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AID SUPPORT FOR PRIVATE SECTOR DEVELOPMENT IN INDIA

Prepared for USAID, New Delhi
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FOREWORD

This report was prepared during the 11 weeks covered by the AID contract referred to on the face sheet. It largely reflects briefing and guidance received in meetings with many helpful people in the Asia, PRE and PPC Bureaus of AID/Washington; the State Department; the Commerce Department; OPIC; the U.S. Chamber of Commerce; The World Bank and the IFC; The IMF; Boston, Yale and Princeton Universities; The U.S. Embassy and USAID, New Delhi; The Ministries of Finance, Industry and Commerce and the Planning Commission, the Economic Administration Reforms Commission and several other agencies of the Government of India; several faculty members at the Indian Institute of Management - Ahmedabad; managers of several of the Gujarat State agencies and corporations concerned with industrial development; officers of several public sector banks and financial institutions; managers of a number of large and medium sized private companies and officers of several business associations.

While I am entirely responsible for the report, I received an exceptional amount of specific assistance above and beyond normal advice and guidance. I am not going to try to acknowledge all my debts, but must record those to the Ambassador and Embassy Officers for facilitating my access to key business and official contacts; J. Westley and his office, particularly M.C. Gupta, for assembling and very usefully abstracting a wealth of background information and materials, L. Rudel for contributing Annex A and other advice; and the Mission Director, R. Nachtrieb and G.P. Varshneya for providing extensive notes on fully two dozen meetings which they had held before I arrived precisely on the subject of my report with government, financial institution and business executives. The final report benefitted from discussion of and comment on earlier drafts by R. Brown, G. Carner, M.C. Gupta, R. Nachtrieb, L. Rudel, J. Van Der Veen, G.P. Varshneya and J. Westley.

I have not attempted to document and footnote the report. I should note, however that I have drawn heavily on the World Bank's annual "Economic Situation and Prospects of India" reports for 1978-1982, the Thorman/Gupta USAID report on "Employment in India", various issues of the CMIE "Economic Intelligence Service", the GOI "Sixth Five Year Plan" and a Workshop Paper prepared for ICRIER by Dr. I.J. Ahluwalia on "Industrial Performance of India: 1959-60 to 1978-79".

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SUMMARY AND CONCLUSIONS

India's industrial policies and programs from the fifties through the mid-seventies emphasized public control of the "commanding heights" of the economy and concentration on building up heavy industry to produce capital goods. These objectives were pursued by nationalization of key enterprises - particularly the major banks and financial intermediaries, - and by massive investment in public sector heavy industry. Trade, foreign exchange and industrial licensing policies also favored import substitution even at high cost and discouraged development of exports despite some limited and erratic offsetting incentives.

Serious difficulties with this strategy built up and were increasingly documented and recognized, particularly after the mid-sixties. These included:

a. Industrial growth slowed despite continued heavy investment. Production increases achieved were inordinately low in relation to investment, particularly in the public sector industries.

b. The public sector enterprises failed to generate profits to sustain additional investment. The consequent heavy drain on the budget starved investment in other areas and, inter alia, contributed to infrastructure bottlenecks further depressing productivity and income.

c. Productive employment generated in industry, particularly in the public sector, - was very low in relation to the scale of investment. Far from absorbing a rising share of the growing labor force, organized industry failed even to maintain its share.

d. Growth of exports was slow and often unduly costly leaving India with shrinking shares in most international markets, unable to expand in areas in which it is most productive and with a costly chronic foreign exchange shortage which became even more depressing with the sharp rise in petroleum prices.

Since the mid-seventies and particularly since the Congress (I) return to power in 1980 the Government has adopted a series of policy shifts designed to reverse these difficulties, mainly by giving private enterprise broader scope and encouraging its accelerated growth. The main changes included: liberalization of industrial licensing; encouragement of foreign investment, particularly in high technology and export industries; and liberalization of imports of raw materials, intermediate inputs, technology and equipment.

The individual measures taken were measured, limited and specific. While their net impact is substantial they do not represent any dramatic ideological shift. They constitute, however, a considered pragmatic application of lessons of India's experience which are now widely recognized. They are, therefore, not likely soon or lightly to be reversed, particularly as positive results become evident.

Rapid growth of private enterprise is, in India's circumstances, essential to achievement of AID's basic objective of enabling the poor majority to meet its basic needs. Growth and equity are not alternatives in India. Basic needs for the poor majority cannot soon be attained without faster growth of productive employment. Faster, more productive expansion of private industry is essential in addition to agricultural and rural development and slowing of population multiplication.

Therefore AID should be prepared to support the private sector contribution to achievement of India's development goals. It should make available the PRE instruments on a selective basis, whether or not it is determined that India should be designated a "target country". AID support can be especially helpful in a number of key areas:

a. Continued strengthening of Indian policy - particularly by supporting competent policy oriented research and analysis.

b. Strengthening capital markets to facilitate channeling of more savings to productive private enterprises.

c. Expanded Indo-American private and joint sector collaboration.

d. Increased private enterprise development contributing to or complementing other AID-supported programs.

e. Rapid growth of small scale, productive-employment-generating industry.

f. Rapid growth of exports.

g. Transfer of technolocy and equipment for energy conservation and development of non-petroleum energy sources.

In the final section of the report a considerable range of activities are suggested for consideration aimed at these key objectives.

INTRODUCTION

The purpose of this essay is to consider how the AID program can most usefully contribute to the sound development of the private sector in India. The primary focus is on private industry although it is not narrowly confined to manufacturing. It does not deal with farming as such or very much generally with education, health and other services; it does, however, in principle consider mineral industries and infrastructure and other services related to agriculture and industry as well as aspects of other services which contribute to or depend on industry.

It is timely and appropriate to take a systematic look at this subject both because of AID's continuing and heightened awareness that private response to the incentives and disciplines of free markets is in most circumstances the best guide and stimulant to sound industrial development and because Indian official and public opinion and policy has entered a phase in which it is turning to the private sector to play a greater role in accelerating and making more effective industrial growth.

It would be a mistake, of course, to exaggerate the role the AID program can play. Results will depend primarily on the adoption and effective execution of sound policies by the government and the response of India's investors, managers and workers. Probably the most important way in which the US and other friendly countries can contribute to the success of India's efforts is by ensuring that the external markets confronting India are as open, growing, dependable and free from distortions as possible. In addition, however, the resources and competence which AID can mobilize can make a significant contribution to the effectiveness of India's efforts.

While it is in a sense marginal, the importance of making this contribution is major. India has embarked on its effort to liberalize and open up its industrial policies in a critical period in its economic and political evolution. It has been moving with boldness and determination, but its approach is basically pragmatic and step by step. Sound policies will produce favorable results, but a lot depends on their timing and being clearly perceived. If they are prompt and widely recognized they will encourage and facilitate further improvement; if they are delayed and obscured confidence could be undemined and further progress jeoparidized. AID should give high priority to rapid identification and implementation of those things it can do that will contribute most to positive response by the private sector to its opportunity and challenge.

The first section of the paper reviews briefly the history and main features of Indian industrial policy during the first thirty years of independence. Part II sketchs the progress of industrial development, emphasizing the role of the private sector and the difficulties which developed and ultimately led to major policy revisions. Part III Describes the emergence and main features of the new policy orientation which has taken shape in the past two years, and assesses its strength and importance. Part IV suggests a broad strategy and set of objectives for AID support for private sector development in India and Part V sketchs and suggests priorities for an interrelated set of program elements designed to contribute to such objectives.

I. Evolution of Indian Industrial Policy

Even before independence came in 1947 some threads of industrial policy had begun to emerge in Gandhian and Congress thinking. The major modern industries developed to that point had been the jute and cotton textile mills. The one large steel mill was somewhat of an anomaly. Various economic and other constraints inhibited development of a broad spectrum of industries. Virtually all industry was in the private sector, though railroads and telecommunications and most of the power plants were public. Most modern industrial products were imported, particularly from England.

Pre-independence thinking in India very generally favored an extensive broadening of India's industrial structure and reduction of its reliance on foreign - particularly British - industry. Gandhian policy emphasized simple, traditional production with local self-reliance and independence virtually down to the household level. But there was also widespread enthusiasm in the Congress for development of modern industry and for achievement of substantial national self-sufficiency in major industrial sectors. A third theme was the Fabian Socialist desire to minimize domination of the economy and influence on the government by major industrial conglomerations - particularly foreign owned - and exploitation of both labor and the consumer by such private economic powers - foreign or domestic.

As specific programs and policies were developed after independence all three of these threads of policy played important roles. Efforts to support and encourage small scale decentralized traditional trades and crafts have continued throughout the subsequent years albeit with varying approaches and emphasis. The broad pattern of efforts to build up a largely self-sufficient modern industrial structure effectively controlled by the government took form particularly in the 1956 Congress Party resolution on industrial policy - which called for a major role for the public sector and effective public domination of the "commanding heights" of the economy - and the "Mahalanobis" development strategy reflected in the Second Five Year Plan (1956-1961) which gave top priority to the building up of heavy industry - particularly for the production of capital goods - designed to permit high investment without severe foreign exchange constraint.

Over the years a number of instruments were evolved and applied more or less vigorously to give effect to these policies:

Nationalization. Direct nationalization of existing industries actually played a rather minor role in building up the public sector share of manufacturing industry. The important nationalizations were mainly those of the major financial institutions, particularly the life insurance companies (1972) and the major domestic commercial banks

(1969 and 1981). These together with the postal savings system and the Unit Trust of India (a publicly managed investment fund) have indeed given the government virtually complete control of the intermediaries between private savings and industrial investment except for internally generated resources in private corporations, direct public subscription to corporate securities and other direct investment in or loans to enterprises by individuals. Such private mineral extraction enterprises as existed were mainly nationalized, most importantly natural gas and oil and coal mining.

Public Investment. The principal means whereby the public sector share in manufacturing industry has been expanded is by heavy public investment financed both directly through the budget and indirectly by channeling private savings through the publicly controlled financial intermediaries noted above to public sector enterprises. Thus the public sector has increased its dominance in a considerable number of major industries in addition to those reserved to it by the exclusive lists under the industrial licensing legislation.

Industrial Licensing. Under legislation first passed in 1951 all new capacity and substantial expansions of capacity other than for very small enterprises must be licensed. Under this legislation investment in a range of heavy and strategic industries has been reserved to the public sector; other industries have been reserved for small and cottage industry. The Monopolies and Restrictive Trade Practices Act (MRTP) of 1969 further limits the areas in which investment is permitted by industrial firms and groups of very large size or producing a large proportion of a product. The (FERA) of 1973 limits foreign equity in new ventures to 40% normally with higher percentages permitted in advanced technology industries, those in the "core sector", and those generating a high proportion of exports.

Trade Regulation. While not usually explicitly intended to favor the public sector, trade regulations can and often do favor the public sector industries. In the case of tariffs and export supports this could occur only to the extent that industries in which the public sector was large received relatively favorable treatment. Under quantitative controls, foreign exchange control and state trading public sector industries have often been directly favored. During most of the period since the crisis of 1958 an overvalued rupee and foreign exchange shortage have made import and foreign exchange licensing the dominant factor in allocation of imports. This has supported the role of the public sector as well as powerfully influencing the direction of private investment and production.

II. Growth and Structure of Industry and the Role of the Private Sector

In 1950 and still in 1960 manufacturing accounted for about one seventh of India's GDP. This has increased marginally over the years and reached almost 18% in 1980/81. As noted in the previous section, industrial development occupied high priority throughout this period in the successive five year and annual plans of the government. While substantial gains were undeniably achieved the results were clearly disappointing in a number of respects and not commensurate with the very large allocation to the sector of scarce resources. By the end of the seventies it was evident that there were serious shortcomings. Moreover it was proving increasingly unrealistic to endeavor to continue on the path which had been followed, and new external problems further added to its impracticability. This led to a substantial reorientation of policy and program which is still in progress.

The following paragraphs briefly consider a number of selected aspects of this experience which highlight specific issues and objectives which must be of special concern to the GOI in evolving its industrial policies and programs and which should be taken into account in planning AID support.

Heavy Investment, Rising Capital/Output Ratio and Slow Growth, Particularly in the Public Sector. Investment in manufacturing industry absorbed over a quarter of total gross capital formation throughout the period. At least two thirds of this went to relatively large "registered" companies and of that 60% (1971-1977) has been in the public sector. Real investment in manufacturing rose at a compound rate of nearly 9% per year for the entire period from 1950/51 to 1980-81 and in the public sector the increase was considerably faster, especially in the earlier part of the period. By the late 1970s public sector factories had nearly two thirds of the fixed capital stock of large and middle sized (registered) manufacturing industry.

The contribution of manufacturing industry to GDP rose considerably less fast - about 5 1/4% per year for the entire thirty years. Moreover it slowed down noticeably in theperiod since 1965 to a level not greatly in excess of the overall GDP growth rate. The performance of the public sector was particularly poor. Compared to its 2/3 of the capital stock it accounted for just over 1/4 of the value of output and under 1/4 of the employment in registered manufacturing firms during the late seventies. Capital/output ratios in manufacturing industry have risen steadily to extremely high levels by international standards. The Incremental rate from the mid-sixties to the mid-seventies was about 12% bringing the average to over 5% by 1977/78. Up to the mid-sixties the overall increase was partly the result of the faster growth of the more capital intensive heavy industries. But even during that period over 80% of the rise was the result of rising rates within virtually all industry groups. From then on they account for the entire increase[1/]. Such information as is available indicates that public sector industry entirely or at least largely accounts both for the high level and its persistent increase. In industry groups in which both are active, the average capital/output ratio in the public sector is twice or more that in the private and in most cases has been increasing while in the private sector it has in most cases been stable or even declining.

Low Employment Generation. Growth of industry has produced extremely low increases in employment, particularly in large and medium sized firms (down to ten employees). Despite the heavy investment in such industry it has not even succeeded in maintaining its share of total organized sector employment, dropping from about 28% in 1960/61 to less than 26% in 1980/81. As noted above, the public sector share in manufacturing employment, although it has increased from about one ninth in 1961 to 1/4 in 1981, remains far below its 2/3 share in capital stock. This despite notorious overstaffing in many public sector plants. Since organized sector employment in toto appears to have grown less rapidly than the labor force, organized industry, far from absorbing excess workers from the farm, has failed even to maintain its share of the total work force.

Failure of Public Sector Industry to Generate Savings for Further Growth. One of the arguments in favor of the emphasis on public sector industry was that its profits would be a major source of non-inflationary finance for continuing buildup of development investment. The results have been disappointing. The nominal gross profit of public sector manufacturing enterprises in recent years (1977-1980) has averaged about 6% on capital employed. Since substantial inflation occurred over the period in which their capital was built upt, this undoubtedly overstates the return because, e.g., depreciation is based on historical cost. In any case it is certainly less than a realistic real cost of capital. The net profit after interest charges has been substantially negative. Thus public sector manufacturing enterprise profits have made very little contribution to financing gross investment and none to net; the entire massive investment in public sector industry has been a charge on savings generated elsewhere in the economy - or abroad.

While there are no comprehensive, consistent series on savings in private manufacturing enterprises, it is clear that they have been substantial. A number of RBI and other studies of sample groups of corporate and larger scale enterprises have shown internal generation - from depreciation and retained profits - of upwards of 40% of gross capital formation - equal in many years to gross expenditure on fixed assets.

1/ There may have been shifts within industry groups to more capital intensive products.

This failure to generate investment resources, largely caused by excessive capital output ratios plus in some cases unrealistic pricing of output, and the resultant heavy burden on the budget were probably the most important factors forcing reconsideration of GOI industrial policy. To sustain rapid growth of public sector industry would have required continued massive increases in allocation of scarce investment resources to public sector industry, increasingly starving other areas of investment - both public and private. In fact it did not prove possible to continue on this track. Public sector investment in industry leveled off noticeably after the mid-sixties; investment in other essential public programs - e.g. railroads, power and coal mines - was squeezed and began to build up bottlenecks slowing growth in many areas; and private industry growth was slowed by slowed demand for basic and capital goods, preemption of investable funds by the public sector and shortages of power, coal and transport.

Misallocation of Resources and Failure to Generate Exports. As noted above, the maintenance of an artificially high exchange rate with imports controlled by a complex system of trade and foreign exchange licensing made for a highly (ad often seemingly haphazardly) protected domestic market and a generally discouraging export market alleviated in varying degrees by special incentives for some products. Domestic price controls, allocations and subsidies further complicated the picture. The severity and pattern of these market manipulations was also changeable, adding a strong element of uncertainty and risk to business calculations. A number of studies were done in the sixties and early seventies which showed conclusively that the result of these market distortions was very costly in many cases in the sense that they provided incentives to produce import substitutes and a few exports at extremely high cost in domestic resources while discouraging other production which would have saved or earned foreign exchange at much lower cost. Thus there were powerful incentives to increase investment in excess capacity, to fight for licenses to import equipment and supplies in preference to buying domestic products, generally to develop capacity for the domestic market rather than for export markets, and to produce particular products in preference to others without regard to the most productive use of the resources involved. Much managerial talent and energy was devoted to figuring out how to manoeuver through the bureaucratic maze rather than how to produce more and better output at reduced cost.

It is extremely difficult to quantify the harm done by such distortions. Clearly, however, one major - perhaps the most damaging - result was to stunt the development of exports far below what might have been achieved. The costs to the Indian economy of this shortfall have been and continue severe as the resultant chronic foreign exchange scarcity has been compounded by the adverse movement of petroleum and other prices.

The Uncertain Role of Small Scale and Rural Enterprise. Information is sketchy and suspect on the characteristics and - even more so - evolution of the smaller scale manufacturing and other enterprises not registered under the factories act and not covered in the annual survey of industry. Enough is certainly known, however, to indicate that they are important in several ways and to suggest that the efforts to encourage their growth and increased productivity are not misplaced. Small and very small non-farm enterprises (admittedly a vaguer and broader term than manufacturing) provide the livelihood of appromimately 20% of the work force - 45 to 50 millions1/. Estimates of total employment in manufacturing were on the order of 22 million in 1977-78 when manufacturing employment in the "organized sector" was less than 6 million. Capital per employee is many times higher in large scale enterprise than in small so that even though value added per employee is much higher the capital output ration is about twice as high for large scale manufacturers. Moreover small scale manufacturers produce a surprisingly large share of exports of many products - perhaps a third or more of total exports.

On the other hand growth of output of the smal' scale sector over the past thirty years seems to have been well below that of the large; capital output ratios in quite a few specific industries in which both operate are as high or higher in the small scale sector2/; and the remuneration per worker in many small enterprises is extremely low - often well below the poverty line3/.

Small scale enterprises cover a wide variety of quite different types of activity. Some major types include small modern enterprises using sophisticated technology and equipment; these are often not particularly labor intensive and are usually located near major urban markets. Ancillary suppliers of large scale industry are normally located in proximity to such larger factories. Traditional producers of simple consumer products mainly for local use are widely dispersed in rural and urban areas. Producers of traditional quality handicrafts mainly for the urban or export market tend to concentrate in particular areas - rural or urban. Many producers of supplies and services for agriculture and initial processors of agricultural products for local use or urban markets must be located in rural areas. Each has special needs and potential.

A wide range of programs has been developed to assist small scale industry in various ways - restriction of competitive production by larger firms; provision of infrastructure including estates; special credit and even equity financing - often subsidized; raw materials supply; equipment supply and financing; advisory services and training; and marketing assistance. Many are primarily State programs and all must

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1/ WB, 78, p. 77

2/ WB, 79, p. 90/Table 4.7

3/ Idem p. 93

perforce be administered through decentralized organizations. Some appear to be quite effective for some types of small industry, at least in some areas. Yet in toto the level of development finance devoted to them has not been great - less than 10% of plan expenditure on industry - and they are often costly in comparison with apparent results.

III. The New Orientation of Indian Industrial Policy

As noted above, there has been increasing recognition in business, academic and government circles of the need to improve the effectiveness of Indian industrial development. The salient needs variously emphasized include: accelerating growth to or beyond the rate achieved up to the mid-sixties; using capital and other resources more efficiently - increasing real productivity; accelerating growth of productive employment; generating more savings without increase in burdensome taxation; rapid expansion of exports and efficient import substitution; and economizing use of energy and expansion of domestic energy production.

A number of measures designed to improve the situation have been attempted and at least partially implemented over the years. The most ambitious until recently was the devaluation and liberalization of trade policy undertaken in 1966-67 with strong World Bank and Aid Consortium support. Unfortunately its launching coincided with the disastrous two year drought. Its favorable impact, although probably significant, was outweighed and obscured by the severe setback from the drought. The program - particularly the devaluation - was widely regarded as a failure. This, together with the allegation that if had been imposed on Mrs. Gandhi's government by World Bank and donor pressure, were exploited by the opposition in the 1967 election. Some of the gains of the program endured, but the impact of the drought and inability of the donors - e.g. the U.S. - to fulfill their aid level commitments after the first year limited and curtailed the extent of trade liberalization. This experience unquestionably set back the cause of liberalization -- perhaps for a decade.

During the intervening years support for change built up. Already during the Emergency a more favorable attitude toward the private sector and disposition to give it a larger role began to be reflected at least in the administration of economic policy. The Janata Government at least in principle turned toward considerably reduced emphasis on public sector investment in heavy industry. When Mrs. Gandhi's Congress Party regained power in 1980 the time was ripe for significant change.

Over the past two years the Government of India has adopted a series of measures designed to achieve the objectives outlined above. The measures taken have been piecemeal and pragmatic. They are not limited to increasing directly the private sector role; they included revised priorities and efforts to improve implementation of public sector programs as well. For the most part they have been accomplished by changes in the administration of the instruments of control; the basic apparatus remains largely intact. Nonetheless they add up to a very substantial liberalization of industrial and trade policy and regulation markedly increasing and rationalizing the role of the market in guiding industrial investment, output and trade and increasing reliance on and opportunity for the private sector - both domestic and foreign. That this was the concious intent was made clear in the Industrial Policy Statement of 1980.and has been repeatedly confirmed, particularly in announcement of this year's import policy.

The principal changes in policy directly encouraging private industry include: industrial licensing was liberalized to permit automatic increase of licensed capacity within a broad range; exemption from licensing for small units was expanded by increasing the size limits; price controls on a number of key products were dropped or relaxed including particularly steel and cement; restrictions on expansion of capacity by large industrial groups were relaxed in a number of industries and authority secured to authorize further expansion or new investment in high technology, heavy investment or export oriented industry; the permitted share of foreign ownership in such industries can also be - and has been in a number of recent cases - raised above the normal 40% to as high as 100%; quick decision has been promised on industrial and FERA licensing proposals and reportedly performance has largely met the promise; import licensing of raw materials has been liberalized to the point where they are practically available on demand; licenses for foreign procurement of equipment and technology by exporters are virtually automatic; and licenses for technology and other sales and management foreign exchange expenditures have been greatly liberalized; private companies have been authorized and encouraged to raise capital abroad directly instead of depending only on the public sector intermediaries.

A pattern of development which is being actively promoted, particularly by some of the State industrial development institutions, is the joint sector enterprise. This seems to offer very considerable scope for both domestic and foreign private companies to move into new areas on an advantageous basis. Arrangements can be negotiated within broad limits, the essential feature being a sharing of the promoter's equity between the private partner and a public sector body (for instance, the Gujarat Industrial Investment Corporation) and sometimes public shareholders. Management is normally left to the private partner, regardless of the shareholding pattern. The public sector partner can often be helpful in dealing with various problems which may arise for the joint venture. Understandings with respect to dilution of the public sector partner's equity position when the enterprise is operating successfully seem to be negotiable. The GITC currently reports that it has six such projects in operation, 19 under construction and over 55 in various stages of negotiation. In many cases these include foreign private partners, often along with domestic private interests.

In addition to measures directly affecting private industry a number of others are in process which will improve its prospects.

Perhaps most important, the government is reviewing the priorities of the public sector investment program to give top priority to overcoming bottlenecks in key infrastructure needs in power and the railways. Prices have been raised substantially in a number of public sector industries and intensified efforts undertaken to increase efficiency in order to generate adequate returns on the capital invested in them and reduce their drain on capital markets. Other measures with the same end in view are also being taken and the government has undertaken a serious study (The Rangarajan Committee) for the first time of the overall financial needs of private industry and how they can be accommodated within the total pool of savings and external resources and reconciled with public sector needs.

An important factor contributing to the feasibility of these reforms and confirming the GOI's firm commitment to them is the GOI understanding with the IMF underlying IMF's SDR 5 billion Extended Fund Facility commitment. The IMF resources provide a cushion enabling India to maintain import liberalization during the adjustment period until the revised financial, trade and industrial policies have time to take effect and restore balance of payments stability with the more liberal trade and industrial policies.

In short the improved opportunity and challenge to the private sector is real and substantial and not likely to be quickly or casually reversed. It is true that it is limited and pragmatic. It certainly represents no philosophic conversion to monetarism or the invisible hand. One could wish it went further; consumer products are still virtually completely sheltered from international competition, for instance, and the major financial intermediaries remain almost entirely in government hands. But it does substantially broaden the scope for private enterprise. The judgment that this new policy orientation is likely to be durable is based, in addition to public pronouncements and undertakings, on the very fact that it does represent pragmatic recognition of the realities of India's experience. These realities cannot be rapidly changed. It is true that virtually the entire apparatus of control and restriction remains and that its application could be tightened again[1]. But the basic fact, now widely recognized, is that unless and until the productivity of public sector interprise has been dramatically increased the only chance for rapidly increasing industrial output, employment and income lies in providing scope and incentive for rapid private sector growth. Public sector performance is not likely to improve rapidly. It will require overcoming stubborn, deeply intrenched political, motivational and management problems.

Able and respected officials known to be sympathetic to the new approaches have been put in key positions. Moreover a prestigious Economic Administration Reforms Commission has been established which has played a role in developing the program to date and is expected to identify further changes in the same vein. Over time these reforms should result in major improvement in the efficiency and vigor of Indian industry. Needless to say it is important for improvement to be as quick and widely felt as possible to strengthen support for continuation and further development of these policies.

1/This may well result in lingering doubts slowing business reaction to and the positive results from the new policies.

IV. Private Sector Development as an Objective of the AID Program for India

The underlying direct objective of the AID program in India is to encourage and support India in planning and carrying out programs to enable all of its people, especially the very poor, to increase their incomes and welfare to acceptable levels and to achieve national self-reliance.

In India's circumstances achievement of this basic goal requires rapid per capita economic growth and better distribution of income and public services. Growth and equity programs are not alternatives. Both are necessary as well as effective measures to slow down population multiplication.

Over the years the GOI has labored steadfastly to accelerate income growth by sacrificing current consumption and soliciting foreign assistance to build up investment in development programs.

Programs in agriculture were initially somewhat neglected, but are now generally receiving good support. Many problems remain, but the broad lines seem to be on track.

The basic industrial strategy of massive public sector investment in heavy industry, however, has not succeeded. The returns have been woefully incommensurate with costs (vide Part II, above).

Savings and investment have been raised to over 22* and 25%* of GDP respectively - high levels for a country with per capita income less than $300. It is not likely that this can be greatly increased until after considerably faster growth is achieved, particularly as foreign aid levels have tapered down from some 3% of GNP in the mid-sixties to about 1% more recently. To accelerate growth it is essential that a higher return to investment be achieved. This should be possible. With current investment rates efficiently used the country should be able to increase income at 5 to 6% per annum instead of the 3.5+% persistently recorded to date.

With the strong encouragement of the World Bank, the IMF and the OECD countries generally, India over the past two years has made major changes in its industrial and trade policies designed simultaneously to raise productivity and bring about adjustment of the economy to the radically changed would market and price structures. (Vide Section II, above.)

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*Gross National Savings and Gross Investment, respectively, : GDP in 1981-82.

The new orientation is sound and entirely in accord (so far as it goes) with U.S. convictions on effective development strategy. Its success is essential to achievement of the objectives of the AID program and more generally favorable to US interests. A more open and faster growing Indian economy will be a better market for US goals, a better source of labor intensive imports and offer better opportunities for mutually beneficial investment and industrial collaboration.

AID should adopt support for private sector growth and efficiency as an independent, direct objective of its of its program for India, parallel rather than subordinate to its support of programs designed to increase directly the productivity and welfare of the poor majority.

This does not imply that equal amounts of AID money should be allocated to PE promotion. Continued progress in agricultural and rural development, family planning and basic health services remain the indispensable bases for a better life for India's millions. Nor does it mean that all AID-financed activities should not be tailored insofar as possible to contribute to both objectives. What it does mean is that it should be accepted once and for all that in the current Indian context efficient growth of private enterprise in relatively free markets is itself essential to ultimate achievement of acceptable income and welfare for all. Where an AID activity can make a critical contribution to promotion of such private sector growth, that should be an acceptable justification for it. It should not be necessary to relate each activity individually to poverty alleviation either by repeating the general analysis or by some tortured attempt to demonstrate a direct linkage.

This raises on overall AID policy question: Should AID designate India as a target country for purposes of the AID PRE program? India clearly meets in reasonable degree the selection criteria: it has a viable private sector encouraged and supported by the government, it is of strategic and commercial importance of the United States, and it has an AID mission. Beyond that, as has been stressed repeatedly above, it is a country in which the private sector now has increased scope for development and in which the growth of the private sector is critical for achievement of the country's and AID's program objectives. Many of the PRE program instruments can contribute importantly to private sector strategy elements which this report recommends, as will be indicated below. Whether or not India is formally designated a target country, therefore, PRE should be prepared to consider high priority proposals at least on a case by case basis.

Formal designation should be carefully considered from the standpoint of its impact both at the Indian and U.S. ends. It would clearly have some positive aspects. It should further encourage U.S. companies to approach with a positive attitude Indian investment and collaboration opportunities. There are also, however, some possible problems. At the Indian end it would be essential for the government to agree that such designation would be constructive. It might fear that such an overt announcement would seem to compromise its economic autonomy and make it more rather than less difficult for it to take positive decisions on specific issues.

Both at the Indian and U.S. end it might somewhat backfire in seeming to accept as satisfactory from a private enterprise standpoint a regime in which a very large and active public sector will continue and liberalized trade and opportunities for foreign investment remain significantly circumscribed.

Before any announcement is made the GOI should be formally consulted and if it does not agree, that should be definitive. But it should not be consulted unless the decision has been made that it will be designated if it does agree.

Specific Areas for AID Program Support. AID should be prepared to use its influence and resources to encourage and support Indian private sector development through all channels open to it, assigning priority to possible efforts in accordance with their likely cost effectiveness.

Some of the most important things the US can do to this end are outside of AID's direct responsibility. The most important is maintenance of open growing markets for rapid expansion of India's exports of a wide range of products. AID should ensure that those directly involved in formulating and negotiating US trade policies are kept aware of the importance of this factor and seek ways to dramatize it in relevant circles.

Only less important is strong US support for continued World Bank and IMF programs encouraging and funding India's trade and industrial policy liberalization. This is closer to AID's "turf" and it should actively support and help to "sell" responsible US actions in this area.

Of comparable importance and much more within AID's control are the funds, technology and expertise which AID controls or can procure or enlist from government, academic or business circules. It is to the most effective deployment of these resources that AID must devote its principle effort.

In assigning priorities both what India needs most and what AID can most effectively provide need to be considered. Probably the most important constraints on private industrial development over the medium term are likely to be shortages of power and railroad transport. Yet it would be a low priority use of resources for AID to attempt to help generally in these fields. Billions of dollars are required and the World Bank is deeply involved. Only if some unique target of opportunity should present itself where US technology or expertise would make a critical, big-payoff contribution should AID consider getting involved. AID as a relatively minor aid source can reponsibly be highly selective in directing its aid to areas in which the US has special strengths and can realistically expect to make a significant contribution to India's progress over and above the importance of its financial resources. This is not to say that these resources are not themselves important. The scale of India's development programs is directly related to the availability of outside resources as well as to its own efforts. Beyond that, in the present situation adequacy of total aid is exceptionally critical. If adequate funds are not available to sustain the liberalized import regime while the economy is adjusting to the new policy environment and regaining balance of payments equilibrim, then the liberalization program could be undermined. The very threat that this might happen could contribute to hesitant adjustment to the new situation. India needs all the financing it can get over the next year or so. Withing the conceivable range AID should provide as much as it can, whether or not highly catalytic uses for the entire amount are identified. It remains true, however, that at likely levels it should be possible to find areas in which AID can exploit special US competence and made a contribution beyond the purely financial. In this light and taking account of the views of a range Indian scholars, officials and businessmen consulted by me and other Mission officers, I would recommend that AID proceed in a careful and systematic way to develop program activities aimed at the following seven specific objectives:

1) Further improvement of policies and programs affecting the private sector;
2) greater effectiveness and efficiency of the Indian capital market;
3) expansion of Indo-American joint ventures and collaborations;
4) expansion and improvement of private enterprises ancillary to aid-supported irrigation, rural development, health and family planning programs etc.;
5) expansion of economic, small scale, productive-employment-generating enterprises;
6) rapid expansion of private sector exports; and
7) accelerated energy developing and energy saving modernization and expansion of private industry.

The reasons for selecting these specific objectives or strategy elements are summarized below. In the final section possible activities under each are outlined and some suggestions made on priority and phasing.

The first three of these proposed strategy elements are in a sense horizontal, cutting across most sections of private sector enterprise. The other four are more vertical, focussing on particular categories of private enterprise which are important and appropriate for AID attention.

Numbers four and five represent new emphases entirely consistent with AID's traditional concentration on programs directly aimed at helping the poor majority to raise their productivity and income. Number four, in fact, is merely a restatement and highlighting of an element which the Mission has included in its programs over the past several years. Number five too builds on previous AID work, particularly the Thorman/Gupta report of August 1981 on "Employment in India".

Numbers six and seven recommend AID support for private sector development in areas which are of critical importance to the success and continuation of India's new industrial policy orientation and in which U.S. experience and technical resources can make unique contributions.

These categories are not hard and fast and can obviously overlap. Activities primarily focussed on each objective can often - and should, when feasible - contribute to some or all of the others. Nevertheless they provide a logical and realistic set of foci around which to organize program planning and determination of priorities.

<u>Analysis and Further Improvement of Policies and Programs Affecting Private Enterprise</u>. There is a major need for more and better monitoring of the performance of private enterprise in India and analysis of the reasons for its successes and shortcomings and the effects of present and proposed policies and programs. As was noted above (e.g. in Part III) the change in India's industrial policy orientation, while substantial and important, is limited in its scope and is still evolving. Also, it is definitely pragmatic Its main features rest on a substantial body of analysis which is now mostly ten years old. The case for further improvement - or, for that matter, for adjusting the improvements already made in constructive rather than destructive ways - can be most effectively made on the basis of reliable up to date information and competent analysis.

It is generally agreed in Indian business circles and among students of the Indian economy both in India and the United States that there is an important need for policy oriented research and analysis on a broad range of subjects from across the board macro economic issues to intensive analysis of particular industries. Among the areas often identified are the following: the impact on savings of alternative tax, price and interest policies; the effect and importance of tax policy in determining decisions between more and less capital intensive technologies; interaction between alternative trade policy regimes and exchange rate equilibrium; updated and extended monitoring of the domestic resource costs of foreign exchange earnings and savings under current and proposed degrees of trade liberalization and exchange rate policy; in depth analysis of current and potential areas of comparative advantage and obstacles to their rapid exploitation; the extend to which tax, price and wage policies influence - and perhaps misdirect - investment and production decisions as between products and processes; markets and marketing methods for major potential Indian exports; implication for policy of the benefits and costs of foreign private investment in India and the implications of the advantages and disadvantages of India compared to other possible locations for potentially advantageous international investments. The cost-effectiveness of a whole range of programs and policies and of varying combinations of programs and policies designed to promote productive employment in small scale, labor intensive enterprises. These are only a few of many important areas of concern.

Efforts to expand and improve such research and analysis merit active AID support for two main reasons: First, positive Indian policy making requires it; particularly in the present circumstances when changes are being made pragmatically and piecemeal there are serious dangers that changes apparently constructive in themselves made in the absence of other complementary changes will be ineffective or even have unanticipated negative effects. An example would be a substantial liberalization of import restrictions which could undermine foreign exchange balance unless a corresponding adjustment were made in exchange rate policy. Second, AID itself must have the benefit of such research and analysis if it is to be effective in advising Indian authorites on policy issue affecting the success of AID supported programs or broader issues.

Certainly the U.S. has the competence to make a special contribution to the planning and conduct of a considerable range of the types of studies needed. The U.S. has by a considerable margin the world's largest concentration of high quality institutions and experts for research and analysis on economic and development policy issues. These include the greatest concentration outside of India of scholars with direct experience in working with Indian data and problem - including a number of outstanding economists and other experts from India.

Improvement of the Effectiveness and Efficiency of Capital Markets. The Sixth Five Year plan calls for Rs.1,742 crores ($1.74 billion) per year (1980-81 prices) to be raised from outside in addition to an equal amount generated internally to finance private corporate sector investment. Such figures can, of course, be no more than rough indications, but if private sector expansion is to proceed at anything near the rate one would hope, something like that order of magnitude will be necessary, which is about a 30% increase in real terms over the best that has been achieved in the past.

Taking account of the impact of public sector needs, likely levels of foreign aid and what India can attract or afford in international money market borrowing suggests that the amount raised through the domestic capital market i.e. by increased public holding of stocks and debentures, will have to rise dramatically if the target investment level for the private sector is to be approached. A sustained level at least double in real terms the recent average might be needed.

IFC studies of country financial system profiles have shown that total per capita financial asset holding and bondholding in India are relatively well developed, exceeding by a wide margin the levels in most countries near its income level. Stockholding, however, is relatively low-- about 4% of GNP. According to informed reports, markets are thin and the exchanges function relatively clumsily so small investors hesitate to buy stocks and smaller companies are reluctant to undertake the costs and work required to list their shares. There are also complaints that the regulatory environment is on the one hand cumbersome and inhibiting to the companies and on the other not sufficiently protective of the small investor.

There should be considerable scope for improving the operation of the Indian stock markets and for eliciting broader participation. This could improve the prospects for financing accelerated private sector development by encouraging increased savings and divertings savings from less productive assets. It would also make the financial structure of private companies less vulnerable and make them less completely dependent on the public sector financial intermediaries for capital they must raise externally.

U.S. expertise should be able to make a unique contribution to the strengthening of the Indian capital market. Shareholding is more prevalent in the United States than in any other major country and U.S. exchanges and brokers are among the leaders both in efficient operation and in encouraging widespread ownership of shares.

While all other major financial channels are dominated by public sector institutions and appear to present a fairly complete array, there may also be opportunities for promotion of specialized private sector intermediaries or even for the introduction of some private competition if a persuasive case can be made that it would serve a useful purpose. It may prove worthwhile to support selective studies of such possibilities.

Expansion of Indo-American Joint Ventures and Collaborations. It is hardly necessary to argue the case for encouraging the greatest possible participation by U.S. companies in joint ventures and collaborations in India. American - as other foreign - companies can bring improved technology, management, marketing expertise and connections, and finance to India and thus contribute to increased investment, efficiency production and sales - particularly export sales. Given a reasonably open and undistored market virtually any joint venture or collaboration upon which the partners can agree can be expected to make a disproportionate contribution to accelerated and more effient growth of the Indian private sector.

This is an area of obvious mutual advantage. Joint ventures and collaborations entail favorable markets for U.S. exports of equipment, components and services. They may also generate advantageous sources of needed imports.

Most of the things the U.S. government should do to support U.S. companies' participation in such collaborations are the responsibility of other agencies - the Commerce Department and the Foreign Commercial Service, OPIC and the Export-Import Bank. There are some areas in which AID support might make a contribution, however, and when careful analysis shows that such activities would be effective they would merit high priority.

Expansion of the Role and Effectiveness of Private Enterprises Complementary to Other AID Program Activities. No elaborate proof is needed that there is a range of ancillary and complementary functions tieing in to and essential to the full effectiveness of AID supported programs in irrigation, rural development, forestry, rural health and family planning, etc. That many of these functions are suitable for private sector activity and that they can be done more efficiently by private enterprises at great saving to the public sector in money and especially in scarce management resources is prima facie highly likely. That GOI administrators responsible for such programs should be suspicious and hesitant to rely on private initiative to perform important functions essential to the success of their programs is not surprising, particularly in view of their tradition and bureaucratic proclivities.

It is therefore entirely appropriate - indeed essential - for AID to make a special conscious effort to identify functions that can most effectively be performed by private enterprise; to analyze the policies, encouragement and support necessary to ensure that private enterprises will perform these functions promptly and fully; and persuade the government to give the private sector the support needed and rely on it to do the job.

The range of functions which can be considered is broad. It could for instance include: distribution and servicing of pumping equipment; sale and delivery of tubewell water; production and installation of water distribution and control facilities; land levelling and preparation services; formulation of fertilizer and pesticide blends tailored to local conditions; sale of same; application of pesticides; procurement, storage, processing and marketing of agricultural products and by-products; production of improved equipment for cultivators; other services to agriculture and processors of agricultural products; production and distribution of medecines, equipment and supplies for health and family planning programs; and harvesting, preparing and marketing the products of social forestry programs. Many of these functions would naturally be relatively small scale, labor intensive and decentralized. These should receive special attention, but others should not be neglected.

Expansion of Small Scale Enterprise. As indicated above (Part II), small scale industry accounts for at least 70% of all industrial employment in India and small scale enterprises more loosely defined for as much again. Such industries and enterprises are virtually 100% private. Creation of productive employment opportunities for the rapidly rising workforce will for the next three decades at least be the key to improvement of the welfare of the poor majority. Capital/output ratios in many small industries are far below those in large scale industry. The Sixth Five Year Plan counts on small scale manufacturing to provide over four fifths of the additional jobs in manufacturing as a whole. Thus there is every reason both from a poor majority and a private sector standpoint to explore intensively what AID could do to assist accelerated growth of small scale private enterprises in India.

Earlier assessments have emphasized the difficulties involved in working in this area. The Lindblom, Boughton, et al. Mission report, "U.S. Bilateral Assistance to India: a Strategy for the Early 1980s" (June 1978), approached the subject with wholesome caution, noted the difficulties involved in mounting an effective program, characterized the Indian plans as "experimental" and recommended against "rapid build-up of AID resources" in experimental programs. The Thorman/Gupta report also emphasized the complexity and difficulty of the field. It did not include recommendations but in its comments seemed to suggest a carefully planned, beginning small, experimental program. The Mission decided, however, not to propose such activities for "1983 and beyond" at that time.

There are additional factors now arguing in favor of undertaking carefully prepared activity in this field. The generally more favorable policy environment and particularly the improved raw material supply position and relatively more favorable market structure for exports should facilitate the expansion of many small scale producers and reduce the need for special support programs. An additional year's experience with the relatively new District Industry Centers can now be assessed and has been reviewed by a broadly representative group convened by the GOI. A number of other programs at national, state, and local level have been under way by government, academic and voluntary agencies; these may offer new insights on the effectiveness of alternative programs - and their costs. Moreover it is timely to consider a broad range of policy issues that could affect importantly the prospects of small scale enterprise. For instance, some of the more arbitrary methods being used to support small scale enterprise, esp. by prohibiting larger scale production of certain products, seem incompatible with a free market emphasis of policy and likely to be costly in relation to the benefits obtained. Careful analysis of the real effects of such measures and of possible alternatives could be timely and important. Finally, AID has been undertaking in Asia and elsewhere an increasing number of activities designed to support small industry development and should now be better equipped to bring to bear not only the considerable experience with programs for US small industries but also increasingly the results of its analysis and experience in other developing countries.

Because of the potentially key role small enterprise development could play in increasing productive employment at modest capital cost, because of its preeminently private sector character, because of its substantial potential contribution to expanded export earnings and because it appears that U.S. experience and expertise may be able to make a significant contribution to Indian policy and program planning in this area AID should undertake a modest, carefully prepared set of activities. Substantial funding should be limited to programs which have been thoroughly studied and proven to be feasible and cost-efficient. A long range effort should be contemplated with emphasis in the early stages on review of present programs and policies, assessment of the merits of new and modified approachs and testing of attractive possibilities in a pilot project basis or in a limited area.

Rapid Expansion of Private Sector Exports. Rapidly increasing exports are of paramount importance for India. Exploitation of India's present and potential comparative advantage offers one of the most important avenues for sharply improving the payoff from investment. Moreover higher export earnings will be essential if the relaxation of industrial controls and liberalization of imports is to continue long without a persistent untenable balance of payments deficit. They are therefore an essential basis for the general improvement of productivity which these liberalized policies are expected to make possible.

The private sector represents the main hope of the future particularly in this area. Throughout the period of massive public sector industrial expansion, despite discouraging trade and exchange policy, the great bulk of manufactured exports (perhaps 3/4) were generated in the private sector. There is every reason to believe that the demands for initiative, flexibility and efficiency which are made by the fast moving situation in export markets can be met much more effectively by private than public management.

U.S. commercial, technical and management expertise can make a major contribution to improved institutional support and management effectiveness for export development. Joint ventures and collaborations can play an important role. AID has a good track record in this field in India. In the mid-sixties an aid project made an important contribution to developing India's export promotion policies and institutions and to the identification and exploitation of favorable export opportunities. Despite the fundamentally anti-export bias of India's broad trade and industrial policy pattern significant gains were made directly traceable to AID's assistance. In today's more favorable policy context results should be even better.

Direct involvement in promoting specific exports to the United States is obviously somewhat risky for AID. It will be necessary to exercise care and discretion in considering specific activities for support. Nevertheless, the importance of expanding exports is so great that it would not be responsible to shy away from the field entirely. There are many things that can be done to help improve the policies, institutions, management competence, data systems, etc. for an expanded effort without becoming directly involved in sensitive specific trade flows.

<u>Accelerated Private Sector Energy Development and Energy Conserving Expansion and Modernization</u>. Despite rapid expansion of India's petroleum production oil imports continue by far the largest import item. In 1981/82 it accounted for over one third of total imports. Import substitution and saving in this sector remains only less important than export growth in validating India's moves toward trade liberalization and adjusting the economy to regain balance of payments equilibrium.

Private sector industry can and is believed to be ready to take the lead in developing alternative energy sources and increasing efficiency of energy use, in the context of realistic market prices and incentives.

The U.S. is far from the leader in the Western World in efficiency of energy use. But US industry and research institutions have been doing research and development work that is in the forefront in many areas and have been improving overall U.S. performance rapidly. In some ways US conditions are more similar to India's than the more compact European and Japanese economies. U.S. technology, equipment and expertise can help Indian private industry to improve its performance in many aspects of energy development and conservation and AID should seek ways to encourage and support exploitation of these potentials.

V. AID Activities to Promote Private Sector Objectives

The main sections of this part of the report propose specific activities that AID should consider undertaking to promote the seven strategic program objectives recommended and suggest priorities and phasing for development of each element of the program.

Several general considerations are reflected in these proposals. First, there is heavy emphasis throughout on policy oriented research and analysis not only under general policy improvement but under each of the program elements. It is always a good idea, when practical, to look before you leap into a new area. But it is especially essential in this area because of the importance and complexity of its policy aspects. As between policy and program, policy is more important and more open to change in this field than in most others. Part III above emphasized that the recent real and substantial reorientation of GOI policy was achieved piecemeal and pragmatically, not as the result of ideological conversion. The government was forced each step of the way by the facts - as they came to be understood. Further policy improvement in all aspects (and rejection of unhelpful changes) is of the greatest importance. To arrive at sound policy decisions the Government must have relevant facts and analysis and AID itself will need to be well armed with more than general philosophy if it is to exercise the constructive influence that it should.

It will not alwasy be easy to find the right auspices and secure needed concurrences for the conduct of desirable studies. GOI awareness of and at least passive acceptance will be essential for virtually all except the most in-house or U.S. based studies. Where feasible the best arrangement will often be to arrange for the study to be the responsibility of a competent and respected Indian organization with cooperation by U.S. experts when appropriate. The desirable degree of direct and overt U.S. Government involvement will need to be carefully considered in each case. Where possible needed studies can be tied in with specific program activities. In general AID must be imaginative and flexible in working out these problems and should be prepared when necessary to be generous in the use of regional and central PE and Research funds for important studies when country program funding is not feasible.

Second, where appropriate AID's effort should emphasize building up institutions to perform the needed policy and program planning and execution responsibilities which we identify. In the Indian context this may often involve choosing between trying to launch a new institution and trying to build on one - or one or more of several - already existing. Each case must be considered in light of all the circumstances, but in general AID should lean strongly toward existing institutions where possible; in many fields the confusion and duplication of effort already existing is an important part of the problem[1].

Third, where possible AID-financed support should be provided not only to private sector entities but by and through such entities. Again, in India the gray area is particularly broad. There is an array of public and quasi-public institutions which vary widely both in their formal legal status and de facto in the extent to which their operating decisions are controlled administratively by government departments or by autonomous bodies responsive mainly to market conditions. In the latter case, if they are working well, the best course may be to work through them and endeavor to strengthen and consolidate their autonomy.

Improved Policies and Programs

Objective: AID, and the U.S. Government generally, should encourage and assist the GOI in improving its policies and programs affecting private enterprise so that the private sector will contribute most effectively to the achievement of India's development objectives. To this end AID should also endeavor to strengthen independent as well as GOI institutions doing policy oriented research on relevant problems.

Strategy: To some extent there is room for direct representations and presentations to the GOI concerning desirable changes. These can sometimes be planned and scheduled or opportunities can be taken advantage of which arise in the normal course of relationships. For the reasons noted in Part IV above, however, Indian policy is much more likely to be influenced by hard facts and convincing analysis demonstrably relevant to Indian circumstances than by generalities or uncritical attempts to apply U.S. experience.

Thus the main basis for effective influence on Indian policy will be sound research and analysis. To some extent studies done elsewhere, where they can be shown to be relevant, can be helpful. AID should certainly keep abreast of and bring to the attention of appropriate Indian officials, and others concerned with public policy, studies which have been done elsewhere which have implications for Indian policy, e.g. descriptions and assessments of measures which have been taken aiming to bring private incentives in line with social interests and priorities. But AID should also give priority to encouraging and supporting competent studies bearing directly on Indian policy issues.

A number of such studies relating more or less directly to the other proposed program elements are mentioned in the following sectors

[1] Cf, e.g. WB 79 p.94

but more general studies should also be supported.

The auspices under which such studies should be performed and the selection of individuals/institutions to do them need careful consideration. These questions are important in all cases but are particularly sensitive in relation to general policy studies. The government of India must normally, of course, concur with undertaking the studies because otherwise it is not appropriate to use Indian Country Program Funds and the results are unlikely to be given sympathetic consideration by officials concerned with policy. Appropriate sponsorship will considerably improve the ease of getting GOI agreement and will add to the attention paid to and influence of the studies. The Mission will have to be imaginative and persuasive in working out these problems.

In virtually all cases it will be desirable to give an Indian institution primary responsibility for conduct of the studies, probably in most cases with support and collaboration of an American institution or experts. This too will facilitate both approval and favorable response as well as contributing to institution building. American participation can be useful to provide specialized background and techniques, specific experience with similar studies and issues in other countries and perhaps additional credibility, particularly when the study is aimed partly at a U.S. audience. It can also help develop a resource which can be drawn on in AID's program planning.

As noted above there seems to be considerable support building up for the establishment of a high level non-governmental policy-oriented institution to monitor the functioning of the economy, identify and analyze policy issues and recommend appropriate policies to government and other economic decision makers. It is quite possible that something will come of this fairly soon, though exactly what form it will take is not yet clear. Brookings Institution, the American Enterprise Institute, CED and NPA have been mentioned as possible models. One leading advocate of such a body has discussed it with U.S. officials and university representatives. USAID and the Embassy have considered whether some sort of U.S. support could be useful in launching such a body. The idea is attractive; such an institution could serve a constructive role in sponsoring competent analysis, bringing the results to public and government attention and focussing attention on important problems and likely solutions. However, it does not now appear that a direct USG role in setting up such a body would be productive. For the institution to command respect it must be free of any suspicion of dependence on any interested source and be recognized as being dedicated solely to the national interest.

An institution with similar though narrower focus recently launched with some support from the Ford Foundation, is the Indian Council for International Economic Relations (ICRIER). Headed by a Research on former Secretary/Ambassador now Chairman of a major private company, it has a prestigious Board including distrinquished government, business and academic leaders. It plans to sponsor policy relevant studies bearing generally on international economic relations and policies. Several are already under way. We have discussed its program informally with its Chairman. It appears that he would welcome - in fact positively wants - participation in some of the studies by carefully chosen U.S. institutions. He is sensitive to the danger of appearing to compromise objectivity and freedom from outside influence, but thinks that U.S. support to enable an appropriate non-governmental U.S. institution to collaborate on some of the studies would be acceptable and could gain GOI approval.

Program Recommendations: AID should seek ways to support responsible research bearing on important policy issues affecting private sector development sponsored by the GOI or well oriented non-government institutions. The Mission should proceed right away to agree on one specific study with ICRIER and to work out the modus operandi for financing at least the costs of participation by an appropriate U.S. institution and part of the costs of the responsible Indian institution. A number of subjects could be considered; one that seems a good possibility would be the labor intensity of major categories of imports and exports and the probable employment effects of alternative trade policies. This should be regarded as the start of a modest continuing program.

AID should keep closely in touch with plans for establishing a new, high level non-governmental body designed to monitor the working of the economy and develop recommendations for policy improvements. It should provide encouragement and be prepared to consider such support as may be needed and consistent with the institution's prestige and reputation for freedom from interested influence.

The Mission should develop a list of studies bearing on policies affecting the private sector and be on the lookout for opportunities to courage and assist appropriate institutions to sponsor and conduct them.

AID/W should systematically make available to the Mission (and other Missions) relevant studies - both general and related to AID-supported activities. The Mission should give more than casual attention to getting these into the hands of Indian officials and opinion leaders where they seem likely to do the most good.

Capital Markets

Objective: To strengthen the system of institutions, particularly private institutions, for mobilizing savings and channeling them to private investment contributing to India's development goals.

Strategy: AID should concentrate initially on efforts to make the stock markets more efficient to promote attraction of savings to ownership of corporate stocks. This seems to be an area in which the Indian financial system - generally quite evolved in relation to its stage of development - is relatively undeveloped and in which improvement could contribute significantly to private sector growth over the eighties. It is also one in which there appears to be a target of opportunity in which AID could make a useful contribution quickly and in the process gain a better basis for judging what additional support it should undertake.

At least one Indian company with U.S. (and other foreign) collaborators has been encouraged to develop a range of proposals for updated equipment and systems for operating the Indian stock markets. The Controller of Capital Issues confirms that the government is interested in plans for improving the efficiency of the stock markets. He has indicated that there would be interest in sending a selected team to the United States to visit one or two stock exchanges, metropolitan and provincial stockbroker offices the SEC and perhaps relevant equipment makers to observe the operation of the exchanges and brokers, the equipment they use for actual operation of the exchanges and for communications, the roles of the exchanges and brokers in encouraging broad public holding of stocks, etc. The team would include one or two from the Controller's office, several stock market officials and a few brokers.

Beyond this AID should explore whether other aspects of the securities markets appear to need help that would improve the flow of funds to private investment. These might include assistance, perhaps to the Controller's office and to the exchanges on procedures and standards for registration, training for stockbrokers in promotion of stock market investment, and/or a study of what could be done to make stockholding more attractive by way of tax treatment, improved security, etc.

The Mission should also explore more generally areas in which there appears to be need for new or improved financial facilities serving private enterprises, particularly in which private institutions could be most effective. A number of areas suggest themselves: would a number of privately managed more specialized investment funds have the potential to develop portfolios appealing to the needs of special groups of savers and draw additional savings into corporate investment beyond those attracted by direct stockholding or the UTI's several programs, is there need for new or additional private financial intermediaries to serve specialized needs not being met by the nationalized commercial banks, is there a case for permitting somewhat increased private competition with the nationalized banks, etc. , and where such needs seem to exist what would be necessary by way of policies and other support to bring them into being and facilitate their effective operation.

Program Recommendations: The Mission should determine rapidly whether the GOI would, indeed, like to send a team for a study tour such as outlined above. If so, AID should endeavor to move quickly to provide it. Perhaps the best procedure would be for PRE to send an expert consultant to work out with the GOI and prospective participants specific ideas on what would be most useful to them, the most feasible time period, etc. He could then assist at the Washington end in working out the program.

AID could also use the consultant and discussions incident to the planning of the team's visit and follow up after its return to help determine what other related activities or studies would be useful.

The planned PRE investment reconnaissance mission should provide an excellent basis for exploring and initiating discussion with the GOI concerning any additional needs for improvement of the scope or quality of India's capital market institutions and services to which AID should attempt to respond.

It is premature to consider what if any AID support might be warranted for second phases of any of these possible areas of activity. Some might provide opportunities for U.S. private investment or collaboration. Possibly some further AID technical assistance or training might serve a useful role. It does not seem likely that any large capital projects would be called for.

Indo-American Collaborations

Objective: The maximum practical participation by U.S. private companies in India's private and joint sector development.

Strategy: Private and joint sector collaborations are ultimately worked out among the parties to them. The principal things that governments can do to promote them are (a) create a favorable environment, (b) help potential collaborators to discover each other and (c) ensure that they have reasonable access to financial and foreign exchange resources.

AID may be able to play a role in helping to improve the policy environment for private sector collaborations in India in general or for U.S. ones specifically. The objective here is one which AID shares with other U.S. Government agencies - e.g. State, Commerce, OPIC and the Export-Import Bank at least. In India promoting private sector development is a prime objective of the FCS program. AID must plan its activities in close coordination with and taking fully into account the related functions of other agencies. As repeatedly emphasized, competent convincing studies are the main tool for effective efforts to influence GOI policy. Under the AID India country program it is more feasible to finance studies which are focussed on Indian policy generally, not relating exclusively to U.S. interest. The availability of PRE funds, however, can facilitate the latter type as well.

Studies showing the positive contributions by private foreign collaborations in other countries to objectives which India shares can help influence Indian opinion and should be used to the extent available. Studies specifically focussed on India are likely to be more effective, however. Such studies could deal with the costs and benefits of past foreign collaborations in India, areas in which collaboration could be particularly useful, impediments to success in attracting desirable collaborators, comparison of Indian and competitor policy environment for types of collaboration in which India is particularly interested, etc. The ICRIER is undertaking some work evaluating the benefits and costs to India of multinational investment. It might be the most appropriate sponsor for additional studies in this field which AID could support.

On issues specifically relating to U.S. private involvement in India, the Indo-American Chamber of Commerce has already done a useful study of the benefits to India flowing from current U.S. collaborations. It is quite sketchy, however, and the analysis is rough and ready. The Chamber Secretary General would like to sponsor a more comprehensive and in depth study. He hopes to have this considered at the Chamber's meeting later this winter. Obstacles encountered by U.S. firms attempting to work out collaborations in India would be pinpointed in this study. Problems flagged in such a survey or arising in connection with individual proposed collaborations may bring to light policy issues worth studying more systematically.

If commerce or some other more appropriate agency can not support such studies PRE might authorize the Mission to offer additive funds for the purpose. Alternatively, if additive U.S. owned rupees become available the Mission might see if agreement could be secured to use some of them in this way. Finally, in some cases it may be desirable to undertake a study unilaterally using PRE funds.

The competition among potential U.S. collaborators and those from other sources of investment, technology and management, while not a primary AID program concern, should not be ignored. The U.S. has been recently and apparently remains the source of the largest proportion of international collaborations in India, but others - particularly the Japanese - are clearly increasing their activity. Reportedly competitors often receive official support from their home countries which enables them to make very advantageous proposals. Some steps can be taken from the Indian end to find out what the competition is offering and consider appropriate U.S. response, but for the most part this would be much better done centrally on a more global basis.

Quite a few programs in addition to normal commercial channels already assist prospective collaborators to locate each other. The activities of the Business Council of the Joint U.S. - Indian Commission, particularly the exchange visits between business groups, provide opportunities. The prospective OPIC team visit has already generated over two hundred proposals and the visit itself is likely to produce more. The PRE investment reconnaissance team can quite likely stumulate additional interest. The continuing Trade Opportunity Program (TOP) of the Foreign Commercial Service offers a two way service for locating potential collaborators, among other things, as does the AID supported World Trade Institute (WTI)Program. There are, of course, a number of commercial economic information and intelligence services available. There are, in short, quite a few cooks at work.

It is obviously desirable that the available services - e.g. the TOP and WTI channels - be widely known and available in India. The Foreign Commerce Service working through the Embassy and Consulates General can best take the lead in this with AID cooperation. Beyond that it does not seem that additional AID activity of a general sort is needed. If AID becomes involved in attempting to strengthen more general economic information and technology transfer channels to small and medium sized Indian industry (see below) consideration should be given to how it could supplement the present "dating" services. When a specific need or opportunity for U.S. private investment and/or technology arises in connection with AID programs the positive initiative of PRE in project development (AID Policy Paper, Bureau for Private Enterprise Policy Paper, III, C.) could be very useful.

Private and joint sector collaborations in India have a fairly wide range of institutions to which they can turn for finance, including foreign exchange where needed. Total resources available to these institutions are however, limited by the dictates of responsible financial policy (particularly as reinforced by understandings under the IMF EFF arrangement) and by the overall balance of payments situation together with competing needs. Both constraints are likely to be severe over the medium term at least. Thus additional external resources easing these constraints can be important. They can probably also tilt the scales in favor of particular enterprise financed, perhaps in favor of specific categories of project such as U.S. equipment and technology for energy efficient modernization but probably not at all or only marginally, because of fungibility of resources, in favor of broader categories such as private and joint sector projects generally.

The great bulk of investment finance credit flows through institutions which are more or less government owned and controlled. The IDBI, FCI, LIC, major commercial banks and UTI are 100% directly or indirectly government owned and responsive on broad policy to government. They are individually managed, however, expected to maximize their returns subject to more or less constraining priorities, and have considerable managerial autonomy. The ICICI was originally entirely privately owned by individual stockholders and foreign and Indian companies. The Indian Company stockholders - 80% of the total - were largely nationalized, so the government has acquired de facto majority control. About 12% of the shares is still held by foreign private companies and 8% by private Indian shareholders Management seems to be autonomous and responsive to market conditions. There are only two government board members.

The AID "Cooley Loan" program is favorably remembered by the business community and the recent Mission review of its borrowers showed that it had indeed been remarkably successful in helping to finance projects which have made important contributions to Indian development. A comparable program would clearly be welcome to the Indo-American business community and, in addition to any real additional resources which it might entail, could inject a useful element of competition in the Indian capital market, particularly if channelled through private sector institutions.

Probably the sort of financial supports which can be most influential in increasing the incentives for U.S. collaborations, however, are those contemplated in the PRE program and the programs of other agencies - e.g. OPIC and the Export-Import Bank - which supplement and complement the ability of potential U.S. partners to take the initiative and to present a favorable proposition.

Program Recommendations: AID should take an active part in support of U.S. private collaborations in the private and Joint sector in India, working through and in coordination with and complementing other U.S. agencies such as Commerce, State, OPIC and Ex.-Im. AID's principal contributions should be in working for GOI policies which improve the incentives for foreign collaborators, assisting potential collaborators to find each other, helping U.S. potential collaborators to offer attractive propositions and improving availability of finance for U.S.-Indian collaborations.

To encourage GOI policy improvements:

1. The Mission should explore with ICRIER the studies it is doing on international investment in India and whether U.S. support would be useful and welcome for participation of U.S. institutions or experts in additional studies.

2. PRE should make available to the Mission (and others, presumably) any available studies bearing on the subject and the Mission should pass these on to appropriate GOI and other Indians concerned with the issues.

3. PRE should explore with Commerce and State how best to support further study under the auspices of IA CofC of the contributions to Indian development of U.S.-Indian private sector collaborations and how GOI policy could promote increased and more effective collaboration.

4. If any additive U.S.-rupees become available for PRE programs their use to finance such studies through ICRIER, the I-A CofC or other institutions should receive high priority.

5. The PRE investment reconnaissance team should discuss with business groups and GOI officials improvements which could encourage increased collaboration and include in its report appropriate recommendations.

To help potential U.S. and Indian collaborators to find each other:

1. PRE should make available its Project Identification and Development support for selected projects. USAID and AID/W should screen potential collaborations thrown up by all the channels available and determine which, if any, need and warrant PRE's active support. These would include particularly [illegible]s under program objectives 4,6 and 7.

2. PRE should work out with OPIC,Commerce and State arrangements for ensuring that the TOP and WTI services are made widely known to likely potential collaborators in India as well as in the U.S. Some guidance to the field would be helpful on how the two programs complement each other and are coordinated.

3. The PRE investment reconnaissance team's terms of reference should include identification and encouragement of potential collaborations.

To increase and improve the availability of financing to collaborations:

1. PRE should utilize appropriately its range of investment modes to support projects in India which meet its selection criteria.

2. If a substantial amount of U.S. rupees become available for PRE programs AID should endeavor to work out agreement to use a substantial amount for loans to U.S.-Indian collaborations in the private or joint sector. Agreement should be sought to establish a fund for such loans administered by the private U.S. banks active in India.

Complementing AID-Supported Programs

Objective: To increase the effectiveness of AID-supported programs and reduce the burdens on the resources of the GOI and other (e.g. State) governments involved in these programs - particularly the administrative and coordination burdens.

Strategy: The strategy for pursuit of this objective is simple. Essentially it is to mobilize the expertise and contacts of the AID personnel working on development programs in India to identify areas in which the private sector - purely indigenous or including foreign collaboration - could play a role and make the program more effective, and then to use all the means AID can control or influence to get agreement that the private sector should be encouraged and assisted to perform that role and provide the support needed to enable it to do so most effectively. This report does not attempt to deal systematically with the possibilities. The Mission has been essentially following this strategy for several years; in the short time I have to work on this report if would not be fruitful for me to retrace the work the Mission has done and is doing along this line. My program suggestions, therefore, are limited to a few ideas on approachs which have come to my attention which AID might emphasize.

Program Recommendations: Generally the Mission should continue to seek out areas in which the private sector could contribute. The current effort to work out arrangements under which the international pharmaceutical companies can contribute actively to India's family planning effort are an excellent case in point. In addition to asking those concerned with AID supported activities to report any pssibilities of which they become aware the Mission should screen all potential collaborations proposed from either the U.S. or Indian side to see if any hold promise from this standpoint. AID Washington should provide the mission with succinct information on functions which are performed effectively in the private sector in other countries relevant to India program activities which could suggest possibilities for exploration and be useful in persuading Indian authorities that the approach may be feasible.

Where opportunities are discovered but the project authorities are dubious about the feasibility of relying on a private sector role it may be useful to include in the relevant project provision for a feasibility study and/or a trial in a limited area.

Where it appears that U.S. private participation could contribute to the effectiveness of the program active PRE project development and support should be available. It should be recognized that greater reliance on private response to market forces to implement Mission project activities may reduce the apparent practicability of timing and quantification of output targets in project design and planning.

One area to which the Mission should give special attention is the development of enterprise which purchase, package/process/store/ etc. and market either new or increased production of special agricultural products or higher value byproducts of major crops. There is a widely shared view that India could produce very competitively a considerable range of tropical and off-season products - tropical fruits, vegetables, flowers - and that there are ways that the value generated from many of the major crops could be increased significantly by better recovery and processing of byproducts - rice husks, cotton stalks, etc. In same cases these could produce important increases in export earnings as there is a growing market in Europe, Japan and especially in the Middle East. For others there are domestic markets. A good bit of relevant work has been and is being done. Quite a number of studies of the potential of new crops and byproducts have been done at the Centre for Management in Agriculture at IIM Ahmedabad. The IIFT has done studies of the markets in the Middle East for various products. The Ford Foundation has supported considerable work along these lines. There are unquestionably a considerable number of other organizations - government,VolAg, and private - which have looked into some of these possibilities from various standpoints.

It appears that in many cases the production end of such activities could be carried on by relatively small farms, but the assembling, processing if any and marketing requires a larger scale operation - either a cooperative or a private company. A key may often be to develop a relationship between the producersand the processor/shipper/ marketer which assures a remunerative market on the one hand and a reliable supply on the other.

The Mission should request a consultant (AID/W TDY or outside) to review in some depth the work that has been done on such possibilities within a feasible range of products, determine whether there appear to be substantial opportunities for high productivity development and decide how AID can help to move them forward. NABARD and ECGC are currently supposed to be developing a scheme to encourage and support such activities. If in the meanwhile or at the conclusion of the consultant's study it became clear that there are such opportunities PRE project Identification and Development support could be mobilized for detailed feasibility study of such development and of what could be done to encourage the establishment of private or cooperative enterprises to go into it.

In this field it would be particularly helpful to get things off to a good start if one of the major Indian business groups were encouraged to sponsor the initial venture with an American collaborator experienced in the type of operation contemplated.

Productive-Employment-Generating Small Scale Enterprise.

Objective: Rapid Growth of small to medium scale private enterprises producing competitively goods and services both for the domestic market and for export, emphasizing efficient low capital output ratio, high labor intensity technology.

Strategy: This should be seen as a long term, selective, multiple component program of support into which AID moves deliberately and with careful preparation of each program activity. It should not be limited to, though it should include, support for the very small enterprises which are the focus of many of the numberous existing GOI and State Government programs.

In the early stages particularly the program should emphasize review and appraisal of the current policy environment and of ongoing and proposed support programs. Such studies can be done both in house and to the extent feasible contracted out to appropriate Indian consultants and research institutions with participation by U.S. consultants and institutions where appropriate. I strongly endorse the conclusion of the Thorman/Gupta report that, "if there is a constraint to moving forward in this area, it is that the Mission will eventually [Sic] need to assign a person to work on program development. Without commitment of a person - staff or consultant - based in India it is difficult to envisage a program developing". I would delete "eventually".

As noted in Part II above, there are many types and sizes of enterprise short of the very large concerns and conglomerates. Ther characeristics, capacities, potential and needs vary widely. Program activities may be useful to, and tailored to the needs of, various bands in this spectrum, bands which may often blur into each other or overlap substantially. Thus overlapping program activities must be carefully coordinated to ensure that they reinforce each other and avoid duplication and inconsistency.

This program element particularly cuts across the others, particularly promotion of collaborations, energy conservation and development, export expansion and reinforcing other AID-supported programs. Activities undertaken under these other headings should be available to smaller enterprises in principle and reasonable effort should be devoted to ensuring that they are so in fact to the extent feasible.

<u>Program Recommendations</u>: The first step in this area should be to ensure that there is a full time officer in the Mission, preferably experienced in the field and familiar with AID's work in it. At least he/she should be thoroughly briefed and oriented to AID's experience and capabilities before arrival. He should start by intensively studying the current status of the major categories of smaller industry; their policy environment; GOI, State, other aid agency and NGO programs designed to promote them; and work in progress on their potential, constraints and needs. As specific program components are identified and spelled out in light of initial assessment of priority and AID capability they should move forward, but the pace should not be forced. In this area particularly the need for adequate study and analysis is great and should receive appropriate emphasis in AID programming.

The following listing of types of activity to be considered is not exhaustive but represents needs and proposals of which I have been informed by knowledgeable people and which I am satisfied are worth serious consideration by AID to establish the priority of the need, the extent to which other programs are meeting it and the feasibility of effective AID-supported activity.

1. Broad Policy Studies - there contine to be major policy issues which merit more serious analysis than they seem to have received. I would mention two areas in particular. First, a major share of the employment in small industry and of the increase in industrial employment expected in GOI plans is in industries in which the market is reserved for very small producers. Serious studies of some of the reserved industries should be encouraged and supported if necessary and feasible to evaluate thoroughly the true costs and benefits of the reservation policy and to explore alternative policies for promoting employment which would be equally effective, less costly and provide better incentives for productivity.

Second, India relies heavily on tax incentives for investment to encourage industrial expansion, location in desired areas and concentration on desired products and markets. Trade and interest rate policy also in the past, and probably still, tends to favor capital rather than labor intensity. Some studies have been done on ways to make the policy environment more encouraging to technologies more suited to India's factor endowment, e.g. the 1980 "Report of the Expert Committee on Tax Measures of Promote Employment". It would appear that quite a lot more study is needed to quantify the effects of present policies and to analyze alternatives and their likely effects. Some comparative work could be useful on policies used in other countries and their effects.

2. Measures to Increase Access to More Productive Technology - In discussing the needs of private sector with individual businessmen, industry association officials and academicians in the field of industrial management the need most commonly mentioned high on the list is better access to up to date information on technology. This need is felt by a very broad band in the size spectrum - all but the very large industrial groups which have global contacts and representation.

For the medium sized modern industries with organized and relatively professional management the need seems to be for availability of a service to get quick, up to date, reliable information. These companies know what they are looking for and what to ask for. They can afford to and are prepared to pay a reasonable amount for the service. There are various services available which in some degree meet this need. There appears to be considerable room for improvement in comprehensiveness of coverage and in accessability to relatively small, geographically scattered concerns.

A Mission consultant with some background on the subject from earlier work in India and familiarity with the evolution in the U.S. of technology data banks and information services has looked into the question and developed some ideas on a project approach that could meet this as well as broader information needs. These are set forth in Annex A. This could well prove an area in which AID encouragement and limited support could make a major contribution.

Particularly for enterprises at the smaller end of the size/sophistication spectrum programs are needed to conduct RD&R on appropriate technology suited to Indian conditions and costs. Again there are a number of government and non-government programs in existence. The AT International is working with a number of local institutions on some experiments and pilot programs. Under its 1978 Technology for the Rural Poor project AID supported some work along these lines. The Mission should explore whether an additional activity would be useful to bring systematically to the attention of one or more of the Indian institutions engaged in this work the results of relevant work being done elsewhere or to support additional research and trials in India.

For the really small household and village industries there is a need for more active programs to identify, adapt and promote the adoption of more productive technologies for producing traditional or improved products and services and for suitable new products. The principal official channel for bringing such information to the customer is through the District Industry Centers, though there are quite a few other public institutions which also perform this function to some extent plus a considerable range of non-governmental programs - mostly local largely pilot operations. The effectiveness of these programs reportedly varies widely. It may be that a systematic review and assessment would be welcome of which programs are getting the best results and why. In any case the Mission should look into the question to determine whether AID should support additional experimental pilot programs or replication of one or more that seems to have proven effective.

3. Training and Advisory Services - there is clearly a major need for a wide range of training and advisory services, both technical and managerial. And there is a considerable proliferation of programs to provide a variety of such needs. Technical training is needed for new workers in traditional activities, upgrading and updating the skills of present workers to improved technologies and standards, and for skills relevant to new, fast growing employment opportunities. These may or may not be primarily destined for employment in small scale enterprises. There are quite a few agencies and programs - e.g. again the DICs the Industrial Training Institutes (ITIs), the Khadi and Village Industries Commission activities, the All India Handicrafts Board and others.

On the management side there are reportedly considerable needs. At university level there are several major institutions of high standing. They have international linkages and access to training. It might be useful to include in the PRE investment reconnaissance team a member who could assess the quality of these institutions and the need for supplementing or upgrading their programs.

At lower levels, however, there is a broad consensus that there is widespread need for more management training and competent practical advice, particularly for the successful self-employed manager beginning to expand his operations to a point at which he needs to be more conscious of the problems of financial management and accounting, marketing, procurement, inventory management, etc. and for the prospective new entrepreneur, often with a background in trade or mainly technical training.

Some of the better DICs provide some training and services of this sort at a low level. A Gujarat State Entrepreneurial Development Center is now being built on to establish a National Entrepreneurial Development Centre which is to train personnel to man state and lower level institutions, particularly state consultancy organizations. At a somewhat more elementary level is the TRYSEM (Training of Rural Youth for Self Employment) program.

In general, while not closing any doors, I would recommend that the Mission give first attention to the possible opportunities to assist in strengthening the low level management training and advisory services available to new and expanding small enterprises. Two specific proposals seem to me worth early consideration. The first, suggested by an IIM, Ahmedabad professor, is to edit, translate and reproduce some of the U.S. Small Business Administration's substantial volume of training videotapes and other materials. These are of high quality and at a level of sophistication that would be quite appropriate for a lower middle bind of the spectrum of Indian industry. They could have a wide application in the programs of a number of the existing and prospective Indian training programs for small scale business managers and entrepreneurs. A possible approach would be to work out an agreement with the GOI Small Scale Industries Development Commissioner (SSIC) to have the SBA work with SSIC and an appropriate Indian management institution - perhaps one of the IIMs - to select, edit and translate into the main Indian languages a selection of SBA material. AID could also use the occasion to ask the SBA experts involved to advise on the plans for utilization of these materials and other related aspects of the institutions and programs involved. The second is to build up a staff at an appropriate decentralized level in a commercial bank to work with the bank's small industry borrowers and prospective borrowers to identify their management problems and advise them or put them in touch with appropriate advisors to help them deal with such problems. This would be an effective focus for contributing to management improvement and the success of expanding small enterprises.

Beyond these, the Mission can appraise the effectiveness and problems of the entrepreneurial development, TRYSEM, DIC, etc. training programs and consider whether more extended support to their expansion and improvement seems likely to be important and is within AID's range of expertise.

4. Material Supply - Material supply has long been a major problem of all smaller enterprises in India. With the extensive liberalization of imports of raw materials and particularly authorization of imports by wholesalers and stockists as well as end-users the problem for medium small enterprises is reportedly greatly improved to the point that an overall reduction in total inventories has occurred in a range of industries. For the very small decentralized village and household industries, however, the problem is still believed to be major. Trying to meet this need is the main function of the State small industries corporations as well as of a number of more specialized public sector institutions. The Mission could consider supporting a study - perhaps for selected small industries or selected raw materials in a particular region - of the feasibility of promoting improved more efficient material supply through private channels, looking towards supporting an experimental trial of the system if the idea seems promising.

5. Marketing and quality control - Marketing is generally considered to be the most limiting constraint to small sector industry development. Obviously it is related to and largely the result of productivity and quality problems. Again, there is a range of public sector programs -

generally highly subsidized and lackluster - to handle marketing for various village and cottage industries and handicrafts. There are also a number of areas in which private traders provide an effective and successful middle man function, particularly for exports of small scale industry products. Again the Mission might explore supporting a study of the potential for more effective performance of this role by private traders in selected areas and what would be needed in terms of incentives and support to motivate private entrepreneurs to undertake the role.

6. Finance - Adequate finance on reasonable terms is of course an essential requirement for small scale industry development, as for most development activities. Overall, India is short of resources and therefore tends to spread them too thin and in any case to allocate less to most purposes than it considers to be needed for such purposes. Allocating aid for one high priority program rather than another does nothing to alleviate this constraint. Within this context financing for small scale industry is given high priority and the forms and channels for access to credit by small scale enterprises seem to cover most types of need. As noted in Part III, foreign exchange needs of industry generally are currently being met quite liberally.

Equity capital is often cited as an unmet need in developing countries. There are a number of programs in India designed to assist new entrepreneurs in funding their initial investments. These include cash subsidies for new small industries particularly in under developed areas and interest free loans from the commercial banks. These cover varying proportions of capital costs. Some say that there is need for additional funding for these programs to meet demand.

A former head of the Indian Investment Center, working under the aegis of the State Bank of India, believes that there is an important role for a new independent venture capital institution to help new enterprises somewhat larger than those reached by the programs mentioned above. It would not only provide equity finance but work actively with the entrepreneurs on spelling out their plans, feasibility studies and management and technical problems. It might be useful for the PRE reconnaissance team to meet with him and consider whether PRE could play a catalytic role in launching such an undertaking.

The Mission might well support a study of equity financing needs of small industries or a more general assessment of their financial needs.

Two specific programs relating to credit types and institutions were identified by a number of specialists as ones which would significantly add to the effectiveness of the financial system. The first would be a credit program for smaller enterprise tied in with development in the bank through which it was channeled of an adequate staff unit to provide the sort of management monitoring and advisory service mentioned under section 3 above. The second would be a credit program which would facilitate the extension of credit by relatively large enterprises to relatively small ones for goods and services which they sell to the latter. This would include renting or selling equipment on hire-purchase terms and financing of materials and work-in-process inventory. The case for this rests on two main points: (a) it is much easier for the supplier in many cases to deal with the lending bank than for his smaller and more numerous customers, and (b) credit from the supplier can be more directly related to the specific need than is often the case of direct bank lending. The supplier, partly for these reasons, may also be better able to secure timely repayment than is the bank.

I would recommend that the Mission explore with one of the commercial banks a small industry credit loan on terms which would provide funding (grant component or an adequate interest spread) for a staff for a trial period to provide close monitoring of and advisory services on the management problems of the borrowers.

The Mission should also explore the usefulness of and appropriate criteria for use of loans through one of the commercial banks to finance credit sales from the borrowers to small enterprises.

7. Infrastructure & Integrated Planning - Availability of plots and buildings, power, water, transport, and housing are often critical limitations on small scale enterprise development, particularly in areas away from existing industrial centers. Establishment of industrial estates and infrastructure facilities is the primary function of the State Industrial Development Corporations and of a number of other public sector bodies. In many cases these efforts are uncoordinated and ineffective. Those that are successful are often located at existing industrial centers where they add to congestion and undesirable concentration problems. Promotion of decentralized growth centers is widely recognized as an important need but efforts in this director have been less successful than hoped. I would recommend that the Mission undertake a long term effort to assist in the selection and development of successful growth centers for private industrial and service enterprises in perhaps two states or regions within states. The approach should be careful and deliberate but contemplate substantial continuing involvement over a period of years. While the actual range of studies and activities to be directly AID supported would be determined in light of the needs and resources of the institutions involved and the support available from other sources, in principle AID should be prepared to support the whole range of analysis, planning and funding of activities. The first step and prerequisite to substantial involvement would be to establish that the state government is firmly committed to a

serious continuing effort at spatial planning and development with heavy emphasis on promotion and encouragement of private industry and enterprises and would welcome active AID supported association with its planning and execution. AID would also have to assure itself that it could provide continuity and competence of support, particularly on the planning, training and management aspects of the program. Careful consideration would have to be given to what sort of Indian and U.S. university and private consulting services would be needed and how they should be integrated. To the extent feasible these instituions should be involved early on in project formulation and negotiation.

It would take a substantial period - perhaps two years - to work out these arrangements and understandings. Funding needs during this period would be minor. If these preliminaries proceeded successfully, however, the Mission should plan on substantial funding commitments beginning perhaps in FY 1985.

As it evolved this program could involve virtually all aspects of small private sector enterprise support - techno-economic studies of potential industries, acquisition and dissemination of technology information, technical and managerial training and advisory services, equipment and technology assessment and advice, development of enterprises for supplying and servicing small enterprises and for marketing and quality control, growth center infrastructure planning and development and financing. It could provide the focus for testing innovative approachs to performing these functions, particularly efforts to promote more effective market incentives and private sector alternatives to administrative controls and bureaucratic services.

If reasonably successful this activity could eventually become the centerpiece and focus of the bulk of this element of AID's program.

Private Sector Exports

Objective: To increase rapidly India's exports thus accelerating expansion of industries in which the country is most productive and supporting its productivity-promoting trade liberalization policies.

Strategy: The earlier successful AID project to support India's export promotion program involved mainly carefully planned studies - mostly of the potential in selected export commodity groups - followed up by educational and promotional tours of potential markets by representative groups of prospective exporters. A few studies of horizontal problem areas for exporters were also included as well as some strengthening of Indian export promotion organizations. Many of these studies highlighted important government policy issues and identified promising export production opportunities.

India now has a relatively evolved set of institutions for export promotion - the Indian Institute of Foreign Trade, a Trade Fair Authority, an array of export councils, etc. These perform a considerable range of functions and generally cover in principle the specific problems of many exporting industries. AID assistance can emphasize initially fairly general studies and assessments of the policies affecting exports, major areas in which substantial expansion of export production is likely to be most advantageous, the importance and effectiveness of present export supporting institutions and programs and the policies and programs needed to encourage private sector exploitation of selected major opportunities.

AID should also be prepared to assist specific programs supporting export promotion where U.S. expertise or external resources can make a key contribution.

Improved information resources and training are particularly important for export industries as well as for institutions concerned with relevant policies. Among the institutions which can make major contributions to export expansion are export zones and other key infrastructure facilities serving export industries and trade and the developing export trading companies, particularly when they provide the key link for marketing and quality control of products of smaller producers which cannot efficiently manage export marketing themselves. AID should consider ways in which it could meet critical needs and help overcome limitations on the effectiveness of these institutions.

Program Recommendations: AID should renew its support for studies bearing on government policies and programs affecting exporters and producers of exportable products. It should consider selectively providing support for improved information for exporters and those concerned with policies affecting exports, critical training needs relating to exports and key infrastructure needs of producers and marketers of export products.

The Mission should explore with the Ministry of Commerce and the IIFT areas in which U.S. expertise could contribute to significant studies of export potential and export policies and programs. It should particularly endeavor to support the program of the ICRIER (see section above on general policy analysis) and seek out other competent non-governmental institutions capable of sponsoring policy oriented studies in the field.

ICRIER is exploring with Ford Foundation seed money the establishment of an information system and data bank focussed on the data needed for research on international economic relations. The Mission should keep in touch with these plans and explore whether AID support would be useful and appropriate.

Improved access to current relevant market and product information is obviously important for exporters and producers of export products, particularly those whose size does not warrant maintenance of extensive overseas representation. AID should consider whether U.S. expertise could usefully contribute to improvement of such access generally or in relation to selected products. If the program discussed in Annex A develops it appears that it could serve the need for such market information as well as technological without overloading and deteriorating the quality of the service.

AID should review with the IIFC and other training institutions their training programs for exporters, particularly any special need for managers of export trading companies, and consider whether U.S. assistance in strengthening these programs would be useful. It should also be prepared to consider assistance in developing training facilities for technical skils needed for rapid expansion of production of important new export products.

AID should also consider capital financing for critical export needs. With the establishment of the Export-Import Bank of India and the existing facilities including the Export Credit and Grantee Corporation (ECGC) there does not seem to be any obvious gap in the institutions and types of financing available for exporters and export producers. I would not recommend direct AID financing of export credit in any case; it is too sensitive and questionable a use of aid. Areas which do merit consideration would include export oriented Indo-American collaborations which should be given high priority both for PRE's Project Identificatiòn and Development facilities and use of its appropriate modes of investment support as discussed above. AID should also consider whether there are critical infrastructure constraints affecting the export zones or concentrations of export producers which could appropriately be addressed. A possible example would be power supply. Power supply is now expected to be a significant constraint on industrial production in many areas over the next 7-10 years. The government is encouraging industrial plants and groups of plants to establish captive power sources. While in many cases these would be high cost and not very energy-efficient there may be cases in which a major company or several companies combined or a separate private company could undertake a fairly large, efficient plant to serve an entire export zone or a cluster or more or less export oriented private industries. Support for a private power plant could in such circumstances not only serve an acute need with multiplier effect but could have important yardstick and demonstration implications.

Energy Development and Conservation

Objective: To Increase Rapidly Private Sector Development of Non-Petroleum Energy sources and energy conserving modernization and expansion of industry taking full advantage of U.S. expertise and technology.

Strategy: In a sense this could be considered as an area complementing AID's ongoing program since the Mission has in process a limited technical assistance and research, development and demonstration program in the field.

Under this heading only one substantial project is recommended at this time. It is one which would capitalize on the work done under the existing alternative energy project as well as on U.S. expertise and technology generally. It should be quickly organized and launched. Its implementation should assist AID in considering possible follow on activities in this area as well as gaining insight more generally into private sector finance needs and problems.

Program Recommendation: AID should move promptly to negotiate a project under which a fund would be established at one (or more) of the Indian industrial finance institutions to provide loans to private companies to procure U.S. equipment and technical services for medium sized projects to develop and use non-petroleum energy sources and to modernize, expand or establish plants emphasising state-of-the-art energy conserving processes and technology. I would suggest the ICICI as the most appropriate institution for this purpose. The project should include provision for funding a technical unit in the lending institution and a substantial quota of U.S. technical consultancy to assist in evaluation of proposed loans from the fund and provide advisory services to the prospective borrowers particularly on energy development and conservation aspects of their projects.

Annex A

Prepared by L. Rudel

Outline of Project to Assist Development of Private Sector Market/Technology Information System for Indian Small/ Medium Scale Industry

I. Expected Achievements and Accomplishments

In view of the existence of certain components of such a news service organization here in India, it should be possible to establish an organization and provide a first quality information service to the Indian business community within 12 months of approval of the project. It is not possible to quantify the impact that such a service would have on the productivity and the technological modernization, export performance and growth of the private sector. The indicators of satisfactory performance of this service would be the degree to which subscribers are willing to pay for this service. The project should be structured so that it should become financially viable within 18 months of the initiation of this service.

The major market for services to be provided by this organization would not be the large scale private sector Indian firms such as Tata, Birla, Mafatlal etc. These firms have their own economic intelligence channels. Their people are travelling throughout the world and throughout India and are able to manage their information needs. The primary market for the service to be offered by this organization would be the middle size industries who are not able to collect the data through their own network and would find such a service most useful. Additionally the Indian Government and the various private consulting firms and financial institutions who serve the private sector would be clients for such an economic news service.

It should also be possible for this service to assist private firms in locating sources of technology in India and abroad required by them to improve their own productivity or enhance and expand their facilities. This could be accomplished by linking UNI's economic intelligence operation to various technology data bases in the United States and Europe. In the United States, for example, Lockheed and Control Data have very fine technology data banks that could be responsive to specific requests made in India for identification of possible partners for mergers or joint ventures. Such a link would be relatively inexpensive and would have high value to the subscriber.

Analysis of technical information drawn from these data banks can be performed by the American Association of Engineering Societies (whose total membership exceeds 400,000 engineers) so that the responses to inquiries by Indian subscribers will be in useable form. Funding for this service is contemplated under this project for the initial 18 months of operation.

The objective of this effort would be to facilitate technology transfer by making it easier for the Indian private sector to tap into available information with respect to market conditions and technological change.

II. Project Outline and How it will Work

The technology transfer/market intelligence service has four major components:

1. A communication network with offices in the industrial centers of India which would be used both for the collection of economic and commercial intelligence to be channelled to an analytical unit, and also for the dissemination of the final product to subscribers throughout India.

2. A linkage to various data banks in the United States such as Control Data or the New York Times Information Bank to obtain access to relevant information in the international markets that would be of interest to the subscribers.

3. An analysis unit to examine the data collected both from within India and from abroad and to prepare material of relevance to the subscribers.

4. A computerized information data storage and retrieval system to be operated by the analysis unit and used for the systematic compilation and storage of commercial market data and technological information of relevance to the subscribers.

Virtually all of these components are available within India at one level of competence or another. What is needed now is to pull these capabilities together into a well managed organization with sufficient resources to provide this service.

An economic and financial news service is offered by the United News of India (an organization owned by 45 Indian newspapers which resembles a non-profit organization). UNI offers this service to subscribers and features information collected not only throughout India but also transmitted to them by Dow-Jones Associated Press in

London via satelite. Mr. G.G. Mirchandani the Director of UNI himself is displeased with the quality of the news service. Even with these known inadequacies 35 banks are UNI subscribers as are some major INdian corporations (special mailings 4 times a week to subscribers). Mr. Mirchandani is reluctant to engage in a marketing program to obtain additional subscribers because of his concerns regarding the quality of the product. He is caught in a vicious cycle. Without a fine quality product he is unable to get additional subscribers; without additional subscribers he is unable to invest in improving the quality of the product.

The quality of the product could be improved by collecting and storing on computer memory banks a regular flow of economic information that would be of relevance of potential subscribers. The information would be stored in India on computerized data systems and would include domestic information as well as data obtained from international sources through Dow-Jones Associated Press or other data sources. Once sufficient data is built up, it will be possible to use the data to perform analytical work for the subscribers, and to respond to specific inquiries. Indeed the service, once established, should provide an unusually useful tool for market research, for the development of potential investment projects and for identification of technology transfer needs. UNI's 90 branch offices would provide a distribution system throughout India for periodic economic information dissemination as well as points by which access to the computer data bank could readily be achieved by subscribers.

A number of reasonably competent organizations now perform economic and market analysis within India. Several such organizations have performed under contract to USAID in the past (Industrial Development Services Limited; Tata Consultancy Services; Operations Research Group) Others perform services to which USAID subscribes (Center for Moni toring the Indian Economy; Commerce Information Service). No single one of these organizations has the full capability to perform this service. An analysis unit can be created with some part of the work being subcontracted to such organizations as those listed above. But the task of creating such an analysis group is not impossible since well qualified personnel are available in India to perform this kind of services.

A number of organizations exist with computer manipulation capabilities. In New Delhi DCM Limited has such a capability. In Baroda the Operations Research Group is one of the foremost computer organizations in the country. In Bombay Tata Consultancy Services has such capability as well. In the course of the project design it will be necessary to determine whether the services for data storage and retrieval can be purchased by the new organization or whether the computer capability calls for an equity participation. All three companies cited above have the necessary hardware and software capability to respond to the requirements of this service.

Finally, a link to various U.S. computerized data bases can be attained through satelite communications by payment of subscription fees to Lockheed, Control Data, the New York Times Information Service or various other major U.S. information systems. The cost of such a service is a foreign exchange element of the project and would represent a major U.S.A.I.D. contribution during the initial start-up period.

Additionally, it might be possible to engage the services of the American Association of Engineering Societies, who have consistently approached the U.S. State Department and AID for an opportunity to work with AID in providing services to developing countries with respect to meeting technology needs. The Society might have its membership provide a low cost service for fee to respond to inquiries from India to evaluate some of the information that might be pulled out of the various technology data banks in the United States.

The project elements of this activity would include the following:

1. The establishment of a subsidiary to UNI to which one other consulting firm, that has a computer systems capability and an economic research capability, would also be included. The new organization would use UNI's communication linkage throughout India plus its link to the Dow-Jones Associated Press via satelite for collection and dissemination of data. The organization would also have the computer hardware and software needed for storage of the data in some systematic fashion so as to provide data for the subscribers. The organization will also have a research and analysis capability to utilize the data collected and to perform specific research assign ments for its subscribers.

2. Project elements should also include equipment to refurnish UNI's communication system, a working capital loan to operate the new enterprise until subscriber service can reach the necessary break-even point, say within 18 months, some training of staff, and subscriptions to technology data banks to Europe and the United States. Another project element might well be a contractual arrangement with the American Association of Engineering Societies in New York city to perform analytical work or provide short term consultancy as requested by the organization or its subscribers.

The organization might be a non-profit organization. Its Board of Directors or Advisory Committee should include prominent persons in India with recognized credentials in economic journalism, economic analysis, market analysis, operations research and engineering consultancy.

An essential ingredient in this project would be the clear understanding that the enterprise will only succeed and continue if it is able to sustain itself with its own subscription fees. Thus, there would be pressure on the staff to be responsive to the needs of the subscribers, recognizing that continuation of the enterprise will be dependent upon the quality of service provided by them. Funds to start up this operation should be provided on a loan basis with the usual guarantees provided by the managers of such an enterprise.

The organization should not be in competition with the general consulting community of India. Rather it should seek to service that consulting community and improve its capability to perform services to the commercial sector. Some care will have to be taken that the consulting firm which manages the data bank does not find itself with a competitive advantage in relation to other consulting firms throughout India.

III. AID Support Capability

AID's assistance to this project will be the following:

1. A working capital loan to meet the operating costs of the project for a least 18 months until it is able to produce a quality product and market that product to sufficient subscribers throughout India.

2. Long term financing of equipment necessary to permit UNI to modernize its communication system and obtain whatever peripheral equipment is necessary to tie into the existing computer system of the company selected to participate in this venture.

3. Financing a contract with the American Association of Engineering Societies to provide services with respect to technological information required by subscribers and available in the United States.

4. Short term consultants to provide technical assistance as required.

5. Training for the analytical and management staff.

6. Payment in foreign exchange of the subscription fees for access to U.S. technological data bases for approximately two years until the service is able to accommodate those expenses from its own earnings.

7. Catalytic inputs from the USAID Mission with respect to the structuring and organization of the service.

IV. Project Design Strategy

In the course of designing of the project certain studies will have to be made. Some of these are:

1. A market survey to clearly delineate the consumer demand by category of consumers and information needs.

2. An examination of the data sources available in the United States that could be linked to the Indian service and their costs, their means of access and the relevence of the data in the light of the market survey results.

3. A technical appraisal of the equipment needs of such a service including the needs to refer the UNI's existing communication linkages and any peripherals which might be needed to link the organization to the computer facilities of either DCM, ORG or the Tata Consultancy Services.

4. A financial analysis to structure subscriber rates at levels that are affordable by the Indian private sector and also would assure that the organization becomes viable within 18 months of the start of the services.