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India's New Economic Policy and the Japanese Response

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In contrast to the attention given to Southeast Asia including China, Japan has long neglected India as a major economic partner. However, India not only vigorously initiated a "reform and open-door policy" in 1991, but has also been very keen to woo Japanese capital and technology in order to promote industrial development. Yet India is neither a major Japanese trading partner, nor is it today an attractive host country for Japanese investors. India seems to be significant for Japan primarily as a recipient of official development assistance (ODA).

In this paper I will investigate the main reasons for this lopsided development of economic relations between Japan and India. In chapter 1 I will begin by focusing on India's new economic policy (NEP) which was launched in 1991. Then in chapter 2 I will present a brief outline of Japanese economic relations with India in the fields of trade, FDI, and ODA. Finally in chapter 3 I will discuss some characteristics of the Indian political economic systems and how Japanese assess them.

1. The New Economic Policy

1-1 From "A Backward Center" to "A Progressive Periphery"

Starting in July 1991 India has launched a systematic economic reform with the major aim of opening up the country to foreign capital. India was ten years behind China in changing to a "reform and open-door policy" and chose this path as a means to join in the tidal wave of Asian economic dynamism.

The central pillar of economic management of the Indian government has dramatically changed under the changing international environment. On the one hand, the socialist economies of the Soviet and the East European countries broke down, and on the other hand a dynamic Asian economic zone emerged, including China. Given this change there was no option for India but to liberalize and open up the country. This means India had to change its principle of economic management from "remaining a backward center" to "becoming a progressive periphery."

The new economic policy (NEP) of the Rao government, which started in July 1991, followed fairly faithfully the structural adjustment programs recommended by the IMF and the World Bank. It included "economic stabilization" cum "deregulation," "liberalization," "privatization" and "globalization," based on the ideas of neo-classical economics.

However, the NEP was not an exact replica of the structural adjustment programs of the IMF and the World Bank, in terms of its speed, sequence, and extent. What is important to note in this regard is that the NEP was executed as an autonomous response by the Indian government. And because the government's commitment to reform was very clear, India was able to achieve high credibility in international society. In particular, the Indian government was able to skillfully navigate the first two years of demand management phase, called "economic stabilization."

1-2 "Look East" Policy, Indian Style

Under the Rao government, India's foreign policy has also changed dramatically. India has tried vigorously to gain access to APEC as well as ASEAN. *The Economic Survey 1995-96* is an epoch making document in the sense that in it India declared its own "Look East" policy (GOI, 1996, pp.14-15). The document reads:

(a) India must learn from the experience of East Asia, which was able to attain a healthy macro-economic balance as well as to maintain high production and employment. India's savings rate has been comparable to those in the high performing East Asian economies. But India's public savings have been much lower than those of the East Asian economies have. Hence, it is necessary to cut back on the Government's revenue and fiscal deficits significantly and continuously.

(b) India's future economic development depends on the supply of an adequate and reliable economic infrastructure at a reasonable cost. Unless there are improvements in the infrastructure, the recent growth of agriculture, industry and exports will be at risk and the prospects for more rapid development elusive. The old public monopolies in the fields of power, telecommunications, port and roads, can no longer cope with the rapidly expanding demand for high quality infrastructure. Thus, it is necessary to facilitate the entry of private corporations. For this purpose, institutional structures, and especially long-term financial institutions, should be developed.

(c) Greater access and use of foreign investment will be necessary for promoting higher growth of output, exports and employment. FDI is one of the most important ingredients of the East Asian miracle. It is the most effective and rapid method for achieving technology transfers and the effective promotion of comparative advantage through exports. For India to attain seven to nine percent growth rates over the next two decades, it will be necessary to encourage FDI to levels comparable to China's \$ 30 billion or more per year.

(d) The experience of the East Asian economies shows that the best way to reduce unemployment and poverty is to ensure sustained, rapid economic growth. Labor-intensive growth patterns are more beneficial in promoting employment. India's labor is among the most competitive in the developing world. As China's experience shows, a rapid expansion of labor-intensive exports can be an important source of new productive jobs. Thus, it is necessary to overhaul the current labor legislation, which discourages employment in the organized sector. Small and medium enterprises have a major role to play in this process.

These are the lessons that the Indian Government has drawn from the East Asian Miracle countries, including China: the expansion of public sector savings, an adequate supply of infrastructure, positive acceptance of foreign direct investment, and massive exports of labor-intensive industrial goods. The Deve Gowda United Front

Government as well as the Vajipayee BJP government that succeeded the Rao Congress government seem to have the same ideas, although there are some differences in nuance. The BJP government is also stressing the importance of the supply of economic infrastructure by the private sector, the maintenance of a growth path by encouraging FDI, and the accumulation of foreign exchange reserves through the export of labor-intensive industrial goods.

This represents an Indian interpretation of the "East Asian Miracle." One of the central issues in the World Bank's report on the "East Asian Miracle" was that regarding the relevance of industrial policies in these countries and on the importance of the "market-friendly approach" (World Bank, 1993). Indian official documents do not refer to this issue at all. And this is a reticence which flavors the Indian style "Look East" policy.

1-3 Economic Performance under the New Economic Policy

India's economic growth rate for the five years since 1992/93 was remarkable. It was 5.2 percent in 1992/93, 6.2 percent in 1993/94, 7.8 percent in 1994/95, 7.4 percent in 1995/96, and 7.7 percent in 1996/97. The average growth rate of these five years was 6.8 percent, which was not only far higher than the 5.6 percent target growth rate of the Eighth Five Year Plan but also the highest recorded growth rate in Indian history. However, in 1997/98 it slowed down to 5.0 percent, and the prospect for 1998/99 does not appear to be so bright (Table 1).

The macroeconomic-balance has also improved. The gross domestic savings rate as a percent of GDP increased to a record level of 25.6 percent in 1994/95 and has maintained that level up to 1996/97. The fixed gross capital formation rate as a percent of GDP also increased to 26.9 percent in 1996/97 and further to 27.1 percent in 1995/96 and 27.3 percent in 1996/97. The savings-investment gap improved con-

Table 1 Economic Growth Rate (%)

	GNP	GDP
1991/92	0.5	0.8
1992/93	5.2	5.3
1993/94	6.2	6.2
1994/95	7.8	7.8
1995/96	7.4	7.2
1996/97	7.7	7.5
1997/98	n.a.	5.0
First Plan (1951-56)	3.7	
Second Plan (1956-61)	4.1	
Third Plan (1961-66)	2.7	
Annual Plan (1966-69)	3.9	
Fourth Plan (1969-74)	3.4	
Fifth Plan (1974-79)	5.0	
Annual Plan (1979-80)	-4.9	
Sixth Plan (1980-85)	5.5	
Seventh Plan (1985-90)	5.8	
Annual Plan (1990-92)	2.9	
Eighth Plan (1992-97)	6.8	

Source: GOI, *Economic Survey 1997-98*.

siderably compared with the pre-NEP period. It was around two to three percent of GNP in the late 1980s, but has decreased since 1991/92 (Table 2).

If we disaggregate gross domestic savings into the household sector, private corporate sector and public sector, although the savings rate of the household sector continues to be dominant, a noteworthy new trend has emerged: the savings rate of the private corporate sector as percent of GDP has increased conspicuously, from 3.5 percent to 4.2 percent since 1993/94. On the other hand, however, that of public sector has remained flat (Table 3).

Another noteworthy new trend is a major change in the composition of domestic capital formation. While the gross fixed capital formation of the private sector as a percentage of GDP has increased from 9.8 percent in 1986/87 to 16.8 percent in 1996/97, that of the public sector has decreased from 11.4 percent in 1986/87 to 7.2 percent in 1996/97 (Table 4). This trend has accelerated under the NEP.

India experienced a relatively high growth phase during the latter half of the 1980s compared not only with the rates of previous periods, but also compared with

Table 2 Gross Domestic Savings and Gross Fixed Capital Formation
(As percent of GDP at current market price, %)

	1. GDS	2. GFCF	3. Savings -Investment Gap (1-2)
1985/86	19.8	22.2	-2.4
1986/87	18.7	20.9	-2.2
1987/88	20.9	22.9	-2.0
1988/89	21.4	24.5	-3.1
1989/90	22.4	25.1	-2.7
1990/91	24.3	27.7	-3.4
1991/92	22.9	23.4	-0.5
1992/93	22.0	23.9	-1.9
1993/94	22.7	23.3	-0.6
1994/95	25.6	26.9	-1.3
1995/96	25.3	27.1	-1.8
1996/97	26.1	27.3	-1.2

Source: *Economic Survey 1997-98*.

Table 3 Composition of Gross Domestic Savings
(As percentage of GDP, %)

	Household Sector	Private Corporate Sector	Public Sector	Total
1985/86	14.6	2.0	3.2	19.8
1986/87	14.2	1.8	2.7	18.7
1987/88	17.0	1.7	2.2	20.9
1988/89	17.2	2.1	2.0	21.4
1989/90	18.2	2.6	1.6	22.4
1990/91	20.5	2.8	1.0	24.3
1991/92	17.7	3.2	1.9	22.9
1992/93	17.7	2.8	1.5	22.0
1993/94	18.5	3.6	0.6	22.7
1994/95	20.3	3.5	1.8	25.6
1995/96	18.8	4.2	2.3	25.3
1996/97	20.3	3.9	1.9	26.1

Source: GOI, *Economic Survey 1997-98*.

Table 4 Composition of Gross Fixed Capital Formation
(As percentage of GDP, %)

	Public Sector	Private Sector	Total
1986/87	11.4	9.8	21.2
1987/88	10.4	11.3	21.7
1988/89	10.1	11.6	21.6
1989/90	9.6	12.9	22.5
1990/91	9.4	13.8	23.2
1991/92	9.5	12.6	22.1
1992/93	8.5	14.0	22.5
1993/94	8.3	13.2	21.5
1994/95	9.1	13.4	22.5
1995/96	8.0	16.2	24.3
1996/97	7.2	16.8	24.0

Source: GOI, *Economic Survey 1997-98*.

growth rates in Latin American and African developing countries. These relatively high growth rates were brought about by massive public sector investment. This public-sector-investment-led growth in turn depended on substantial borrowings from abroad as well as from the domestic market. As a result, huge budgetary deficits and external debts accumulated. In spite of the relatively high growth, macroeconomic imbalances were aggravated, resulting in the political and economic crisis of 1991. The recovery of growth momentum and the continuous high growth under the NEP has been different in character from that of the pre-NEP period. The main driving force of the high growth under the NEP has been not public sector investment but rather private sector investment.

It was the satisfactory growth in the industrial sector, especially that of the manufacturing sector, which brought this high growth phase under the NEP. Looking at the growth rates for industrial production by use-based classification, we discover that consumer durables and capital goods were the two leading sectors that brought high industrial growth under the NEP. This pattern of industrial growth is exactly the same as that for the late 1980s (Table 5).

Foreign capital inflows have dramatically increased. Actual foreign capital

Table 5 Growth Rates of Industrial Production by Use-based Classification (%)

	Basic Goods	Capital Goods	Intermediate Goods	Consumer Durables	Consumer Non-Durables
1986/87	9.2	18.2	4.4	18.9	4.9
1987/88	5.6	15.2	4.8	7.8	6.2
1988/89	9.9	7.0	11.5	12.0	2.5
1989/90	5.4	22.4	4.3	1.7	7.5
1990/91	3.8	17.4	6.1	14.8	9.4
1991/92	6.2	-12.8	-0.7	-12.5	1.2
1992/93	2.6	-0.1	5.4	-0.7	2.4
1993/94	9.4	-4.1	11.7	16.1	1.3
1994/95	5.5	24.8	3.7	10.2	8.4
1995/96	8.3	17.9	11.8	36.1	8.8
1996/97	8.2	5.9	9.7	5.4	2.4

Source: GOI, *Economic Survey* (various years).

Table 6 Foreign Investment Flows by Category

(US \$ million)

	1991/92	1992/93	1993/94	1994/95	1994/95	1995/96	1996/97
A. Direct Investments	129	315	586	1,314	2,133	2,696	3,197
B. Portfolio Investments	4	244	3,567	3,824	2,748	3,312	1,601
Total	133	599	4,153	5,138	4,881	6,008	4,798

Source: GOI, *Economic Survey 1997-98*, p.87.

inflows were a meager US \$ 133 million in 1991/92, but increased to US \$ 4.2 billion in 1993/94, US \$ 5.1 billion in 1994/95, US \$ 4.9 billion in 1996/97, US \$ 6.0 billion in 1996/97, and US \$ 4.8 billion in 1997/98. From 1993/94 to 1996/97 portfolio investments were the dominant form of capital inflows. However direct investment has also doubled every year since 1991/92, and it crossed the US \$ 2 billion threshold in 1995/96 (Table 6).

As is evident from the brief outline given above, India's economic performance during the five years under the NEP was extremely good. In spite of this fact, however, the Congress Party led by Mr. Rao was devastated in the eleventh general election held in April and May 1996. Why?

During this election, for right or wrong, economic liberalization was not the point of contention. Every party, although there were some difference in nuance, recognized the necessity of liberalization. The humiliating defeat of the Congress Party was partly caused by corruption that, it was suspected, involved Prime Minister Rao himself and partly by the end of the charismatic politics of the Nehru family. The charge that economic liberalization had brought about widening economic gaps also affected the results of the election.

However, there is still a lack of solid academic investigations on whether the new economic policy since July 1991 have in fact resulted in widening income gaps among people. At present, we don't have enough available data to judge on this issue. Thus far we have studies of Tendulkar & Jain [1995] and Gupta [1995] on the distributional outcomes of the liberalization policy. Both studies use household consumption data of the NSS for the periods of July-December 1991 or January-December 1992. Tendulkar & Jain concluded that the economic reform-related decisions contributed indirectly rather than being a sole or major cause, to the sharp acceleration of rural poverty. Gupta reached a similar conclusion, namely that the social costs of reform, while probably being low compared to those in many other developing countries, were nevertheless high enough to demand a corrective course.

With regard to trends in regional inequalities, Das & Barua [1996] conducted a study. Their study examined the pattern of regional inequalities in India during 1970-92, and their analysis shows that inter-state inequalities are widening in India in almost every sphere of economic activity, particularly in unorganized industry. But we don't know whether these trends are the results of the new economic policy since 1991.

2. The Japanese Response to the New Economic Policy

2-1 "Japan's Significance for India" and "India's Significance for Japan" in Terms of Trade

As shown by Table 7, India's exports to Japan increased from Rs. 598 crores in 1980/81 to Rs. 7,411 in 1995/96, i.e., a 12.4-fold increase in 15 years. Japan's share in total exports from India jumped from 8.8 percent in 1984/85 to 10.7 percent in 1985/86 and maintained a level over 10 percent up to 1988/89. But its share began to decline sharply from 1989/90. The share in 1996/97 was just 6.0 percent. On the other hand, India's imports from Japan increased from Rs. 749 in 1980/81 to Rs. 8,254 crores in 1995/96, i.e., an 11-fold increase in 15 years. It is rather difficult to find any stable trend in Japan's share in total Indian imports during the 1980s and 1990s. From 1986/87 to 1989/90, the Japanese share jumped from the 8 percent to 13 percent range, but in other years it remained stagnant at around 6 percent to 7 percent. This means we cannot see any discernible new trend neither in terms of exports from India to Japan or imports from Japan to India during the NEP period. The NEP has had no positive impact at all on exports from India to Japan.

We can deduce the same trends from the statistics on the Japanese side (Table 8). India's share in total Japanese exports declined from 1.0 percent in 1986 to 0.5 percent in 1997. On the other hand, India's share in total Japanese imports stagnated at a low level of around 0.8 percent to 1.0 percent during the 1980s and 1990s.

Tables 9 and 10 show the changing direction of India's trade from a longer-term perspective. The most conspicuous change is the fact that the share of Eastern Europe in both total exports and imports has declined sharply since 1992. This is of course a result of the collapse of the socialist systems in those countries. How was the loss of these markets compensated for? There was an increase in the share of exports

Table 7 Japan's Share in India's Exports and Imports (Rs. crore)

Year	Exports		Imports		Trade Balance	
	Total	Japan (%)	Total	Japan (%)	Total	Japan (%)
1980/81	6,711	598 (8.9)	12,549	749 (6.0)	-5,838	-151
1981/82	7,806	690 (8.8)	13,608	887 (6.5)	-5,802	-197
1982/83	8,803	834 (9.5)	14,293	1,088 (7.6)	-5,490	-254
1983/84	9,771	826 (8.5)	15,832	1,447 (9.1)	-6,061	-621
1984/85	11,744	1,029 (8.8)	17,134	1,240 (7.2)	-5,390	-211
1985/86	10,895	1,164 (10.7)	19,658	1,164 (5.9)	-8,763	0
1986/87	12,452	1,334 (10.7)	20,096	2,592 (12.9)	-7,644	-1,258
1987/88	15,674	1,614 (10.3)	22,244	2,126 (9.6)	-6,570	-512
1988/89	20,232	2,154 (10.6)	28,235	2,631 (9.3)	-8,003	-477
1989/90	27,658	2,727 (9.9)	35,328	2,820 (8.0)	-7,670	-93
1990/91	32,553	3,039 (9.3)	43,198	3,245 (7.5)	-10,645	-206
1991/92	44,041	4,071 (9.2)	47,851	3,375 (7.1)	-3,810	-696
1992/93	53,688	4,160 (7.7)	63,375	4,136 (6.5)	-9,687	-24
1993/94	66,751	5,460 (8.2)	73,101	4,774 (6.5)	-6,350	-686
1994/95	82,674	6,363 (7.7)	89,971	6,405 (7.1)	-7,297	-42
1995/96	106,353	7,411 (7.0)	122,678	8,254 (6.7)	-16,325	-843
1996/97	117,525	7,068 (6.0)	136,844	7,758 (5.7)	-19,319	-690

Source: GOI, *Economic Survey* (various years).

Table 8 India's Share in Japanese Exports and Imports (US \$ million)

Year	Exports		Imports		Trade Balance	
	Total	India (%)	Total	India (%)	Total	India (%)
1982	138,831	1,408 (1.0)	131,931	1,122 (0.9)	6,900	286
1986	209,151	2,009 (1.0)	126,408	1,297 (1.0)	82,743	802
1988	264,917	2,082 (0.8)	187,354	1,804 (1.0)	77,563	278
1989	275,175	2,018 (0.7)	210,847	1,978 (0.9)	64,328	40
1990	286,948	1,708 (0.6)	234,799	2,075 (0.9)	52,149	-367
1991	314,525	1,523 (0.5)	236,737	2,190 (0.9)	77,789	-667
1996	410,872	2,435 (0.6)	349,124	2,849 (0.8)	61,748	-414
1997	420,896	2,208 (0.5)	338,705	2,661 (0.8)	82,191	-453

Sources: GOJ, MITI, *White Paper on International Trade* (various years).

Table 9 Direction of India's Trade: Exports (%)

	1970/71	1980/81	1990/91	1992/93	1995/96	1996/97
1. OECD	50.1	46.6	53.5	60.5	55.7	55.7
(a) EU	18.4	21.6	27.5	28.3	26.5	25.0
(b) USA	13.5	11.1	14.7	19.0	17.4	19.8
(c) Japan	13.3	8.9	9.3	7.7	7.0	6.0
2. OPEC	6.4	11.1	5.6	9.6	9.7	9.7
3. Eastern Europe	21.0	22.0	17.9	4.4	3.8	2.9
4. Other LDCs	19.8	19.2	16.8	20.8	25.7	26.9
(a) Africa	8.4	5.2	2.1	2.7	3.4	2.9
(b) Asia	10.8	13.4	14.3	17.4	21.3	22.7
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: GOI, *Economic Survey 1997-98*, p.S-90.

Table 10 Direction of India's Trade: Imports (%)

	1970/71	1980/81	1990/91	1992/93	1995/96	1996/97
1. OECD	63.8	45.7	54.0	56.1	52.4	49.2
(a) EU	19.6	21.0	29.4	30.2	26.7	25.6
(b) USA	27.7	12.9	12.1	9.8	10.5	8.8
(c) Japan	5.1	6.0	7.5	6.5	6.7	5.7
2. OPEC	7.7	27.8	16.3	21.6	20.9	26.4
3. Eastern Europe	13.5	10.3	7.8	2.5	3.4	2.4
4. Other LDCs	14.6	15.7	18.4	15.2	18.3	16.9
(a) Africa	10.4	1.6	2.2	3.4	2.3	2.4
(b) Asia	3.3	11.4	14.0	10.5	14.4	13.2
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: GOI, *Economic Survey 1997-98*, p.S-91.

of the OECD countries and, even more significantly, of the Asian developing countries. The share of Asian developing countries in India's total exports increased from 14.3 percent in 1990/91 to 22.7 percent in 1996/97. Thus, the fall in Japan's share in total exports from India is really an exception. The share was 13.3 percent in 1970/71, but has been declining since then. The trend of India's imports is similar to

Table 11 Composition of Japanese Imports from India
(US\$ thousands)

	1990 (%)	1997 (%)
Total	2,074,777 (100.0)	2,660,905 (100.0)
1. Food	345,205 (16.6)	827,650 (31.1)
(1) Shrimps	265,539 (12.8)	613,901 (23.1)
2. Raw Materials	759,622 (36.6)	618,171 (23.2)
(1) Iron Ore	531,475 (25.6)	397,004 (14.9)
3. Manufacturing Items	961,894 (46.4)	1,123,817 (42.2)
(1) Chemical Products	31,404 (1.5)	111,354 (4.2)
(2) Textile Products	136,442 (6.6)	312,098 (11.7)
(3) Metal Products	79,944 (3.9)	119,413 (4.5)
4. Diamonds	628,562 (30.3)	439,624 (16.5)

Source: MITI, *White Paper on International Trade* (various years).

that of exports, although the change has not been so dramatic. In addition, it is OPEC that has substantially increased its share in total imports from India since the late 1970s.

It is shocking to note that trade relations between India and Japan have not developed at all since 1992/93, and in fact have gone backward.

The main four import items from India to Japan have remained unchanged between 1990 and 1997: iron ore, diamonds, shrimps, and textile products, although the shares of the different items have changed (Table 11). In 1990, the shares of the top four import items were: diamonds (30.3 percent), followed by iron ore (25.6 percent), shrimps (12.8 percent), and textile products (6.6 percent). In 1997 the figures were: shrimps (23.1 percent), followed by diamonds (16.5 percent), iron ore (14.9 percent), and textile products (11.7 percent).

2-2 FDI

Various quantitative and qualitative data confirm beyond doubt that India is very much a marginal player in the Japanese FDI scene. According to a Toyo Keizai survey, as of December 1997, a total of 18,863 Japanese companies were operating abroad with more than 10 percent equity participation, and among these, 9,462 were operating in Asia. The number of Japanese companies operating in India was 138, so that their share in total number was just 0.7 percent of the total, and even just a trifling 1.5 percent of the Asian subtotal (Table 12). However, India's share of the total increased slightly in 1991-97 period to 1.0 percent, compared with the previous period figure of 0.5 percent

Table 12 Number of Japanese Companies Operating Abroad

	Total	1951-90	1991-97
1. Total	18,863	10,744	7,624
2. Asia	9,452	4,370	4,876
3. India	138	55	78
4=3/1 (%)	0.7	0.5	1.0
5=3/2 (%)	1.5	1.3	1.6

Source: Toyo Keizai, *A List of Japanese Companies Abroad 1998*.

Table 13 Japanese FDI, 1951-96 Cumulative Figures

	Number	Billion Yen
1. Total	82,871	310,808
2. Asia	26,825	14,945
3. India	261	108
4=3/1 (%)	0.3	0.03
5=3/2 (%)	1.0	0.7

Source: GOJ, MOF.

Table 14 Indian Foreign Collaborations Approved — Countrywide

	Numbers		Rs. crores	
	Total [FC]	Japan [FC] (%)	Total	Japan (%)
1960/61-69/70	2,678 [n.a.]	254 [n.a.] (9.5)	n.a.	n.a.
1970/71-79/80	2,698 [182]	237 [6] (8.8 [3.3])	54	2 (4.1)
1980/81-89/90	7,296 [1,719]	696 [98] (9.5 [5.7])	1,155	104 (9.0)
1990	666 [194]		13	n.a.
1991	950 [289]	[72]	534	53
1992	1,520 [692]	[45]	3,888	610
1993	1,476 [785]	[26]	8,859	257
1994	1,854 [1,062]	[45]	14,187	401
1995	2,337 [1,355]	[34]	32,072	1,514
1991-95	8,137 [4,183]	[222] ([2.7])	59,540	2,835 (4.8)
1996	2,303 [1,559]	[n.a.]	36,147	1,488 (4.1)

Source: H.L.Chandhok & The Policy Group, *India Database: The Economy*, LM Books: New Delhi, Vol.2; Ministry of Industry, *SIA News Letter*.

If we look at the cumulative data reported by Japan's Ministry of Finance, here again we see the marginal position of India as a destination for Japanese FDI. India is host to just 0.3 percent of Japanese FDI in terms of number of companies, and its position is almost negligible, at 0.03 percent, in terms of investment.

According to Indian data, the total amount of approved FDI was Rs. 54 crores during the 1970s. This rose more than 20-fold in the 1980s to a total of Rs. 1,155 crores, and again skyrocketed to Rs. 95,687 crores in 1991-1996. It is clear enough that these jumps in FDI are due to India's economic liberalization beginning in 1980.

The number of collaborations with Japanese firms was 254 during the 1960s (9.5 percent of the total), 237 during the 1970s (8.8 percent of the total), and 696 during the 1980s (9.5 percent of the total). The amount of investment was meager: Rs. 2 crores during the 1970s (4.1 percent of the total), though this figure jumped to Rs. 104 crores during the 1980s, 47 times that of the 1970s. The Japanese share in India's total inbound FDI also more than doubled, to 9.0 percent, during the 1980s.

Japanese FDI in India during the 1980s was centered around transport machinery and related fields. The best known case of a successful India-Japan joint venture is Maruti Udyog Ltd (MUL), which commenced production in December 1982. Encouraged by this case, Japanese investors entered India vigorously in the period from 1983 to 1987, investing in the production of four-wheeled as well as two-wheeled vehicles, including light commercial vehicles and motorcycles. Other notable fields of Japanese investment during the 1980s included consumer electronics especially color TV tubes, video cassette-recorders and electric rice cookers.

As economic liberalization moved into fuller swing under the Rao government, direct investment by Japanese firms into India initially became more active. Some leading Japanese companies extended their investment paths towards India. Asahi Glass tied up with Tatas to manufacture high quality float glass, which has wide applications in automotive and construction industries. Fujitsu began to manufacture PBX telephone switchboards in collaboration with Punjab National Electronics Corporation, while Nippon Cement started to manufacture special steel in collaboration with Associated Cement. Fanac now manufactures numerically controlled machines in collaboration with Voltas and IGE, and Itochu builds oil refinery facilities in

Table 15 Top Five Investor Countries in India: 1991- April 1997

	Rs. crores	%
1. USA	30,558	25.9
2. UK	7,854	6.6
3. Mauritius	5,765	4.9
4. Korea	5,412	4.6
5. Japan	4,842	4.1
* NRI	5,446	4.6
Total	118,107	100.0

Source: GOI, Ministry of Industry, *SIA Newsletter*, May 1997.

Table 16 Number and Amount of Japanese FDI: 1989-96

	Numbers	Billion yen
1989	6,589	9,034
1990	5,863	8,353
1991	4,564	5,682
1992	3,741	4,431
1993	3,488	4,151
1994	2,478	4,281
1995	2,863	4,957
1996	2,501	5,409

Source: GOJ, MOF.

collaboration with Reliance Industries, and so on.

However, in spite of the Japanese firms' high profile in India and their investment spurt, they still appear to be rather reluctant to invest in India, and are far behind US firms (Table 15). The total amount of Japanese investment during the period from 1991 to 1996 was Rs. 4,323 crores, which is more than 40 times that of the 1980s, but the share of Japanese investment substantially decreased during this period, from 9.0 percent during the 1980s, to 4.5 percent. The data give the clear message that there has been a net pullback, or at least a sluggishness on the part of Japanese investors in the age of the Indian NEP. One of the reasons for the reluctance is, without doubt, the end of the Japanese "bubble economy" in 1991. Total Japanese FDI has decreased sharply since 1990, in terms of both number and amount invested (Table 16).

The total value of exports from India to Japan during the period from 1980/81 to 1996/97 was Rs. 50,542 crores, while India's imports from Japan during the same period amounted to Rs. 54,693 crores. The cumulative amount of Japanese ODA sanctioned during the same period was Rs. 29,003 crores. By contrast, the cumulative amount of Japanese FDI approved in India during the same period was a mere Rs. 4,427 crores, a figure which accounts for only 8.8 percent of Indian exports to Japan, 8.1 percent of India's imports from Japan, and 15.2 percent of Japanese ODA to India. Relative to the impact of this bilateral trade and aid, the role of Japanese FDI in India has been limited (Murty, 1993; Esho, 1996).

2-3 ODA

In striking contrast to the disappointing Japanese response to India's NEP in terms of trade and FDI, Japanese ODA has risen immensely since 1990/91. Although Japan was already the top bilateral donor country to India since 1986, during the latter half of 1980s Japan's ODA share in total ODA authorized by India was still just 7.6 percent. But in 1990/91, its share in total ODA jumped to 21.0 percent and maintained that level up to 1992/93, when it jumped again to more than 30 percent of the total for the three years from 1993/94 to 1995/96 (Table 17).

From the mid-1980s, India has ranked among the top five recipient countries of Japanese ODA loans. In 1993 India ranked fifth, in 1994 second, and in 1995 fourth (Table 18).

In 1984, Japanese Prime Minister Nakasone visited India, the first premier to do so in 23 years. In 1985, when Indian Prime Minister Rajiv Gandhi visited Japan,

Table 17 Authorization of External Assistance to India (Rs. crores)

	Total	Japan (%)
1980/81-1984/85	16,761	947 (5.7)
1985/86-1989/90	44,971	3,424 (7.6)
1990/91	8,123	1,703 (21.0)
1991/92	12,708	2,677 (21.1)
1992/93	14,094	2,844 (20.2)
1993/94	14,034	4,343 (30.9)
1994/95	13,460	4,080 (30.3)
1995/96	12,163	4,676 (38.4)
1996/97	17,141	4,310 (25.1)

Source: GOI, *Economic Survey* (various years).**Table 18 Top Five Recipients of Japanese ODA**

(US \$ Million)

	1993		1994		1995	
1	China	1,351 (16.5)	China	1,479 (15.3)	China	1,380 (13.1)
2	Indonesia	1,149 (14.1)	India	887 (9.2)	Indonesia	892 (8.4)
3	Philippines	758 (9.3)	Indonesia	886 (9.2)	Thailand	667 (6.3)
4	Thailand	350 (4.3)	Philippines	592 (6.1)	India	506 (4.8)
5	India	296 (3.6)	Thailand	382 (3.9)	Philippines	416 (3.9)
Total	8,164 (100.0)		9,680 (100.0)		10,557 (100.0)	

Source: GOJ: Ministry of Foreign Affairs, *White Paper on Japanese ODA 1996*.

Japanese ODA to India nearly doubled from the 30 billion yen level. And then in 1990, when Japanese Prime Minister Kaifu visited four South Asian countries, including India, he stressed the promotion of political and economic dialogue, cultural exchange and cooperation, and the strengthening of ODA, and pledged to supply 100 billion in yen loans to India. And in 1991, when India faced an external debt crisis, the Japanese government supplied US \$ 600 million as a contingency BOP support. The Indian government's attitude toward Japanese ODA has undergone a major change from that time.

If we look at the composition of Japanese ODA to India, there has hardly been any change over time (Mishra, 1997). More than 95 percent of Japanese ODA to India was in yen loans both before 1990 and after 1990. The share of grants remained constant at more or less 4 percent, and technical assistance at less than 1 percent

Table 19 Composition of Japanese ODA to India

(100 million yen)

	Loan (%)	Grant (%)	TA (%)	Total (%)
1956-1990	11,518 (95.3)	493 (4.1)	81 (0.7)	12,093 (100.0)
1991	1,066	21	8	1,095
1992	1,119	43	11	1,173
1993	1,196	42	10	1,248
1994	1,258	34	12	1,304
1995	1,288	36	11	1,335
1991-1995	17,445 (95.6)	664 (3.6)	137 (0.8)	18,246 (100.0)

Source: GOJ: Ministry of Foreign Affairs, *White Paper on Japanese ODA 1996*.

(Table 19). This composition is thus very different from that of Canada, Denmark, Holland, Sweden, UK, and USA, which is mostly in the form of grants.

3. Images of India's Political Economy Frameworks in the Japanese Eyes

The three main pillars of the Indian political economic framework are: (a) India as a mixed economy system; (b) India as a democratic nation; and (c) India as a large but poor country. The combination of these three factors is very unique, and not comparable with other countries.

In the light of this framework, we find that the coverage of the NEP or the "structural adjustment programs" implemented since 1991 have not been so comprehensive. The objective of the NEP has been limited to liberalization of the mixed economy system that had ruled the Indian economy since Independence.

3-1 India as a Mixed Economy System

The economic system maintained by India since Independence was a unique mixed economy, where the public sector was by far predominant: investment priorities were determined by Government planning and the public sector units occupied key industrial areas. This unique system was formed during the Second Five-Year Plan (1955-60) and Third Five-Year Plan (1960-65). Mahalanobis growth model gave the theoretical underpinning. The Indian Government promoted import-substitution industrialization, and in particular promoted heavy and chemical industries using public sector units. All the key industries were entrusted to the public sector units (Chakravarty, 1987).

In addition, regulatory industrial policies were imposed against private companies. On the one hand protective policies were adapted to enhance indigenous technological capability and to protect indigenous firms from the competition of foreign countries. On the other hand, various license systems were introduced to allocate scarce resources. It was an economic system intended to promote economic nationalization through the quantity regime. This system which insulated itself from the competition of foreign capital, continued more or less up until 1991, although there were some movements toward liberalization starting in the late 1970s.

Neo-classical economists made a major contribution by extracting the evils of the Indian mixed economy system. Anne Krueger called this evil "competitive rent-seeking" and Jagdish Bhagwati termed it "directly unproductive profit-seeking activities" (Krueger, 1974; Bhagwati, 1982). Enormous time and money was spent getting licenses from the Government, and vast resources were wasted. In such a society, there was fierce competition for licenses, but once licenses were allocated there was no market competition. Moreover, the continuation of protective policies bred various vested interests. The results of the system were poor quality of goods and technology and a loss of international competitiveness of Indian manufacturing industries.

Looking back upon the twenty-five years of economic performance since Independence, Bhagwati explained that the main cause of economic stagnation was not "insufficient savings" but "the low level of productivity" (see also Ahluwalia, 1985).

And he continued that the main causes of low productivity were: (1) extensive bureaucratic control over production, investment, and trade; (2) inward-looking trade and foreign investment policies; and (3) a substantial public sector, going well beyond the conventional confines of public utilities and infrastructure (Bhagwati, 1993).

The ideas, which have supported the Indian government's economic reform since June 1991, are almost identical to the prescriptions of Bhagwati. The main contents of economic reform, in accordance with his prescriptions, are: (1) the abolition of excessive bureaucratic control over production, investment, and trade; (2) liberalization of inward-looking trade and foreign investment policies; (3) reform of public sector and/or promotion of privatization. Among these three main pillars of economic reform, it is trade and foreign capital liberalization that has made the steadiest progress. On the other hand, there has been no substantial progress so far on the abolition of excessive bureaucratic interventions or administrative reform. There have been many different forms of public sector reform and/or promotion of privatization. Broadly they can be classified into four: (1) the opening to private companies of industrial fields which hitherto were the sole preserve of public sector companies; (2) the reconstruction or closing down of sick public sector units; (3) the selling of a part of the equity of public sector companies to the public; and (4) the exchange of MOUs between the Government and public sector companies to enlarge the autonomy and enhance the responsibility of public sector companies. Among these four categories, (1), (3), and (4) are progressing, but (2) "the reconstruction or closing down of sick public sector units" is hardly progressing at all.

It is difficult to imagine, but many leading Japanese businessmen believe that India was and still is a socialist country. This unfounded belief among Japanese businessmen has been created by the long-lived "license-raj" system and closed nature of the Indian economy.

3-2 India as a Democratic Nation

Parliamentary democracy as a political system has been rooted in India since Independence. Indians often take pride in calling themselves "the world largest democratic country." This political milieu is clearly very different from those of most developing countries, including the East Asian nations. In India, civilian control has been established and the armed forces have never intervened in politics. The 1998 general elections were the 12th consecutive election based on plural parties and general franchise.

However, the fact that on the one hand the East Asian countries including China have experienced remarkable growth rates under more or less authoritarian political regimes, whereas on the other hand India, under a democratic political regime, has experienced long term stagnation, casts new questions on the relationship between political regime and economic growth. Authoritarian regimes seem to be conducive to economic growth, whereas democratic regimes do not. Deepak Lal presented a typical argument. He stated that "A courageous, ruthless and perhaps undemocratic government is required to ride roughshod over these newly-created special interest groups" (Lal, 1983, p.33).

Bhagwati's argument is another example (Bhagwati, 1995). After explaining that "the quality of democracy" decides "the quality of economic development,"

Bhagwati presented four types of combinations of political regimes and markets. Namely:

- (a) Democracy with markets: these are the Western democracies; they performed well until the OPEC crisis; they also have generally good social indicators.
- (b) Democracy without markets: India is a prime example; it had deplorable economic performance and social indicators are also unsatisfactory.
- (c) Authoritarian rule with markets: China in the last decade, and the Far Eastern countries since the 1960s. They were able to quickly remedy poverty and their social indicators are not bad.
- (d) Authoritarian rule without markets: These are the former socialist countries. They are abysmal failures, both in terms of growth and social indicators.

Bhagwati then suggested three broad propositions.

- (1) Where neither democracy nor markets function, the incentive structure for production and innovation will have been weakened so much as to impair productivity and growth.
- (2) Markets can deliver growth, with or without democracy.
- (3) Democracy without markets is unlikely to deliver significant growth.

The aim of Bhagwati's discussion was to contrast India's "democracy without markets" and East Asia's "authoritarianism with markets" or "markets without democracy." He found that democracy, with its civil and political rights, including the ability to travel, work and be able to learn and invent abroad, has been well established in India. Because of this, the Indian elite had the advantage of access to modern education for a century, and was extremely capable and receptive of innovative ideas and technologies from the outside. However, the ability to translate those ideas and know-how into effective innovation and productive efficiency was seriously handicapped by the restrictions that placed straitjackets on economic decisions at all levels. By contrast, despite their authoritarianism, the East Asian economies profited immensely from the far freer inward diffusion of technology that their substantially more open markets permitted and facilitated.

His assertion was that India's economy has stagnated simply because of the lack of markets, which can transform the benefits of democracy into economic development. In other words, only if various regulations were "liberalized," could markets work well and the benefits of democracy are transformed into economic development. Is this true? Although Bhagwati himself pointed out that there is a close relationship between the quality of democracy and the quality of development, regrettably he ignored his own point and proposed that once regulatory systems were liberalized, the markets would work and the bottlenecks to Indian economic development would disappear. At first glance his argument appears to be political economic analysis, but in fact it depends on the very simple logic that the precondition for economic development is the functioning of the market mechanism. Here there is no insight into the political system itself (see Przeworski & Limongi, 1993).

The point which I would like to stress here is that today in Japan many influential scholars in the fields of development economics or area studies believe that authoritarian regimes are a necessary precondition for economic development, and that they are much more efficient than democratic political systems. In other words, these scholars are more or less the followers of Deepak Lal or Bhagwati. That is why not only Japanese scholars but also Japanese industrialists look toward India with

doubtful eyes.

As Bhagwati clearly recognizes, the Indian parliamentary democracy is in fact a political system "of elite, for elite, and by elite." "The dominant coalition" hypothesis of Bardhan [1984] is one of the best guides to understanding the nature of interests among dominant elite classes under democracy. Bardhan indicated that there are three dominant proprietary classes in Indian society: the industrial capitalists, the rich farmers, and the professionals in the public sector including white-collar workers. These three dominant classes make up the top 20 percent of the population, that is "the middle classes." But the interests of these three proprietary classes are not mutually consistent. Each class forms a "heterogeneous pressure group," and none is individually strong enough to dominate the process of resource allocation. Because of the existence of these diverse interests among the loose and uneasy coalition of the dominant classes, a public policy that satisfies every proprietary class has developed. Thus "an elaborate network of patronage and subsidies" was embedded in the policy-determined process, and corruption and black money have spread. As a result of this, the positive developmental function that the Government ought to have played was impeded. This is what Myrdal once called "a soft state" (Myrdal, 1968).

But with the dramatic changes of economic policy since mid-1991, "the uneasy dominant coalition" has changed somewhat. A lifestyle similar to that of the middle classes has permeated among the proprietary classes that belong to the top 20 percent of national income. As a result of this consumers' revolution, some salient changes have appeared in recent years. Bardhan [1992] stated that:

(1) The rich farmers have started to diversify their investments and to branch out outside agriculture into private trade and commerce, real estate, transport and into small and medium-sized industry. The powerful force of TV is also forcing farmers to become closer to the lifestyle of urban dwellers.

(2) The industrial class has also become somewhat diversified. A whole range of dynamic medium-sized industrial companies have emerged, sometimes providing intense competition to those perched in the top few big business houses. Increased competition has induced the notion that technological upgrading is the key to winning market competition. Thus on the issue of opening up the economy, there is now less division in the business community. CII, FICCI, and ASSOCHAM all support gradual opening up of the economy.

(3) There has also been a perceptible change in the attitude of the bureaucracy. There is a general feeling, particularly in the higher echelons, that the Indian state has overextended itself in the economy, far beyond the limits of its administrative capacity.

These new trends show that the influence of the industrial capitalists on policy formulation has been substantially enhanced during the liberalization period of the 1980s and 1990s. We can say that not only because of the changing international environment but also because of the changing internal political economy, liberalization is the only option for India today. With the consumers' revolution, the cycle of "liberalization leading to another liberalization" has been built in.

And this is precisely the fact that is leading Japanese investors to focus their attention on India today. The most important and interesting theme for Japanese industrialists is how to assess the size of the Indian middle class (see Rao, 1993).

3-3 The Middle Class and the Brazilian Model of Economic Development

India is the second most populated country of the world, following China. This "large size" in itself casts doubt on the possibility of India emulating the industrial experiences of the Asian NIES [Perkins & Syrquin, 1989; Chakravarty, 1988]. Not only this. The population of roughly one billion is divided by a variety of historically formed social factors, such as language, religion, caste, and gender. Because social mobility has been low, various systems of "divide-and-live-together" have developed in production markets as well as in factor markets.

The foreign-capital-dependent-development triggered by the economic liberalization policy has enlarged the consumers markets of the middle class. Among the urban middle classes, dubbed the "New Rich," caste consciousness is certainly fading away. The desire for consumer durables such as cars, two-wheelers, consumer electronics, and personal computers is immense. But just the top 20 percent of the population in terms of national income, at best, can meet such demand. We can say that economic development following "the Brazilian model," which was once a topic of discussion among Indian economists, is occurring at a feverish speed today.

It was through a paper by Celso Furtado that the term "the Brazilian model" gained its civil rights in academics (Furtado, 1973). According to Furtado, the Brazilian model indicates a special economic growth pattern, characterized by the following main factors: (1) economic growth which depends heavily on the demand for consumer durable goods by the rich class; (2) a supply of such durable goods by the MNCs; and (3) Government economic policy which makes the above-mentioned (1) and (2) possible. Since the late 1970s, Indian economists have criticized liberalization policy of the Indian government as following this Brazilian model (Raj, 1976; Nayyar, 1978; Patnaik, 1986).

The primary factors attracting foreign capital to India are the size of the internal markets, preparation of infrastructure (especially power supply), supply of cheap and good labor, and the small likelihood of labor disputes. These conditions are widely different among the different State. The Indian "reform and open up" strategy has already expanded the economic disparities among States. We can also expect to see increasing disparities among social classes in the future. Considering India's enormous population base, it is a big charm for foreign capital that 20 percent of total households belong to "the middle class" which has reasonable purchasing power. Even if we ignore the other 80 percent household of the total, still India has big markets. As long as the poverty problem does not become a political issue, and the debt crisis does not become a serious matter again, the Indian Government will certainly continue to choose the Brazilian model of economic development.

3-4 India as a Large Poor Country

Although India can certainly learn lessons from the industrial experiences of the East Asian countries, there are big differences in the initial conditions faced by East Asian countries and India. One of the fundamental differences is the size of the population. It is the vast and increasing population that casts the largest shadow on the future economic development of India. The Eighth Five-Year Plan 1992-97 estimates the growth rate of population at 2.12% per annum during 1981-91 and the

population for 2006-2011 at about 1,164 million. The vast size of population will aggravate the food shortage as well as energy shortage, and promote further environmental degradation.

It is highly plausible that India's economic development will be hampered by the population bottleneck. Chakravarty has argued that the difficulty facing the development of the South Asian countries, including India, lies in the fact that they have to initiate three crucial transitions: the demographic transition, the agrarian transition, and the transition towards an industrial society, all at the same time (Chakravarty, 1988).

Not only this. Two critical differences in the initial conditions between East Asian countries and India are land reform and education attainment. The high growth experiences of the East Asian countries, including Japan and China, were brought by liberalization policies implemented after they had met two pre-conditions, namely the fulfillment of land reform and the development of human capital (especially primary education). Regrettably in India even today these two fundamental pre-conditions have not yet been met. Compared with the other Asian countries, India's adult literacy rates are lagging (Table 20).

With regard to poverty indicators, there is a big difference between India and the East Asian countries (Table 21). Because of the massive population and the backward social development in areas such as education, health, sanitation and so on, vast numbers of the poor were left at the bottom of Indian society.

It is precisely this image of India as a large poor country that the Japanese government uses to explain the importance of ODA to India to Japanese people. And it is also this image of India as a large poor country that leads Japanese capital to be reluctant to invest in India even today.

Table 20 Adult Literacy Rates in Selected Asian Countries (%)

	1960	1980	1992
India	28	36	50
South Korea	71	93	97
Hong Kong	70	90	100
Thailand	68	86	94
China	n.a.	69	80

Source: Drèze & Sen, *India: Economic Development and Social Opportunity*, p.38.

Table 21 Changes in Selected Indicators of Poverty

Economy	Year	Percentage of population below the poverty line			Number of poor (million)		
		First year	Last year	Change	First year	Last year	Change
Indonesia	1972-82	58	17	-41	67.9	30.0	-56
Malaysia	1973-87	37	14	-23	4.1	2.2	-46
Singapore	1972-82	31	10	-21	0.7	0.2	-71
Thailand	1962-86	59	26	-30	16.7	13.6	-18
India	1972-83	54	43	-9	311.4	315.0	-1

Source: The World Bank, *East Asian Miracle*, p.33.

Lastly, it is needless to say that culturally and physiologically, Japanese are much more familiar with Chinese traditions than those of India and that most of us think that India belongs to another world, historically recognized as “*Tenjiku* (the Outer World near Heaven)”.

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