private sectors) or through the establishment of new units, the question of further expansion of the then existing units (both public and private sectors) would arise."

It will be seen that the Government is not only proposing to ban all competition with its own unit but that this present ban applies to all items which this future undertaking at Naini might manufacture, for it is evident from this quotation that the Government does not yet know what the unit is actually going to produce.

But the picture here is not yet complete. This ban on the manufacture of large compressors has been imposed by the Government for the past seven years, since the original agreement with Russia to set up a large pumps and compressors unit was signed in 1959. However, this Government unit, which is now estimated to cost Rs. 13.5 crores with a foreign component of Rs. 6.32 crores, has yet to make its appearance.

On the other hand, there are several companies in India which already have the capacity and the know-how to make large compressors. One company in Western India is in fact producing compressors of 1,000 cfm capacity and so far no action has been taken against them. Another company in Western India, however, which wishes to make compressors of 1,500 cfm, and can do so with its sanctioned capacity, has been told by the Government to keep its manufacturing range below 700 cfm. Another company in Eastern India has the installed capacity and know-how to make compressors of 2,000 cfm capacity and above but has been instructed not to do so.

It should be noted that these large compressors can be produced here and now without any requirement of foreign exchange for materials or components. They are

also an essential item required not only by many of our Industries but also by our armed services. So these large compressors are still being imported costing as much as Rs 2 lakhs each in foreign exchange. During the nine months from April to December 1965, when licences for maintenance imports for private industry as a whole were completely suspended, the country still imported air and gas compressors to the value of Rs. 1 crore 11 lakhs.

Now let us look at another "industrial tree"—or perhaps it is better, in the context of our developing economy to speak of "saplings". This particular sapling is the industrial instrumentation industry. There are several known instances here where the Government has refused to permit private industry to develop manufacture of industrial process and control instruments, ostensibly to protect two large Government units which are to be set up with Russian collaboration.

One particular company, a pioneer in instrument manufacture in India, has been trying for years to obtain permission to expand its range of manufacture, but permission has been refused on the grounds that its expanded production would "duplicate" the future manufacturing programme of one of the Government units. This company today has 40% idle capacity in the works, it requires no foreign exchange for the proposed expansion by way of capital equipment, and all the jigs and tools required would be made in India.

Here again the first of the Government units (at Kotah in Rajasthan) is still not completed, although the agreement with Russia was signed in May 1959. The other unit (at Palghat in Kerala) is still little more than a paper plan.

Here also we have the peculiar phenomenon of the Government, in the midst of a most critical foreign exchange crisis, holding back indigenous production and meanwhile permitting large-scale imports of instruments,

presumably to avoid criticism from users of the slow **development** of instrument manufacture in the Public Sector. During 1965 the State Trading Corporation imported from East European countries alone no less than Rs. 1½ crores of measuring and control instruments, mostly through dealers with little or no facilities for installation and after-sales service. At the same time, imports have been permitted from the general currency area of instruments which can be made locally at one quarter to one-tenth of ~~the~~ foreign exchange cost. But this is unfortunately not ~~the~~ end of the story. We must not forget that our **industries** of today and of the future are increasingly dependent on instrumentation. Their efficiency will depend not only on having the best and latest types of process control and measuring apparatus but they will also require the highest standards of service from the instrument suppliers. The handicap to our industries can well be imagined if they are forced to purchase certain ranges of instruments from **only one company**, especially if the company's technical know-how is limited to only one foreign country which is technologically behind several other countries in this particular field.

The instrumentation industry is a field in which competition is the only guarantee that the customer will be properly served. The productive scope for this industry may be illustrated by comparison with the U.K. Whereas the industrial instrument makers in India can now be counted on one's **fingers**, there are more than a thousand British companies in the field, many of them with a world-wide organisation. So it is reasonable to conclude that the present restrictive policy of the Government is **harmful** not only to the instrumentation industry itself but to all the many other industries here which depend on instrumentation.

My third "industrial tree" or "sapling" is the glass manufacturing industry, and I refer in particular to the production of ophthalmic glass which is used in making spectacles, goggles, cameras, microscopes and other optical instruments.

Here is another case where the Government has **refused** to issue industrial licences to private industry. The **object** is to reserve the business for a Government unit at Durgapur which is scheduled to produce **300 tonnes** of ophthalmic glass per annum. The Indo-Russian Agreement to set up this plant was concluded in 1957, but owing to various delays the unit is still not completed.

Over this period India has been obliged to import her minimum requirements of ophthalmic glass at the rate of about Rs. 20 lakhs per annum. The continued dependence on imports has also restricted the development of other industries which depend on supplies of this material.

Another tragic aspect is that the Public Sector glass, when it is eventually available, will undoubtedly be very costly. The capital invested in the Durgapur unit is reported to be in the region of Rs. 3½ crores. Compare this with the project of a Private Sector company whose licence application was sponsored unsuccessfully by the IEA three years ago, which provides for the same output (i.e. **300 tonnes a year**) of ophthalmic glass, using the most modern technology, for an investment of only Rs. **60 lakhs**. Moreover, the gestation period for this project, from the date of Government approval, is less than 15 months, as compared with no less than 10 years in practice for the Government project.

When one looks at details such as this, instead of at the Five-year Plans, we are not surprised by the disappointing rate of industrial growth or at the mounting costs of production. But in this particular case we are concerned not only with the barriers to growth but with a threat to the survival of certain glass manufacturing units in the Private Sector. The rolled plate glass industry in India, consisting of four separate units, is at present heavily under-utilised for lack of demand. Production is now less than 25% of the installed capacity and at least two units are completely shut down. In these circumstances an industry might reasonably ask for the maximum freedom

to diversify, but unfortunately the Government has so far closed the door to a promising line of diversification, namely, the production of ophthalmic glass.

My next "industrial tree" is heavy electrical equipment, the manufacture of which by private industry was originally banned by the Government but has later been relaxed to some extent. Nevertheless it appears to be the Government's intention to discourage or prevent any competition with its own heavy electrical plants at Bhopal, Hardwar, Hyderabad and Tiruchirapally.

In one particular-case, a Private Sector company is able to supply turbo-alternator sets which are required by sugar factories or other factories generating steam during the manufacturing process. The only foreign exchange required is Rs. 50,000 for each 1,500 KW set to cover the import only of raw materials such as copper and nickel alloys. The company can make the steam turbines from its existing plant and would incorporate alternators and gear boxes made locally by other companies.

Despite this the Government has instructed the company not to produce steam turbines, presumably to reserve the market for the future output of its own units under construction. Meanwhile the turbo-alternator sets continue to be imported at a cost of Rs. 5 lakhs each in foreign exchange, ten times more than is required by private industry to produce them in the country.

There is also the case of another Private Sector company which has the installed capacity as well as the technical know-how to make 220 KV transformers. Although they wish to manufacture, the Government has advised them not to do so. Here again the object is clearly to protect a Government unit from competition even before the unit is able to produce the particular item. Meanwhile each 220 KV transformer must be imported at a c.i.f. value ranging from Rs. 5 lakhs to Rs. 20 lakhs each. It is also worth noting that during the past two years the

total imports of transformers into India have been averaging approximately Rs. 8 crores per annum.

All these cases show how the system of industrial licensing is holding back industrial growth, at considerable cost to the nation, and is also being used by the Government as an instrument to give monopolistic advantages to its own industrial undertakings.

Of course, if we reject the theory of industrial licensing control we must accept the philosophy of competition in a free market economy. We shall have to accept that the interests of the consumer are supreme, in accordance with the commonsense proposition that the object of all productive effort is to satisfy consumer demand.

At this point I may be called a cynic, but it seems to me that the producer himself is usually the poorest judge of what is healthy or unhealthy competition. Competition invariably makes life more difficult for each producer and this is precisely why it is so useful. It compels the producer, if he wishes to stay in business, to serve the consumer better—to improve his product, to keep his prices down, to serve the product up more attractively, to give earlier delivery, to improve his after-sales service, and so on.

Now this applies to the Government as much as to any private producer. The only real guarantee that the consumer will be properly served by a Government unit is to expose the unit to competition, to place it on a strict profit-making basis and, most important of all, to give it due notice that if it does not prove its economic worth in this competitive world it must eventually take the consequences, like any private industrial unit, and go out of business.

In case there is any gasp of horror at this revolutionary idea, let me point out that this is no new proposal and some Government authorities in India have already had

the courage and commonsense to act accordingly. For if any State undertaking cannot support itself for a reasonable period and give a proper return on the investment it becomes a running liability to the nation, and the only practical solution is to off-load this liability by measures of denationalisation or by simply winding up the unit and selling off the assets.

If any one of us is a little worried by this philosophy of free competition it is always refreshing to remember that no one can be a producer without also being a consumer. We may still be in the market to sell one or more products but we are also there as a buyer. In fact we all have to buy a much greater variety of items than we actually sell. We not only have to buy machines but we must also feed and maintain them with raw materials, spare parts and also components from ancillary industries. We are also in the market for human resources, for managerial and technical personnel and for skilled and unskilled labour. We must also bid for capital and for credit, and as family men we all know that there is nothing like a good supply of food and consumer goods in the shops to keep our wives satisfied,

So whilst competition may make us miserable sometimes as producers, it also makes life sweet for us as consumers. If we keep this in mind, we can avoid that peculiar inconsistency of complaining one day about Government restrictions on production and the next day asking for a ban on further licensing so as to protect us from the threat of further competition.

The Indian Engineering Association has been careful to avoid any complaints to the Government about "over-licensing", though of course the seriousness of over-investment or mal-investment has always been clearly recognised. In fact, in the IEA report on "Foreign aid, collaboration and investment" published more than two years ago, a strong case was made out for a system of automatic industrial licensing. This stems from our belief that it is the job

of civil servants to register, and not to judge, the intentions or decisions of the individual citizen to invest his time, energy or money in industry. The slogan here should always be "invest or produce at your own risk".

Not that the Government should be merely a passive bystander. It is most important that accurate and up-to-date statistics about investment and production should be available to assist businessmen to make the right decisions. Much of the present over-investment in certain industries would never have occurred if reliable statistical and market information were available, instead of the highly mis-leading targets which have been fixed under the Government's paper plans. So the Government's move to free industries progressively from industrial licensing control is to be welcomed.

Of course decontrol is not enough. There must be opportunity as well as freedom if the economy is to surge forward, and questions of industrial, fiscal and monetary policy are most relevant here. Indeed the first two industries which have been listed by the Government for decontrol are now suffering from a serious work famine. The shortage of orders both for ferrous metal castings and for structural fabrication is now so widespread and severe that it is difficult to conceive of any businessman wishing to enter or expand production in these industries at the present time.

It is also here, in these two major engineering industries, that we find our first examples of how the enormous economic power now wielded by the Government, both as a producer and as a consumer, still gives the Government *de facto* control over the industry's fortunes no matter how many political controls may have been removed. In this matter, as I shall show, there is increasing need for public vigilance.

Let me first take the case of the structural fabrication industry. An IEA survey has revealed fabricating capacity of about 500,000 tonnes per annum amongst 100 struc-

tural shops out of a total of about 170 units listed by the Central Government. It appears that for lack of work more than half of this capacity will be lying idle by the end of this year.

Despite this, the Government is still proposing to invest many crores of rupees and also foreign exchange to erect several giant structural units in the Public Sector. These include a 25,000 tonne unit at Naini (Triveni Structural-Private Ltd.), a 30,000 tonne unit as part of the Bokaro project, the substantial expansion of Tungabhadra Steel Products Ltd., and a new structural unit for a Kerala Government undertaking—Fertiliser & Chemicals (Travancore) Ltd. This massive Government entry into the structural industry is not only an apparent waste of public resources but may take away much of the business on which existing fabricators will depend for their future survival.

The figures of spare structural capacity are alarming enough without the extra capacity which the Government proposes to instal. But what is still more disturbing for the established industry is the dominant position of the Government as a purchaser of structural steelwork. The dangers here are all too real that the Government will give preference to its own structural shops in the placing of orders. I am afraid that the system of public tendering is not an adequate safeguard against this practice so long as the Government units are permitted to follow non-standard costing practices and the public is obliged to subsidise their working in various ways.

The situation that is developing is indeed tragic, for structural fabrication is both the oldest and largest engineering industry in India. Our engineering standards here compare with the finest in the world, and there is visible proof of this in such structures as the Howrah, Ganga and Brahmaputra bridges. As for tradition, may I blow my own trumpet a little and tell you that there are bridges in Calcutta which were fabricated and erected by my own

company more than 150 years ago and which are still in use today?

Much the same situation exists in the steel foundry industry, where the present total demand has fallen off to less than half the capacity now installed in the Private Sector. The recent cut in orders by the Indian Railways has come as a very severe blow and further inroads are being made by the transfer of orders for wagon castings to certain Government foundries without giving the private foundries an opportunity to compete for the business.

The long-term prospects for the steel foundry industry are still more grim as the Government is proposing to instal still more steel casting capacity in the Public Sector even though the existing Government foundries would probably be capable of meeting the entire foreseeable demand during the next five years if their capacity is properly utilised. Apart from the foundries already under construction I understand that further Government projects include the expansion of Bhilai steel foundry from 5,000 tonnes to 12,000 tonnes, and completely new foundries to be installed at Rourkela (5,000 tonnes), Bokaro (5,000 tonnes?), Naini (10,000 tonnes), Hardwar (15,000 tonnes), and Wardha (12,000 tonnes).

As an engineer, I can appreciate the convenience of having a captive foundry on the doorstep. But in the present context of surplus capacity and of scarce capital resources, these projects for more and bigger Government foundries are just another instance of 'empire-building' and do not seem consistent with the official policy of encouraging ancillary industries.

Perhaps the biggest case of industrial 'empire-building' in our country today is provided by the Indian Railways. For in recent years this gigantic organisation has been progressively developing the manufacture of all types of railway equipment which have traditionally been supplied by private industry. Here is a case where political controls

plus overwhelming economic power are being used in such a way that producers established for half a century or more are being squeezed out of the railway equipment business altogether. In this case I am concerned not with just one particular industrial tree but with a whole cluster.

The manufacture of railway locomotives, for example, has been pioneered in India by private industry. Nevertheless industrial licensing controls have been used to confine the Private Sector to producing only steam locomotives, whilst permission has been given only to the Indian Railways to produce electric and diesel locomotives. And now the Railways have decided, despite the huge surplus production of coal, to change over from steam exclusively to diesel and electric traction, and in the process the production of locomotives by private industry will be effectively eliminated.

Let us turn next to the manufacture of railway rolling stock. The position here has been thoroughly analysed in a special IEA report. The main point which I would like to emphasise here is that wagon production by private industry has been generally held back to the 1963-64 level, and has been cut back last year to well below this level, partly through the purchasing policy of the Indian Railways and partly through the control which the railway authorities exercise over the supply of wheelers. At the same time the Railways have been rapidly developing wagon manufacture in their own maintenance workshops, whilst the established producers are left with substantial idle capacity and are now compelled to lay-off or retrench their employees. In these circumstances it is indeed extraordinary to read that the World Bank has granted another loan to the Indian Railways which will be used *inter alia* for the manufacture of railway wagons.

Producers of railway track materials are also in the doldrums, largely owing to the severe cutback in the Railway Budget for 1966-67. It is worth mentioning here that many iron foundries have suffered severely from the policy

decision by the Railways to change over from cast iron to concrete sleepers. The concrete sleepers of the future, it appears, are to be made by the Railways themselves.

Another sphere in which the Railways now propose to enter in a big way is that of electrical signalling equipment. It appears that the latest World Bank loan is also to be used for setting up a Central Signalling Workshop at Secunderabad at a capital cost of Rs. 1½ crores. Units in the Private Sector, however, claim that they are already in a position to manufacture the items which are scheduled to be produced in this new railway workshop. One of these companies, established nearly 60 years ago, has in fact pioneered the manufacture in India of electrical signalling equipment some 10 years ago.

If I am asked why this emphasis on private industry rather than Government industry, I would strongly deny that this has anything to do with political prejudice or with any kind of ideology. My reasons are purely pragmatic and can be classified simply into two categories.

Firstly, I have the practical reason that every Government has certain basic jobs to do such as maintaining law and order, national defence, education, social welfare, and improving the economic infrastructure. Any Government, however efficient, will find these basic jobs much harder to discharge effectively if it also tries to enter direct into industry or commerce on a large scale. In the latter event the attention of politicians and administrators is inevitably distracted from the primary task of Government, and more and more time, energy, finance and administrative skill tends to be diverted to large-scale industrial projects which may well be uneconomic but which seem to bring great prestige, power and glamour to those associated with them. In the process many of the basic tasks of Government are liable to be neglected, such as the provision of better roads and ports, adequate drinking water and electricity supply, irrigation, land development, drainage, afforestation, and so on.

But quite apart from this, I have a sound economic reason for this bias in favour of private industry. **Investments**, in Government industry, taken as a whole, have so far proved to be far less productive than investments in non-Government industry. Even on the basis of official figures, as highlighted by Mr. L. N. Birla in a recent speech, and taking only Public Sector units which have been established for 10 years or more, the addition to national income which results from investing an extra rupee into private industry is two to three times greater than if the rupee is invested in Government industry.

This comparison does not, of course, mean that every Government unit is necessarily inefficient or that every non-Government unit is efficient. These are simple average figures. Nevertheless it is enough to show that if we genuinely wish to speed up the rate of economic growth it will not be enough to remove certain Government controls. We must also challenge the dogma of a "dominant Public Sector" and call an immediate halt to the policy of expanding the Public Sector purely on political grounds. We must then make a re-appraisal of the huge investments already made in Government industry throughout the country, see what can be done to make these investments really productive, and take the necessary steps to put matters right, however politically embarrassing those decisions may be.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.

**"Free Enterprise was born with man
and shall survive as long as man
survives."**

**—A. D. SHROFF
(1899-1965)
Founder-President,
Forum of Free Enterprise.**

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The Forum of Free Enterprise is a **non-political** organisation, started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through **booklets** and **leaflets**, meetings, essay competitions, and other means as befit a democratic society.

Write for further particulars (state whether Membership or Student Associateship) to the Secretary; Forum of Free Enterprise, 235, Dr. Dadabhai **Naoroji** Road, Post Box No. 48-A, Bombay-1.

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