STATEMENT

The payoffs from regulatory reform: India and Indonesia

India's strategy for industrialization has been based on import substitution and an unusually comprehensive and restrictive regime of regulation in domestic markets. In eleven subsectors that produce about 50 percent of Indian manufacturing output, the main results of this strategy have been that: (a) A few large firms dominate, while medium-size producers are "squeezed out". (b) Average plant sizes are below economic scales of production for most products. (c) Protected firms have captive markets and thus garner high rents: net pretax profits in India's manufacturing sector were on average 20.8 percent of value added in 1982, compared with 3.5 percent in the Republic of Korea in 1981. (d) Technological innovation is slow. Total factor productivity in these industries fell by more than 1 percent a year between 1966 and 1980.

Unsurprisingly, India's international competitiveness has suffered. Is manufactured exports as a share of developing countries' manufactured exports has declined, and its share of manufacturing in GDP has not increased since 1978. Other results are harder to quantify: transaction costs are high; and resources are diverted by excessive administration, by unproductive rent-seeking, and by uncertainty and delays.

In Indonesia, the private sector has also been hindered by regulation. Until 1988, domestic and foreign investment was restricted to certain areas; there were capacity limits and ceilings on the number of permitted projects. Before starting operations, even approved indigenous firms had to obtain import and export licenses, a domestic trading license, land rights, a permanent operating license, and storage and location permits. All this often took two years. Total factor productivity fell by 2.5 percent in the mid-1980s.

In India, recent partial reforms proved successful. Industrial licensing has been eased since the mid 1980s, as have some import controls on some raw materials and intermediate goods. These changes, though modest, have nonetheless had a positive effect. Competition has squeezed the profits of large firms (the top 100 firms reported a drop of about 24.3 per cent in 1986-87 despite a 9 percent rise in sales), and many new, smaller firms have been created.

In Indonesia reforms has been more comprehensive: foreign investors are now able to acquire firms in priority areas as long as 20 percent of the equity is domestically owned; rules on domestic investment have been significantly relaxed. Private investment grew in 1989; the growth of total factor productivity has been prositive in recent years; and the average rate of return on investment increased from 13 percent in the period 1982-85 to to 22 percent in 1986-88.

[*English*]

Standing Committee on Agriculture

542. SHRI RAM NAIK: Will the Minister of PLANNING AND PROGRAMME IMPLEMENTATION be pleased to state:

(a) whether the Government are considering to wind up the Standing Advisory Committee on Agriculture; and

(b) if so, the details thereof and the reasons therefor?

THE MINISTER OF STATE OF THE MINISTRY OF PLANNING AND PROGRAMME IMPLEMENTATION (SHRI H. R. BHARDWAJ): (a) and (b) The Standing Advisory Committee has been wound up w.e.f. 16-5-1991 after it had given its views on the formulation of Agriculture policy.