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The Role of Law and Legal Institutions in Asian Economic Development: The Case of India

Patterns of Change in the Legal System and Socio-Economy

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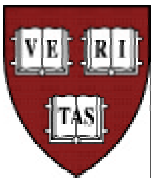

THE ROLE OF LAW AND LEGAL INSTITUTIONS IN ASIAN ECONOMIC DEVELOPMENT: THE CASE OF INDIA

PATTERNS OF CHANGE IN THE LEGAL SYSTEM AND SOCIO-ECONOMY

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Abstract

This paper is part of a collaborative research project entitled *The Role of Law and Legal Institutions in Asian Economic Development (1960-95)* sponsored by the Asian Development Bank. The study included six Asian countries: People's Republic of China (PRC), India, Japan, Republic of Korea, Malaysia, and Taiwan,China. Oxford University Press is publishing the comparative report.

This essay is the first part of the background study done for India and closely follows the comparative research guidelines for all six countries. It addresses the question, Did law matter for economic development in India between 1960 and 1995?

The authors divided the 35 years into economic strategy subperiods: from before 1960 to 1965/6, high growth in a closed economy; from 1967 to 1980, a closed stagnant Socialist economy; and from 1980 to 1995, a period of reform and liberalization. The authors analyzed legal change separately for each period. They found that during each period law and legal institutions changed to reflect the dominant economic policy. In the early periods, the changes enhanced the procedural discretion of the bureaucracy, which began to decline in the last period. Also in the early periods, the legal changes gave the State increasing power over the allocation of resources, which also declined during the last period. In an interesting finding, compared to many of the other countries in the study, the judiciary emerged as a major challenger of executive power during the early periods and a major defender of certain economic rights in the later period. So while law and legal institutions tended to follow economic strategy, at least one institution -- the Supreme Court -- played an important independent role.

JEL codes: O16, O19, O53, O57, K10, K11, K12, K2, K42, P52

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Executive Summary

Introduction

The following analysis "The Role of Law and Legal Institutions in Asian Economic Development: The Case of India; Patterns of Change in the Legal System and Socio-Economy" is part of a collaborative research project entitled "The Role of Law and Legal Institutions in Asian Economic Development (1960-95)" which was sponsored by the Asian Development Bank. The study included six Asian economies: People's Republic of China (PRC), India, Japan, Republic of Korea, Malaysia, and Taiwan,China. The research was carried out by interdisciplinary research teams consisting of at least one lawyer and one economist in each of the six countries and based on research guidelines developed by a Harvard-based research team in collaboration with the country teams.[1] The comparative report that resulted from this study was presented at a Symposium at the Asian Development Bank in Manila in September 1997 and will be published by Oxford University Press.

The presentation and analysis in this essay closely follow the research guidelines. The essay addresses a number of concepts developed in the guidelines as well as in the comparative report. For a better understanding the following overview summarizes the conceptual framework used for the comparative study.

Framework of Analysis

The comparative research effort addressed two major questions: Does law matter for economic development? and Is Asia different?

To explore these questions, the research guidelines asked the scholars in each country to divide the period from 1960 to 1995 into major economic policy periods and to analyze legal change separately for each period. The purpose of this exercise was first, to identify the areas of the law that experienced most change, and second, to explore the nature of legal change during different policy periods.

The modern legal history of the countries included in the study suggested that major legal changes, such as the adoption of civil and commercial codes, or the establishment of a court system with broad jurisdiction, could not be expected for the period under investigation. These

[1] The core group of the Harvard team included Katharina Pistor, Jeffrey D. Sachs, Hal Scott, and Philip Wellons.

changes had taken place in most countries much earlier. An exception is China, where earlier changes were repealed by the new socialist order so that the legal development after 1978 in many areas of the law started virtually from scratch.

Typology of Legal Systems

The research guidelines developed a typology of legal systems and served as a common reference for detecting changes in the nature of legal system. The typology of legal systems presented in the comparative report maps a country's legal system along two dimensions: a procedural dimension which depicts whether a legal system is more or less rule-based as opposed to discretionary; and an allocative dimension, which captures whether the legal system refers the decision over the allocation of economic resources primarily to the market or to the state. In theory, the two dimensions may combine in four ways: market/rule-based; market/discretionary; state/rule-based; and state/discretionary.

Legal and Economic Indicators

The following indicators were used to locate a country's legal system along these two dimensions at any point in time, including:

the contents of major legal rules;
the role of the executive as opposed to the legislature in issuing such rules;
the discretion exercised by rule makers and rule enforcers;
the status of courts and judges;
the status of the legal profession;
public opinion about the legal system.

In addition, economic indicators were used to measure the allocative role of the state vs. the private sector, among others:

the size of the state owned sector;
the extent of trade controls, including quotas, tariffs, and black market premia as an indication for foreign exchange controls;
state controls over the financial sector, such as state ownership of banks and controls over the allocation of credits.

To the extent possible, relevant data were collected for the entire period from 1960 to 1995. Where data has not been available, or a country's historical development suggested a different periodization, this was taken into account. The analysis of China's economic development and interaction between legal and economic development, for example, focuses primarily on the reform period from 1978 to 1995.

Macro- vs. Microanalysis

The primary focus of the analysis outlined above was the overall change of a country's legal system. We refer to this as the macroanalysis. In order to obtain a better understanding of the actual functioning of specific laws and legal institutions, the research guidelines supplemented this analysis with a microanalysis. Although we do not present the findings of the microanalysis in this series of essays, many of the findings of the macroanalysis are informed by the microanslysis.

Three areas of the law were selected for the microanalysis, each of which includes several subareas:

Business Governance (corporate law, securities market regulation)
Credit and Security (secured transactions; property rights, contract law); and
Dispute Settlement Institutions (courts, arbitration bodies, civil and administrative procedure codes).

Rather than attempting to link changes in these areas of law to overall economic performance as measured by GDP growth rates, this research sought to find patterns of interaction between specific laws and legal institutions on the one hand and intermediate growth factors on the other hand. Intermediate growth factors (IGFs) are defined as factors, which reflect the structure of an economy, including its key institutions. The major IGFs used in this study include:

Capital Formation;
Lending Volume;
Division of Labor.

Each IGF corresponds to one area of the law; i.e. capital formation to business governance; lending volume to credit and security; and division of labor to dispute settlement institutions.

Katharina Pistor and Philip A. Wellons

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1. INTRODUCTION

India inherited a mixed legal system as a consequence of its colonial past. While Criminal laws, Revenue and Land laws, and Business and Trade laws are mainly borrowed from the British Common law system, Personal laws like marriage, inheritance, succession, etc. were all dominated by traditional texts and customary practices. Of course, in business laws there are a variety of customary laws loosely related to the British Common law and local customary law. Hindu law in particular contains what is one of the leading forms of business organizations viz. Hindu Undivided family business which is in a way, similar to a limited partnership[1].

While India had been governed by constitutional regimes under imperialist rule, they were primarily non-developmental and non-representative. In 1950 with the formation of the republic a representative and developmental constitution for the first time governed India. The adoption of new goals and principles in the form of liberal fundamental rights[2] on the one hand and economic and developmental goals as Directive Principles of State Policy (DPSP)[3], on the other originate in the opposition to the exploitative colonial rule. Changes were therefore required to the legal regime to ensure `democratic sovereign republic and yet to ensure equality in a society so long divided on the basis of caste, religion and sex.[4] Further the Constitution through the Directive Principles of State policy (DPSP) itself identified certain specific goals, e.g. distribution of material resources for the common good, equal pay for equal work and other principles for the governance of the country. These principles are prescribed as positive

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1 However unlike in a partnership one is not entirely free to join or leave.

2 Incorporated in Part III of the text. The part III rights are viewed as limitation to State power as they impose limitations on the otherwise unbridled power of the State. In essence the State cannot act in a manner which infringes these rights. Some of these rights like right to equality (Art.14); right to life (Art.21); right to religion (Art.28) and right to seek protection of those rights from the Supreme Court of India are rights ensured to all persons. Other rights including freedom of speech and expression, freedom of movement, freedom of trade, industry and commerce etc. (ensured in Art.19) are given to citizens only.

3 As mandated in Part IV of the text. The DPSP though not judicially enforceable are fundamental in the governance of the State.

4 This is not to suggest that there is unique ideal form of governance. However the impact of colonialism was to destroy the viability of earlier multi-ethnic social hierarchies.

obligations on the state to achieve the set goals.[5] The method to achieve these goals was however within the discretion of the government of the time. It is the method as much as the goal that has generated the need to adopt appropriate legal tools. The choice of the methods and the tools over the years that are now in need to be studied for the purpose of evaluating the role of law in Indian economic development of the past four decades.

The economic goals of the new state had their origin in the philosophy of the Indian National Congress (INC) during the Independence movement. It was but natural that the first national government headed by Pandit Jawaharlal Nehru, would choose means that reflected this ethos. An indication of this ethos is available in the resolution of the INC in its annual session at Karachi in 1931, where it was resolved to adopt a socialist pattern of development.[6] The immediate focus of the new government was on agrarian and industrial reforms. The INC in its 1955 `Avadi' session also pledged to follow a socialistic pattern of development[7]. The Parliament passed a resolution to the same effect in 1956. This led to a series of measures in the form of abolition of the zamindari system (a form of landlordism), the land reform legislation's, abolition of managing agency houses in the industry, etc. Some of these led to friction within the legal system as the right to property was also a fundamental right.[8] The friction came to the surface when the judiciary nullified many actions of the government on the ground of violation of Part III rights[9] compelling the government to bring about changes in the Constitution itself.[10]

The pre-independence experience was combined with a very clear inspiration from the experience of the socialist countries, in particular the Soviet Union, which was reflected in the speeches of the Prime Minister Jawaharlal Nehru and in the now famous Mahalonobis model which had many similarities to the work of Feldman for the first Soviet Five year plan (see

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5 Art.37 enumerates`.....it shall be the duty of the state to apply these principles.....'

6 The emphasis was on State ownership of important resources, protection of workers interests, etc. The session also adopted a charter of Fundamental rights and economic policy, which envisaged real economic freedom for the people. For details *See*, A.M.Zaidi and S.G.Zaidi, *Encyclopaedia of the INC,1930-35*,(1980).

7 The resolution adopted by the party called for`..... planning with a view to establish a socialist society in which the principal means of productions are characterized by social ownership or control', The phrase socialistic was now used over socialist to reflect the desire for a mixed economy. *See*, Chandrika Singh, *Socialism in India*, (1986), p. 128.

8 Art.19(f) at that time provided, *`No person shall be deprived of his property*....This provision has now been removed from Part III.

9 For *e.g. Kameshwar Singh v State*, AIR 1951 Pat 91, where the Bihar Land Reforms Act, 1950 was found to be invalid. Also, *State of West Bengal v. Bella* Bannerjee, AIR 1954 SC 170 examined appropriateness of compensation.

10 Art.'s 31A and 31B were introduced through the First Amendment in 1951 to secure the constitutional validity of land and agrarian reforms. These articles limited the scope of challenge of Acts or regulations seeking to abolish institutions like zamindari, etc. and also those Acts, which were included in the Ninth Schedule. These were later supplemented by 25th, 42nd, and 44th amendments to the constitution.

Domar (1957))[11]. This activist role of the state had to be reconciled with the requirements of a democratic political framework and a structure of capitalist and pre-capitalist institutions from the past. This reconciliation was done by the adoption of a mixed economy model. This was clearly enunciated in the Industrial Policy resolution of 1956 which envisaged a clear separation of responsibility between the public and private sectors. A number of industries were reserved as the exclusive domain of the Public Sector. The centralized role of the state was to be co-ordinated and directed by the Planning Commission. The commission however did not enjoy any legal or constitutional status but derived its effectiveness due to its political proximity to the office of the Prime Minister.

The plans[12] themselves were formulated under certain critical assumptions about market parameters.[13] These can be characterized as: *Export pessimism*, *Savings Pessimism, Private Investment Pessimism, Employment pessimism, Distrust of Multinationals, Distrust of large private industrialists,* and of course running through all of these is a D*istrust of the market.*

These attitudes and preconceptions were not unique to India but were more widely felt. In fact a number of the pre-independence actions of the Govt. were rooted in similar attitudes. Economists from India and abroad shared many of these beliefs. What is however noteworthy is how these beliefs persisted in policy formulation well after sufficient evidence from India and elsewhere had demonstrated their fragility.

The Development experience over the nearly four decades can be characterized into three broad phases. The first two being marked by a preference for centralized decision-making and control and the last being one of liberalization. First is a *High Growth* Phase till 1965-66, covering the first three plans. The phase in many ways begins with the first plan in 1951, but reached its zenith with the second plan in 1956. It is at this time that many of central principles were enunciated. The first phase ends with the death of Prime Minister Nehru and the economic crisis of the mid-sixties. The basic structure of the mixed economy was put into place during this time, with the adoption of the Industrial Policy of 1956, a very clear demarcation was made between the areas of responsibilities of the Public and Private Sectors. Major changes to the organizational and institutional structure for the private corporate sector was done with the passing of The Companies Act, 1956 and the beginning of the regulatory economy which ultimately resulted in the establishment of *license raj*. The Soviet legal system had already started being incorporated into the then dominating bureaucratic structure . But so long as Nehru was

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[11] The ideology of the freedom struggle was not as monolithic as this discussion seems to present. Actually there were at least two main strands, the Soviet experience and socialist discussion influenced the first, dominant strand. The second was a strand reflected in what is termed as Gandhian Economics. While it was not sufficiently influential in the overall schema, it played a critical role in a number of later developments. A major aspect of this was a distrust of modern technology, a concern for social welfare and addressing the needs of the poor.

[12] There has been an intense debate and re-examination of the role of Planning in the Indian Economy in recent years. Some of the parties to the debate are those who were key players in the planning process in the past few decades. This discussion is largely influenced by these writings. Chakravarty (1987,), Bhagwati(1993,), Srinivasan, Bhagwati and Srinivasan are some of the key examples.

[13] See the discussion in Byrd (1990) and Tendulkar (1991) for a detailed analysis of these issues.

alive the Soviet legal system was not as influential as it became later.[14] However freedom for the private business sector was viewed with suspicion and contempt, and were given a go-by. The order of the day was a regulatory mechanism imposed through bureaucratic processes[15]. In the discussion that follows we identify the economy at 1960 with this first phase.

The focus of planning effort was in building up infrastructure and basic industries. The transition to the second phase, of stagnation, which saw slower growths in all except the agricultural sectors was associated with a change in the political framework. In 1967, for the first time the dominance of the Congress was challenged. Several states, saw for the first time non-Congress Govts[16]. Later in 1977 there was a non-congress Govt. in the Center as well. These non-congress Govts were relatively short-lived and did not significantly challenge the hegemony of the congress. The major exceptions were in Tamil Nadu, West Bengal and Kerala were regional parties and the left coalition became serious contenders to political power. The advent of Mrs. Indira Gandhi to power intensified the process of strict regulation and reduction of freedom in the business sector[17]. Some key industries were nationalized[18]. During this period laws relating to trade, commerce and industries became highly centralized, and strongly contributed to the development of the socialist legal culture. Mrs. Gandhi made radical changes in the Constitution to give her polices a constitutional color[19]. The judiciary too accepted that the Indian Constitution had a socialist tinge[20]

The reasons for the slowdown in economic growth have been extensively studied and analyzed. They have been attributed in part to a slowing down in public investment in this period as well as to the various Institutional processes which hampered the growth in productivity of both labor and capital. It is difficult to mark the exact end of this phase. We can certainly see a watershed with the death of Mrs. Gandhi in 1984. But in fact a number of measures to loosen the regulatory regime[21] were initiated as early as 1981-82 with her return to power for a second term in 1980. On the other hand full and frank liberalization does not really occur till 1991. However

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[14] Mitra, *Nehru and the Planning Commission* PRAJNA, vol. 35, no 1-2, 1989-90. Banaras Hindu University.

[15] See, for e.g. The Industries (Development and Regulation) Act, 1951.

[16] The first non-Congress electoral victory was in 1957 with the communists in Kerala. The Govt. lasted for almost two years. However these early changes did not as yet constitute any major challenge to centralization. This was partly due to the expectation that through the center and the planning process more funds would be mobilized and distributed.

[17] See, for e.g. The Monopolies and Restrictive Trade Practices Act, 1969.

[18] For e.g. the nationalization of banks during 1969. Following this the general Insurance sector was also nationalized during the same period

[19] The 42nd amendment introduced the word *Socialist* into the preamble of the Constitution apart from making many other changes.

[20] *Minerva Mills v Union of India*, AIR 1980 SC 1789; D.S.Nakara v.Union of India, AIR 1983 SC 130

[21] Changes were initiated in the licensing regime to increase flexibility of companies to expand capacity. To revitalize the working of the MRTP etc.

as there is growing recognition that centralized planning processes does not work during this period. The selection of the cut-off date at 1980-81 is partly on statistical grounds and partly to cover the entire spectrum of attempts at reform

The advent of the new government in 1984 headed by Rajiv Gandhi heralded the adoption of a liberal attitude in the trade and business sector. The period between 1984-1990 saw the onset of liberalism without any certain objective and plan of action. As such no change in the statutory regime was made. However changes were sought to be made through a series of administrative orders that were often uncoordinated and contradictory.

The process of reform and marketization got a major push with the advent of the government of Prime Minister Narsimha Rao in 1991. In this period the impact of globalization started forcing the political power process to open up the economy. This also necessitates associated radical changes in the legal system both in content and functioning as it is obvious that a structure unsuitable for a market economy can lead to severe structural failures[22].

Sources of Law: Naturally, India adopted a mixed legal order as well. As such we must at this stage, take account of the various sources of law to assess this mixed character. The different sources of law in India governing economic and business activities are :

Customary law: A number of business ventures are conducted by and within (Hindu) Joint Families. Customary law and textual laws largely regulate their internal organization and functioning. In many respects this form resembles a Limited Partnership. The power, functions, liabilities and duties of the manager or managing partner (called Karta) of such business house is regulated by both textual and customary law and the law relating to co-parcenary properties. His liability is unlimited as per textual law, but liability of all other co-sharers or co-parceners are limited to their interest in the business. Except for this area most other parts of Hindu law have been codified in 1956. This organization is recognized as a valid entity for tax purposes but the formal tax law does not cover all aspects of organizational behavior. Some of the larger business houses in India particularly in the north still follow this form of organization. In general this organization does not suffer from great deal of formal litigation. The only problem that does come up for litigation relates to claims for partition.

Statutory laws: Indian law is predominantly statutory, certain and predictable. The procedure is also very clearly codified. Indian courts follow the adversarial procedure and the burden of proof clearly lies on the part making a claim or assertion.[23]

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[22] One such structural failure was seen in 1992 in a *scam* relating to stock market functioning and the securities operations of several major Banks.

[23] The principle that the person best able to prove a fact must discharge that burden has in fact been much neglected. In certain economic legislation, FERA for instance, the burden of proof has in fact been put on the defendant as an attempt to restore this principle.

Case Law: India has a long tradition of common law. Therefore judge made law, or commonly termed as, precedent, has gone into the marrows of judicial culture. The Constitution except mentioning in Art.141 that the law declared by the Supreme Court shall be binding on all courts within the territory of India[24] does not provide any other provision to stipulate the place of precedent as a source of law. But, a good and rich case law has made Indian legal system strong, transparent and predictable, though time consuming.

Administrative law: In the last 50 years, Administrative Law has become unquantifiable and very bulky because every statute empowers the appropriate government to frame detailed rules and regulations within the framework of the statute itself. Acts are passed by the legislature and require the president's assent. The executive, i.e. the central government, on the other hand frames rules and then these are placed in the parliament for noting. Acts and Rules are both promulgated by notification in the official gazette.

Bureaucratic law is it Developmental or Political? Ever since 1956, the executive institutions established either under Acts of legislature or through practice e.g. Controller of Capital Issues and later the Securities Exchange Board of India, Pollution control Boards (by acts of Parliament) and the Planning Commission, the Directorate Generals of Technical Development, Supply and Disposal (by administrative orders) etc. have been given extensive powers to regulate through regulation, guidelines and orders. In practice these are generally made with prior consent of the Central Government. As a result this structure considerably enhanced the power of the Indian Bureaucracy. However in spite of both a strong bureaucratic focus and the control of the bureaucracy by the political system, Indian laws do not have a character of a *political bureaucratic system* because judicial review is one of the basic features of the Indian legal system. Therefore, all legislative and executive action can and often does go through the test of judicial review for non-arbitrariness, natural justice and procedure established by law. While it is not the case that access to the legal system is either cheap or quick, the presence of a free press and an active judiciary has restrained the arbitrariness of state power.

It must be pointed out that the Indian Constitution, unlike many other constitutions of the world, in adopting a normative framework tries to harmonize the relation between the conventional rule of law and aspirations of the people. Whereas rule of law has been enshrined as a basic structure of Indian Constitution through a prescribed code on Fundamental Rights, the social aspirations have been enshrined in the directives for state policy and placed in Chapter IV of the Indian Constitution. So, Indian laws and legal institutions attempt harmonization of these two structures of constitutional process. As such, every institution and law has also an element reflecting the dominant political ideology of the time. To illustrate the Planning Commission functioned as an adjunct of the Prime Ministers Office. The constitution had visualized the creation of an inter-state council to co-ordinate the developmental goals of the state. But given the prevalent ideology of centralization it never got off the ground except for series of pious statements on its desirability. The directive principles of state policy enjoined the state to take up

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[24] Refer to Motiram v. NEF Railway, AIR 1964 SC 600; Casket Radiators v. ESK (1985) 1 SCC 68; *Asst. Controller v. Dunlop* (1985) 1 SCC 260; *Star Company v. Union of India*, AIR 1968 SC 179.

a number of issues of public interest. However depending on political convenience some have attracted greater attentions than others have.

Thus to conclude while the framework clearly reflects a mix of all types of law the overall structure has been one of a rights based law, where institutions have adequate authority, procedures are established by law and tested by judicial review. The functioning of these institutions have been hampered by poor infrastructure and inadequate human resources, but they have on numerous occasions risen above these constraints. Economic legislations and their interpretation have not been free of ideology. and the dominant ideology of the time was reflected in the structures of the mixed economy. Regulated markets do not give right signals to the investors nor are investors free to take signals from any market conditions. The Government often regulates prices. Freedom to contract has been restricted and in many cases ruled out *ab-initio* in many cases. But in overall, it has been a constitutional governance ensuring justice.

2. LEGAL STRUCTURE IN INDIA

India is a Constitutional Democracy. The Indian constitution is a formidable document with 395 sections and some 12 schedules. The constitution prescribes the basic law for almost all aspects of economic and political organization in India. The constitution provides for a separation of powers between the legislature, executive and the judiciary on the one hand and between the Union and the States on the other. Constitutional law has not remained static but has evolved due to three fundamental tensions in the structure, between the Center and the States, the Legislature and the Judiciary and the Legislature and the Executive, it has provided for a coherent uniform framework for economic activity over the entire post-independence period. Both the parliament with its constituent power to amend and the Judiciary with its power to interpret have been key actors in this process. It is difficult to cover all issues of constitutional law here, we will, therefore, examine the key components of this process has it has evolved in the last thirty-five years.

Center-State relations:

1950 –1965: The basic character of India's constitutional governance as a federal state, but with a strong unitary character was established by this time. Except for Jammu & Kashmir and Sikkim, no other state has entered into an agreement to join or form a union of states. The states at independence were either provinces under colonial administration or princely states under British suzerainty. These were subsequently reformed in 1956-60 on the basis of a wider political consensus on linguistic grounds. The process of state formation has not ceased in India and continues today as part of the ongoing political dialogue of managing the aspirations of local communities with the requirements of development.[25] The center and states have there own

[25] Even at this point there are strong peoples movements in Western Uttar Pradesh - Uttarakhand, Bihar-Jharkhand and Bengal- Darjeeling for the creation of new states

legislative, executive and judicial structures.[26] The constitution has built in safeguards to preserve the autonomy and character of the multi-ethnic-religious mosaic of India. The power of the center and the states are described in great detail in attempt to dovetail the advantages of strong unitary decision making with the sensitivity to local issues of a federal structure. Federalism has a very important impact on the participatory and complementary model of constitutionalism especially in business-legal regulations. Most of the major issues in Business, Trade and Commerce of the country are either stipulated in the Union or Concurrent lists[27], thereby empowering the central Government to establish the regulatory mechanism in trade, commerce and industries. There have been a number of economic and non-economic controversies in the area of center state relations. Some of these like the language issue have engaged considerable political effort to resolve. While they have not had direct economic impact, indirectly they have probably played a role in inter-state differentials in development. In the remaining discussion we focus on the more economic focused issue of center state finances.

The Constitution tries to avoid duplication in tax matters, as in USA, Canada or Australia, and lays down a very detailed structure of tax management, clearly separating taxes and duties that were to be levied and collected by the center and states, as also those to be levied by the center and collected by the states. Of the taxes collected by the center, the structure identifies those, which are to be shared with the states and those that are retained by the center. Since most of the productive taxes are in the Union list or are collected by the Center the fiscal system at present, which has been virtually unchanged since the early fifties, involves resources flowing from the union to the states through allocations by the Finance Commission, Planning Commission and Union Ministry of Finance. The Constitution provides for a Finance Commission to be appointed once every 5-years to decide on the mechanism of sharing divisible taxes between the states. The Planning Commission and the Union Ministry of Finance, through its annual budgets provide for mechanisms for distributing the resources in the central sphere to be spent within the states. The Planning Commission as we have already noted is neither a constitutional body nor a statutory institution. Its fund allocation is on the basis of need of planned development. The proponents of a more federalized structure have always felt uncomfortable with the concept of a planning commission. The argument is purely formal, the constitution, it is said, does not provide for any mention of planning except for a brief mention in the concurrent list[28]. However the implementation of plans has come to be accepted as the joint responsibility of the center and the states. The fiscal arrangement so identified worked reasonably well in this period for two major reasons. For the most of this period the same party was in power

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[26] Part V Chapter I (Article 52-78) relates to the Union Executive, Part V Chapter II (Art.79-132) relates to the Parliament and Part V Chapter IV (Art.124-147) relates to the Union Judiciary. The union executive power is vested in the President with his Council of Ministers to aid and advise him. The legislative power comprises the President and two houses of Parliament.

[27] The features governing the distribution of legislative power under Indian Constitution are outlined in Schedule VII; List 1 with 97 entries, is the union list, list 2 (66 entries) is the state list and list 3 (47 entries) is the concurrent list. Residuary powers not found in any list are vested in the union. In some situations where, if either the state agrees or there is emergency, the union may be vested with legislative power even on state subjects

[28] The first finance minister of independent India Finance Minister John Mathai had a well-known disagreement with Prime Minister Nehru on this issue.

in both the center and the states. Secondly and possibly more importantly the expectation that the process of central planning and resource raising will rapidly increase the divisible share implied a wide consensus on the framework

1965 - 1980: This period saw a major change in the political character of the system with non-congress governments getting formed and gaining stability in a number of states. However, the basic conservatives of fiscal decision making ensured that central budget deficits were small in relation to GDP and in fact the center almost always had a surplus on the revenue account. This implied that no major strains developed in center state fiscal relations even with non-congress Governments. For example in 1979 the 7th Finance Commission had observed that 'the center state financial relations envisaged in the Constitution had stood the test of time and work fairly smoothly, but there is weight in the argument that the President by stipulating the terms of reference to the Finance Commission can reduce the arbitrariness in the planned allocation by the Planning Commission.' However the picture was rapidly changing by this time and concerns due to the lack of buoyancy in state finances had created demands for a relook at the issue of center state fiscal relations.

1980 – 1995: The eighties proved to be a critical period for both center and state finances. The states saw a rapid growth in a number of non-developmental components of expenditure relating to subsidies and interest payments. Thus the growth in current expenditure out stripped the growth in tax and non-tax revenue. In this connection it has been increasingly argued that the center has got all the important and elastic sources of revenue and the states are spared with limited resources. Further since collection of major taxes is with the center there is greater attention to improve yield of non-sharable taxes or where the states get less[29], though most of the social welfare and nation building departments are under the care of the states only. The fiscal scheme makes for a yawning gap between the fiscal requirements of the state and their revenue sources, and thereby putting them under continuous dependence on the Center for covering their deficits.[30] In the Srinagar Statement of the major opposition they have argued that the authority of the Planning Commission and the Union Ministry of Finance to offer discretionary grants to the state must be drastically curtailed. Such discretionary transfers now the amount for more than 70% of the total transfers to the states and constitutes a major source of arbitrary behavior on the part of the center.[31] The West Bengal Memorandum to Sarkaria Commission similarly argued that the planned and non-planned allocation should be done on similar criteria. The Sarkaria Commission considered in detail all these arguments especially the plea suggesting that the states should have more power to impose taxes on their industries.[32] But the case for transfer of some central taxes to the states did not find favor with the Commission. Nor did the Sarkaria Commission suggest any major modification in the basic constitutional scheme of fiscal relation

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[29] The use of surcharges on Income and Corporate taxes, instead of revisions in rates, is a case in point.

[30] Singh: - Center-State Relations in India 1990, HK Publishers and Distributors, Delhi, p.160.

[31] The statement adopted by the opposition parties at their meeting in Srinagar, October 5-7, 1983, Of Centre-State Relations**,** 1983, Progressive Printers, New Delhi, Para 24, p.9.

[32] Memorandum of Government of West Bengal on Centre-State Relations, December 1977.

between center and the state is concerned. But later the Tenth Finance commission noted that " We are of the view that there is a clear rationale for the finance commission to deal with the revenue account as a whole and not merely the non-plan revenue expenditure" and further also that "...it would be in the interest of better center state relations if all (emph added) central taxes are pooled and a proportion devolved". In the 1997 budget the Union finance minister accepted this principle and it is being implemented from the 1998 budget.

The Judiciary:

1960 – 1965: The constitution provides for a three tiered judicial structure with the Supreme Court of India as the apex court. The Supreme Court is the watchdog of Indian Constitution since the Court enjoys wide powers of judicial review. By virtue of this power Supreme Court can strike down any of the laws enacted by the Parliament. Judicial review has been decreed to be part of the basic structure of the Constitution. The Supreme Court has powers to issue directions, or orders or issue writs for the enforcement of any right conferred under Part III of the Constitution.

The powers of the High Courts are guaranteed under Article 226 of the Constitution. The power of the High Court to issue writs is wider than that of the Supreme Court. It is not confined to fundamental rights, but applies to all cases of alleged breach of rights. [33] In 1960 there were 8 Supreme Court Judges, 284 High Court Judges and approximately 2182 subordinate Judges.

Almost from the very beginning the tension between the legislature and the courts became apparent with the Supreme Court striking down land reform legislation as being violative of fundamental rights leading to the first and second amendments to the constitution. In AK Gopalan (AIR 1950, SC 27) the court upheld the principle of judicial review. However on the whole there were few areas of disagreement between the courts and the legislature.

1965-80: This period saw some of the most fascinating interactions between the courts and the executive/legislature. In A.K. Gopalan,[34] the Court was only reviewing the procedure in which law was established, but in Keshavanand[35] as well as in Maneka,[36] the Court brought in the concept of natural justice in the process of legislation as well. Finally more recently in Minerva Mills[37] judicial review has been held to be the basic structure of the Constitution and therefore cannot be tampered with or defaced with even by constitutional amendments. These Judgements arose in the context of the 25th and 42nd amendments to the constitution which

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33 *Calcutta Gas Company v. State of West Bengal*, AIR 1962 SC 1044.

34 *A.K. Gopalan v. State of Madras*, AIR 1950 SC 27.

35 *Keshavanand Bharati v. Kerala*, AIR 1973 SC 461.

36 *Maneka Gandhi v. Union of India*, air 1978 sc 597.

37 *Minerva Mills v. Union of India*, AIR 1989 SC 1789.

sought to give primacy to the enforcement of directive principles over fundamental rights, the courts held that would be a violation of basic structure.

1980-1995 : The period saw a marked enlargement of the power of the judiciary, with the growth of Public Interest legislations. As a consequence the courts have intervened in a number of areas related to environmental degradation, human rights, child labor etc. to force the executive to take remedial action. The seventies had seen an attempt to increase the power of the executive over the Judiciary through the appointment and transfer of Judges. This was rectified by the court in SP Gupta v Union of India (AIR 1982 SC) and later in the PIL of The Supreme Court Bar Association where it held that the consultation, with the Chief Justice of India, provided in the constitution must be effective. In practice this has meant that the concurrence of the Judiciary is needed in appointing or transferring judges.

The Executive:

The executive power of the state is vested in the President. The President exercises his executive power either directly or through officers' sub-ordinate to him in accordance with the Constitution.[38] By virtue of the provision contained in Article 74 of the Constitution of India there is Council of Ministers to aid and advice to the President.[39] A combined reading of the Constitutional provision explicitly shows that the union executive (i.e., the President) in fact enjoys very wide powers. But the actual functioning of the Constitution has taken a different footing and the Council of Ministers (especially the Cabinet) have been made the real seat of power.

One of the misnomers of the present century in liberal democracy, is that, law is made by the legislature. Like in most other countries in India, too, we find in every statute a rule making power of the government. The quantum of rules, regulations, orders, guidelines and notifications in the last fifty years in India would certainly be twenty times more the quantum of total legislative efforts. Further most legislations originate in the executive with somewhat limited scrutiny of the legislature. Thus in effect conferring much greater powers to the executive.

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[38] Executive power must be executed in accordance with the Constitution - including in particular the provisions of Article 14. (*Rao v. Union of India* AIR 1971 SC 1602. *Sanjeevi v. State of Madras* AIR 1970 SC 1102). Executive power may be exercised without prior legislative support. (*Maganbhai v. Union of India* 1969 SC 783. *Ron Jawaya v. State of Punjab* (1955) 2 SCR 235.) Executive power is the residue of functions of government; which are not legislative or judicial. *Madhav Rao Scindia v. Union of India* AIR 1971 SC 530.

[39] Article 74 as originally framed does not envisage a Cabinet at the Centre which enjoys parmountcy as regards executive power but after the 42nd and 44th amendments to the Constitution of India and decisions of *Shamsher Singh v. State of Punjab* (AIR 1974 P 2192) and *S.P.Gupta v. Union of India* **(**AIR 1982 p.149), the President is bound to act on the advice of the Cabinet. In *State of Rajasthan v. Union of India*, (AIR 1977 SC 1361) the Supreme Court recognized the existence of a powerful Cabinet though not constitutionally envisaged.

Indian Courts, in their assessment of administrative law have emphasized the principle of audi alteram partem, commonly interpreted as fair hearing as a rule of Natural Justice.[40]

There has been little formal change in this structure except that with the growth of the public sector and increased involvement of the Govt. in major areas of economic activity, the powers of the executive have grown immensely. In 1976, the practice of the President acting on the advice of the Cabinet was given formal sanction with the requirement that the President is bound to act according to the advice given. The exact liability of the council of ministers has not been fully clarified but is these days as we write forming the basis of judicial intervention. The nature of the intervention is to set limits on the discretionary power of the executive and as well fix responsibility for damage on the ministers. In recent years with the rise of minority Government's and coalition Government's there has been a slight increase in the powers of the president, as the president has a degree of discretion in deciding which party to invite to form the Govt.

Tribunals :

A major factor in the post-independence legal structure has been the growth of tribunalised justice. There are a variety of tribunals operating in the country, like Land Tribunals, Industrial Tribunals, Tax Tribunals, Service Tribunals, Company Law Board, Water Pollution Tribunal, Air Pollution Tribunal, Family Courts (which is a half way between the Court and Tribunal). These came up for two main reasons. Firstly, where a degree of specialized knowledge is required to decide the case and secondly where the various regulatory acts, Companies Act, MRTP Act, the various environmental acts gave wide powers to the state to regulate business; tribunals were used as the primary mechanism. By 1960, most of the major tax, labor and land tribunals were in fact in place. The conventional argument in favor of tribunalisation was that conventional take long time to settle disputes and raise litigation costs. However the advantages may have been overstated as due to the possibility of appeal to high courts and supreme court as well as large backlogs in the major tribunals, has created significant costs of its own.

[40] The Supreme Court has observed that the principles of Natural Justice have to be considered "as an essential requisite for the procedure established by law, *Maneka v. India*, AIR 1978 SC 597.

Box: Income Tax Appellate Tribunals

The following special features have been noted in tribunal proceedings:

i) In almost 55 to 60 percent of cases, the Income Tax Department itself lodges the appeal against the decision of the commissioners of appeal (who are also members of the department). Further it apparently loses 95% of these cases.

ii) At the Regional Tribunal level, the Income Tax Department on an average, does not seek more than one or two adjournments. In tax cases, the assessee is interested in prolonging the dispute, as the time factor erodes the value of the claim. Thus most attempts to delay by adjournments, reference petitions, or appeals come from the assessees. According to the Comptroller and Accountant General 's (CAG) Report, 25,336 cases were pending in various High Courts as on 31st March 1992. Out of these, 5,064 cases were pending for over five years, 6,235 for over three years, 8,128 for over one year and 5,909 cases upto a year. Pendency at the tribunal level is also very high. For example, Bangalore has one bench. But it has a backlog of about 15,000 cases. Hyderabad, with two benches, has a backlog of about 13,000 cases. The situation in Bombay and Delhi is worse. The 'output rate' is generally five to six cases per bench per day. At this rate, the Bangalore bench would have a capacity of deciding about 1,800 cases annually, against the average number of appeals filed of over 3,000 every year.

In addition the tribunals suffer from some structural defects as well:

a) The District judges transferred to these bodies are older, average age being 54-55. Many of them do not have any formal academic background in tax jurisprudence and revenue matters. Besides, long exposure to civil and criminal litigation creates a different orientation. Few advocates are appointed as judicial members and those who are lack experience and practice in tax matters.

b) Accountant members of the bench are either chartered accountants or revenue officers who generally lack adjudication skills.

1965- In 1976 with the 42nd amendment to the constitution a category of constitutional Tribunals, under Articles 323 A and 323 B was created. Central and State Administrative Tribunals, Land Tribunals and Custom, Excise and Gold Tribunal have so far been included in the Constitutional Tribunals. This was done in order to exclude the jurisdiction of the High courts. In Sampat Kumar v. India (AIR 1987 SC 386),[41] the Supreme Court held that, if the Tribunals are constituted to be a substitute of the High Court, they must provide as a successor of the High Court in every state, then only principle of substitution could be allowed. But insofar as the jurisdiction of the Article 33 and 136, the Tribunals are covered by the judicial review of the

[41] Rules made under Article 329, and 327(A) to specify the procedure to be followed by the Constitutional Tribunals, which ousted the jurisdiction of the High Courts, and also of the Supreme Court excepting the jurisdiction of the Supreme Court under Article 136, was challenged as violative of the basic structure of the Constitution.

highest court.[42] In spite of this no further additions to this class of tribunals have been made. Effectiveness of tribunals is partly a function of the nature of the law being implemented and partly inherent in the structure of the system. We will defer issues related to specific laws in our discussion of elements of the legal system, but some general concerns about tribunals can be seen in the case study on the Income Tax Appellate Tribunal. The eighties saw establishment of tribunals for Consumer Protection and the rehabilitation of Sick Industrial Companies and recently in the nineties we see the establishment of the Debt Recovery Tribunals and an appellate tribunal for SEBI.

LEGAL PROFESSION

When India achieved independence there were about 40,000 lawyers in the country including Bar-at-laws, Advocates, Pleader and Mukhtiars. There were fourteen High Courts and about 5000 subordinate courts in the country. The Advocates Act 1961 introduced uniformity in the profession. The Act of 1961 replaced the Indian Bar Council Act 1926 as well as all other laws in various provinces including the Legal Practitioner Act 1879 relating to the profession. The Act based on the recommendation of the Law Commission of the all India Bar Committee (1953), introduced the following:

1) It established an All-India Bar Council with a common roll of advocates ,

2) Advocates have the right to practice in any part of the country, in any court including the Supreme Court.

3) A single class of legal practitioner known as advocates has been introduced dispensing with all other classes of law practitioners like pleaders and mukhtiars etc.

4) A uniform qualification for admission to the profession has been introduced.

5) An autonomous Bar Council has been established for the whole of India as well as for each state who are given the power to regulate professional ethics.

There were at that time 24 law schools in the country. There were 6872 judges; 87,268 legal practitioners and lawyers; and 5848 para-legal workers.[43] In the early 60s there were not many new schools founded but from the late sixties many new law schools started being affiliated to the universities and many new universities were also founded. Due to the cumulative effect of this process and the patronage of local political leaders there were by 1995 nearly 450 Law Schools with an average annual intake of 200,000 students and an annual output of nearly 60000.

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[42] More recently a Supreme Court decision appears to have restored the writ jurisdiction of the high courts.

[43] Menon, The Legal Profession, Bar Council of India Trust 1983, New Delhi.

About 1/3 of the law graduates seeks practitioners certificate from the Bar Council of India.[44] At present there is about one advocate for every 20 thousand population.

At present there are, 26 Supreme Court judges, about 540 High Court, 9000 subordinate judges including 336 District Judges, and with another 2000 judicial officers posted at various tribunals constitute the total judiciary. Therefore the population per judicial officer come to an astronomical figure of about hundred thousand for every judicial officer excluding the High Court and Supreme Court judges. Total expenses on the Judiciary have remained rather low at approx. 1.7% of the total budgetary expenditure, over the entire 35-year period. Out of this almost 60% is recovered from court fees and fines. The infrastructure in the subordinate courts and even some of the high courts is quite poor. Use of modern technology, like computers, is limited and even that has only recently begun. Only recently did the Supreme Court computerize its operations.

Though India has the second largest population of lawyers' in the world, about four hundred and fifty thousand lawyers, but per capita availability is very low. Further given the poor quality of legal education even this is not very well trained. The poor quality of advocacy has its impact on the entire judicial process. The legal practice is highly individualized with generalists dominating the field. There is however a discernible trend, though probably not large as yet in numerical terms, towards specialization and group practice. The profession is regulated by the autonomous Bar Council of India.

One of the biggest problems facing the legal system in India has been that of delay. It is difficult to give precise estimates but some idea may be obtained from the fact that in 1961, in the supreme court, the turnover was at an average of 464 cases per judge per year, this number had increased to 2025 cases per judge by 1995. Inspite of this the number of cases filed continues to exceed the disposal rate. The problem is much worse in the high courts and subordinate courts.

The growth of Social Action Litigation (SAL) and Public Interest Litigation (PIL) has further exposed the weaknesses in judicial training. The judicial culture, to be compatible with the changing character of litigation and management, requires a new pattern of organizational learning, and capacity building for new generation of philosophy and thoughts on the basis of social needs. In response to this need in 1995 a Judicial Academy was established.

Legal Education: Indian universities and Law schools have not given adequate importance or priority to legal education. Investment in legal education in the country is very low, more than half of the 450 law schools function in the evening, more than three fourth do not have any full time teaching faculty or even a full time Head. Local Practitioners teach in their spare time sometimes in the evening. There are inadequate library facilities. Attendance in classes is poor. The three year law course was started in 1961, all India, as the uniform system but two year courses continued side by side for quite a long time. Under the 1961 Act, practical training in

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[44] Menon, Perception of the Role of Law and Lawyers in Indian Society - A paper presented in All Australia-India Legal Education Conference, 1996.

law and an examination thereafter was required (section 24(1)(d) of the Act). The State Bar Councils were required to frame rules for this purpose. This led to utter confusion as in some states there were practical courses conducted with an examination before enrolment and nothing in other states. Ultimately this requirement of practical training was abandoned.

Different reports of the Law Commission and Education Commission have outlined the poor position of legal education. The Bar Council has the power to regulate the professional legal education did not have the expertise and the University Grants Commission, in charge of higher education, did not have the intention to do so. Legal education thus was in a limbo. Some good law schools did come up, e.g., in Banaras, Delhi, Cochin, Lucknow, Aligarh, and Pune, largely due to individual efforts of legal scholars and teachers. These law schools could not meet even the immediate demand of the profession. In addition a significant portion of their products went to U.S.A., U.K. and Germany for higher education.

From the mid 70s, there has been discussion in the profession about a model law school and a model five year integrated law course in line with other professional courses like medicine and engineering. The Bar Council of India framed rules and syllabus for 5 years' law course and declared that from a cut off year to be declared by the Bar Council of India, 3 years courses would be stopped. But this could not be implemented due to resistance from vested interests. Finally, what has happened is that a few law schools (specially in the South) started running 5 years' law courses and others continued 3 years conventional law course as post-graduate level education. The National Law School of India was established as a `law teaching University' of the country and started with a 5 years' law course in 1988. Inspired by its success, the 1995 Law Ministers Conference and Judges Conference decided that each State should have a model law school in the pattern of National Law School of India. Bar Council and UGC held a combined workshop to prepare a uniform syllabus in October 1996 for the 5-year law course. The Bar Council now must amend the Law and Rules of the Bar Council of India in order to make five years' law course as the only professional course in law. The Bar Council of India has already prescribed ten months pre-professional apprenticeship with a lawyer of at least 15 years' standing with effect from the `1996 batch of passing out student'. This program has already come into force w.e.f. July 1, 1996 without any preparation.

Non-Formal Dispute Settlement Institutions:

India has a rich diversity of community institutions dealing with disputes (Baxi, 328) especially in rural areas. Some of these institutions have long cultural background as well as participatory techniques. `Panchayat' or the Council of five, as these Institutions are called relate to various Kula (family); Sreni (Class/Caste) or Gram (village) matters. For example people in Dharmasthala (a village in rural Karnataka) do not go to any formal Court. A wise Council even today settles disputes amongst the people of nearby villages. Gujarat, Maharastra, Karnataka, Andhra Pradesh, Madhya Pradesh and Tamil Nadu still maintain many of these non-formal people's Court for resolving disputes. Similarly non-formal dispute resolution mechanism are still common to most tribal communities. But in West Bengal there is virtually no non-formal institution except among the Santhals (a tribe) in Purulia and Bankura (two districts). This maybe because Bengal had exposure to formal education, industrialization, urbanization and government employment under the British government earlier than any other State of this country. Non-formal Courts or Institutions have survived primarily in the non-British India or Princely states. In some cases in the Northeast the tribal communities have their own system recognised by various Statutes (Section 5 of the Criminal Procedure Code) as the State sponsored formal system (example, Shiyan's Court in Meghalaya is recognized as the State Court).

The trading communities, in rural India, also have some type of non-formal dispute resolution mechanism. In urban environments, trading communities have their own associations recognized under the overall umbrella organization of Federation of Indian Chamber of Commerce and Industries (FICCI). These Associations actively help the members to resolve their disputes. A sample study showed that the Wholesale Rice Dealers Association in Bangalore successfully resolved disputes among its members, so much so that there was no occasion for any member to go to the Court in the last ten years (Mitra,178). Unfortunately, these associations don't keep any formal record of resolution of these day-to-day disputes between the members, members on the one hand and the transporting companies on the other and with the retailers. There is no way to assess the number of panchayats or non-formal dispute resolution institutions over the whole country nor the number of disputes solved by those bodies.

In the late seventies, as a desperate move to provide expeditious and cheap legal services to the poor, Lok Adalat, a non-formal institution for decision making started as a people's movement in Gujarat. Soon the movement gathered public support due to number of reasons, including patronage of leading legal luminaries. In response to this development the Legal Services Authorities Act, 1989 was passed to give some statutory back up to this movement. The popularity of the movement can be envisaged from the following table.

Table 2.1: CASES SETTLED IN LOK ADALAT 1982-93

State	Lok Adalats	Cases Pleaded	Cases Settled	Advise Given
Gujarat	355	78,375	52,497	2623
Maharashtra	553		19,245	
U.P.	1349		13,66,869	
A.P.	65		53,153	
Orissa	174		97,017	
Rajasthan	293		4,64,366	
Assam	16		1,456	
T.N.	131		15,025	
Kerala	12		784	
Karnataka	965		2,39,034	
Bihar	41		41,354	
M.P.	344		5,10,354	
Haryana	310	1,29,046	1.03,666	
Union Territories	148		22,957	

Source: Law Commission Reports

Substantive Economic Laws

At independence, India's overall economic condition was appalling. Agriculture was marked with low productivity, insufficient production and highly vulnerable to droughts or floods in a cyclical presence. A feudal system of land tenure Zamindari in large parts of the country deprived 'tillers' the right of ownership and was a major source of social tension. Modern infrastructure was limited to urban areas. There was wide spread poverty and underemployment. In addition the trauma of partition had major distortions in the economic structure[45] and on the population in affected areas. However compared to the other postcolonial countries in Africa and Asia India had a relatively more diversified industrial structure, financial institutions and a network of stock exchanges. In absolute terms however industrial capitalism was limited and in important areas under foreign control. Over half the industrial production and value added was in just two industries Cotton and Jute. Technology and engineering education were at a low level. It would be fair to say that relative to the aspirations there was a wide gap. Thus the period immediately after independence saw rapid growth of policy, both economic and legislative. During this time India adopted a system of constitutional governance, rule of law, and distribution of powers between various functionaries of the State with checks and balances.

[45] For instance in both Cotton and jute the Mills were in India but the raw materials were cultivated in Pakistan.

By 1960 most of these laws were in place. There was little change in this framework between 1960 and 1965. We examine this framework in some detail.

Law governing property rights including right to Land:

Real & Personal Property: The primary area of legislative concern in the matter of real property in India was in issues related to land. If one looks at 9th Schedule under Article 31-B, one gets a sense of the importance of the concept of landed property. There are 258 legislation made for reforming the land tenure, land holding and the land ownership system. Land Reforms were mostly, done between 1948 and 1965, with Zamindari abolition. The primary concern was that of changing the land tenure system. The economic implications of commercial vs. Subsistence farming and the rural credit system were not that carefully evaluated.

In urban areas the main interest was in Land Development and Planning. Some of the important legislation by the States and the Center are: West Bengal Land Development and Planning Act 1948, Delhi Development Authority Act, Madras Development Authority Act, Calcutta Improvement Trust Act 1911, Bombay Improvement Trust Act, Bombay Land Improvement Schemes Act 1942. All of these relate to the development and use of urban properties. India does not have a comprehensive real estate law even though urban land has become an important economic factor. The Development Authorities constituted under these acts have the responsibility of acquiring land and converting them to residential sites for individual use. They are given the power to raise resources through local taxes and charges, as well from land development. Typically the properties are sold to individuals on standard form lease- cum-sale agreements. These authorities have similar structures and rules, and typically have a number of lacunae. For instance there is no law to regulate developmental Housing complexes that have important, the laws relating to Mortgage, Lease and Rent Controls are often quite old and inadequate to regulate the entire gamut of real estate dealings.[46]

Almost all states developed some form of Rent Control legislation. These Acts have been criticized as being anti-developmental. The law is highly litigative requiring extraordinary long time to settle disputes. Once a building is given for rent it comes under the highly bureaucratic control mechanism under the rent controller. It is the rent controller who regulates the entire landlord tenancy relation. There are protections against eviction. The grounds for eviction are limited. Prime Urban properties in Bombay, Calcutta, Madras, Delhi are covered under these laws and causing a major hurdle in their redevelopment.

Land Laws: The constitutional position in relation to land is one of the most interesting areas in Indian legal history. Some of the major tussles between the judiciary and the legislature took place over the right to property and compensation for acquisition. The changes in the law

[46] To illustrate, almost all property transactions in Delhi are carried out under Special Power of Attorney. In other words what is transferred is not the title but a complex web of rights, which include a irrevocable Power of Attorney, a long-term lease and a will and of course physical possession. The reason is that the owner is a leaseholder, and transferring the lease is incredibly cumbersome and expensive: 50% of the unindexed capital gains were to be shared with the development authority.

that took place as a result in this area both in case law and by way of amendments to the Indian Constitution are very interesting areas of study. This is one of the few areas where the judiciary and the legislature were in constant conflict at least till the late seventies. At the beginning of 1960 the constitutional position was as follows:

i) the individual had a fundamental right to acquire, hold and dispose of the property;
ii) the State could not deprive the property of an individual without the authority of law;
iii) the State could not acquire any property without granting compensation for the same and either had to fix the amount of compensation or specify the principles on which it would be granted. This was subject to some limitations was that the act of acquiring the property could not be questioned on the ground that the compensation fixed was inadequate. The prerogative to fix the amount of compensation whether adequate or not was with the Legislature.[47]

The State was however required to acquire or require[48] the land only for public purposes;

(iv) the right of an individual to challenge any legislation relating to land laws (in particular acquisition of estate) was limited, viz., such legislation could not be challenged on the ground that they violate fundamental rights; and
(v) the restriction mentioned in (iv) above was supplemented by providing that any act inserted into the Ninth Schedule to the Constitution could not be challenged on the ground of violation of fundamental rights[49].

Between 1948 and 1965 almost all the states had enacted a variety of legislation relating to land reforms. These land reform legislation were primarily enacted with the objective of correcting the unequal pattern of land holdings in the rural areas, that too in the context of agricultural lands.[50] They involved identification of excess land holdings, nature of tenancies and

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[47] As per the amended Art.31 (2). This particular change was brought in through the Fourth Amendment in 1955,after the Supreme Court had in various cases nullified laws on the ground that the compensation fixed was inadequate. *See*, for eg. *State of West Bengal v Bella Bannerjee*, AIR 1954 SC 170.

[48] The Amendments in the Fourth Amendment Act 1955 were made to serve this objective, as Parliament was not willing to accept the judiciary's interpretation that compensation had to be just and equivalent of the property acquired.

[49] As per Art. 31A of the text. This Article was inserted by the Constitution (First Amendment) Act, 1951, after the decision in *Kameshwar Singh* where the Bihar Land Reforms Act was held to be violative of Part III. The Fourth amendment in 1955 further reorganized this article by enumerating the various kinds of laws saved by this article.

[50] The definition of agricultural land assumes great importance, as that is the basis for the entire paradigm of land reforms. Different States have defined agriculture in different manners so as to cover the local practices too. The broad definition is however the same. For e.g. the Karnataka Act defines agriculture to include horticulture, raising of crops, grass or garden produce, diary farming, poultry farming, breeding of livestock and grazing but specifically excludes the cutting of wood only. This broad definition makes a lot of difference when the ceiling limit is being fixed as even land used for grazing etc is computed to arrive at the ceiling limit in case of each in individual. Through an amendment to the Karnataka Land Reforms (Amendment) Act, 1995, even `aqua-culture' has been brought into the definition of agriculture.

other land relationships, land ceilings, and acquiring & redistributing excess land. While some states went in for a comprehensive legislation[51] others went in for different legislation for each purpose.[52] The enforcement methods adopted in each State also varied depending upon the local organizations that were in existence. This legislation entailed identification of land holdings with the objective of ensuring that the tiller should also be the owner of the land; Abolition of certain systems of land holdings; Ceiling and identification of Excess land and its Distribution.

We shall briefly examine the Karnataka Act to understand the broad pattern of land reforms. It should be however noted that land reforms were only partially successful in Karnataka. The Karnataka Act was passed in 1961 but it came into effect only in 1965. The Act was subjected to a major amendment in 1974. The Act has various chapters dealing with tenancies, ceiling and restrictions on holding and transfer of agricultural lands. Formally the act prohibits creation of new tenancies and grants to existing tenants unlimited and inheritable use rights. The Act vests the ownership of land subject to tenancy or lease in the state government. The Act imposes a prohibition on the disposal of land by the tenant who has been registered as an occupant as per this Act.

The Act also imposes a ceiling on the land that can be possessed by an individual, whether as a landlord before the beginning of the Act or after being registered as the occupant under the Act. The land in excess of the ceiling limit is then vested in the State and sold as per the Act The Act provides for exemption of plantations, leases obtained by industrial, commercial under-takings, co-operative societies etc. The Act prohibits the ownership of agricultural land by companies; it also prohibits transfer of agricultural land to non-agriculturists.

Inheritance: Inheritance Rights in India are governed by the succession laws of various religious groups. In the case of inter-religious marriages or marriages under special acts the Indian Succession Act is applicable. Hindus who constitute 70% of the Indian population are now governed by Hindu Succession Act of 1956 which prescribes equal rights to male and female children. This law has not changed since 1956 excepting that in some states the Hindu joint family itself has been derecognised and in some other states women have been declared to be coparceners in the Hindu joint family.[53] In spite of the codification of the Hindu law, which provides for enhanced rights for women and their share in family property, not more than 3% of the land in India is registered in female names.[54] This is because of several social reasons, namely, use of testamentary succession has increased giving ancestral property to the male

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[51] e.g., the State of Karnataka has enacted a comprehensive legislation namely, The Karnataka Land Reforms Act, 1961.

[52] For e.g. The State of Uttar Pradesh has enacted various legislation, viz. The U.P. Zamindari Abolition and Land Reforms Act, 1950, The U.P. Imposition of Ceiling on Land Holdings Act, 1960 etc.

[53] The State of Kerala has abolished Hindu Joint Family System, whereas state of Andhra Pradesh and Karnataka have declared women as coparceners in the Joint Hindu Family.

[54] Mitra and Balchandran, *Role of Women in Land Management***,** a research conducted on behalf of HABITAT 1992.

children only, and also that due to socio-cultural practices which ensure that daughters do not claim their rights in ancestral property.

Intellectual Property Rights: Article 51 of the Directive Principles of State Policy makes it incumbent upon the State to foster respect for international law and treaty obligations. Article 253 of the Constitution, empowers the Parliament of India to legislate for implementing any international treaty or agreement. Further the Union list in the seventh schedule lists under item 49 "intellectual property". Although it has nowhere been clearly stated, the obvious conclusion is that the power to formulate laws relating to intellectual property and accede to international treaties in this regard is with the Parliament.

Statutory Regime: India's historical record, present position, and the future course of action in regard to the protection of intellectual property rights (IPRs) presents a fascinating aspect of the Indian legal system, the developments in which are far from settled at the time of writing this report.

But, for understanding the legal position regarding protection of IPRs in India at 1960 and its subsequent evolution, it is essential to first understand the legal regime, which India inherited at independence. While it was in British interest to try to bring Indian laws in line with British laws and World's legal developments in general, the position regarding IPRs was different.

Intellectual Property Rights are directly related to market access and free trade. As one of the purposes of colonialism was to provide for a captive market for goods and resources the colonial regime resisted, joining the 1883 Paris Convention for the Protection of Industrial Property. As signing the convention would require them to throw open this market to the rest of the developed nations of the world. Thus in 1947 we had the following legal regime in place:

1. The Indian Copyright Act, 1914 (Act 3 of 1914), which was based on the UK Copyright Act, 1911.
2. The Indian Patents and Designs Act, 1911 (Act 2 of 1911).
3. The Indian Merchandise Marks Act, 1889 (Act 4 of 1889);
4. The Trade Marks Act, 1940 (Act 5 of 1940);
5. Accession to the Berne Copyright Convention for the Protection of literary and Artistic works, 1886, administered by the World Intellectual Property Organization (WIPO),
6. The Names and Emblems Act;
7. The Drugs and Cosmetics Act;

Immediately after achieving independence, in 1948, the Government of India appointed a "Patents Enquiry Committee"; to review the patents laws in India, with a view to ensuring that the Indian patents system became more conducive to the national interests. The main recommendations of this Committee were that India should join the Paris Convention.

The spirit of the recommendation was partly implemented through the Adaptation of Laws Order, 1950. India also signaled its willingness to be a party to the international treaties and

conventions relating to IPRs by acceding to the UNESCO's Universal Copyright Convention, 1952, which has since seen revisions at Paris and Berne, by enacting the Copyright Act, 1957 (Act 14 of 1957); and The Trade and Merchandise Marks Act, 1958 (Act 43 of 1958).

But the patent regime under the Indian Patents and Designs Act, 1911 (Act 2 of 1911) continued unchanged. Driven by its fierce nationalistic and isolationist attitude, the Indian Government could not convince itself to accept the recommendations of the First Patents Enquiry Committee[55] to accede to the Paris Convention, 1883. Therefore, the whole issue of patents protection was examined by another Committee, which submitted its "Report on the Revision of the Patents Law" in September, 1959, disfavoring India's accession to the 1883 Paris Convention "for the present", as the provisions of that Convention were more suited to the developed countries.

While India was dithering in its attitude towards accession to the Paris Convention, there was considerable change in the concept internationally, through Revision Conferences held at Rome in 1886, Madrid in 1890 and 1891, Brussels in 1897 and 1900, Washington in 1911, the Hague in 1925, London in 1934, Lisbon in 1958, and later in Stockholm 1967.

The Indian Patents and Designs Act, 1911 (Act 2 of 1911) fell much short of the expectations of these developments at the international level, as it did not take into account even the principles of the changes brought about by the earlier Revision Conferences. This was a source of some friction between India and the developed world.

[55] Patent Enquiry Committee, 1948, Chair: Justice Dr. Bakshi Tek Chand

Laws Governing Factors Of Production

Labor Laws: Indian Labor Jurisprudence is a peculiar mix of the colonial heritage with post independence era concepts of social security and welfare. During the Second World War the Government formulated the Defence of India Rules giving the power to intervene in Industrial Disputes. The Industrial Disputes Act, 1947 followed the structure of the Defence of India Rules.[56] The 1947 Act was has been amended more than twenty times subsequently to incorporate political-bureaucratic rules consistent with the ruling ideology. Under the Defence of India Rules the employers and the employees of any industry could not take any decision of their own, with out involving the state, even if there was some agreement between the parties.[57] The 1949 Act also ensures that the State remains a necessary party. While one may see the logic for the state retaining the right to intervene in Industrial Disputes, the essential inclusion of the state in order to refer the dispute to the National Tribunal; or to the industrial tribunal or to the labor court, has unnecessarily complicated the process of dispute settlement. Thus the decision on whether there is a dispute or not is colored by a political decision of the government. Further once the government takes a decision, any party to the dispute can take the matter to the High Court under writ jurisdiction under Article 226 of the Constitution. So Government, who is not a party and really an `interloper' now, becomes a party to the dispute. The State has thus unnecessarily involved itself into the area of contractual relations between employers and employees. The State should provide rules ensuring `fair play' and provision for `compensation' to the employees, in the event of closure of an industry by the employer. It is irrational to keep an industry open when it is no longer commercially viable.[58]

The process of collective bargaining as a method of settling industrial disputes was introduced in 1956 by amending the definition of `settlement' in section (p) of the Industrial Disputes Act of 1947. However the major loophole remained in weak definitions relating to Trade Unions. Except in some States like Maharashtra and Gujarat where recognition of Trade Union is statutorily provided for, collective bargaining in the rest of the country, has not made much headway. At present there is no central legislation with regard to the recognition of trade unions leading to a multiplicity of Trade Unions, with consequent inefficiencies in bargaining.

In addition to the legislation regulating disputes there are a number of laws governing compensation to workers and other welfare measures. These include the Payment of Wages Act (1936) which is one of the oldest Acts in this area. It was enacted to ensure that wages are paid

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[56] See Rule 81-A, which gave powers to appropriate governments to intervene in Industrial Disputes, appoint industrial tribunals and to enforce the award of the tribunals on both sides. The rule put a blanket ban on strikes. The essential features of these were included in the I.D. Act.

[57] Government was a necessary party under the Defence of India Rules because the government was to see that industrial production was not hampered during war situation.

[58] Section 25-R. Closure of an industry in violation of section 250 is made a penal offense punishable with imprisonment upto six months or fine upto Rs.5000 or both. But in case the appropriate government's order refusing to grant permission to close down is violated, the punishment is imprisonment one year or fine upto five thousand or both.

in a timely manner with no unauthorized deductions. An amendment in 1965 declares any agreement null and void whether contracted before or after the commencement of the Act through which an employed person relinquishes with or without consideration any right conferred by the Act. This type of contracting out has been resolved against public policy.[59] The Minimum Wages Act 1948 (MWA), which came into effect from 15th March 1948, aims at preventing exploitation of workers in scheduled employment's by fixing the minimum wage rates. The employments in the schedule were those "where sweated labor is most prevalent or where there is a big chance of exploitation of labor" arising from a situation where the labor is unorganized or poorly organized. The Workmen's Compensation Act schedules of list of injuries deemed to result in permanent total disablement. The Employees Provident Funds and Miscellaneous Provisions Act 1952, Employees' State Insurance Act, 1948, The Maternity Benefit Act 1961 and the Payment of Bonus Act 1965 were created for employees of factories. These provided a spectrum of social welfare support to workers in organized industry.

In spite of these numerous welfare measures there were still major gaps in the area of labor legislation. India did not have at this point laws prohibiting the use of forced labor or child labor. Further the impact of these on the unorganized sector was limited, either because of the restriction to factories[60] or because of ineffective enforcement machinery.

Capital Markets: The Bombay, Calcutta and Madras Stock Exchanges had started functioning essentially as small clubs, from the beginning of the present century. The legislative history of an appropriate legal regime concerning securities and dealings in securities dates back the Bombay Securities Contract Control Act, 1925. The legislation was not very effective as it made transactions contravening it only void and not illegal.

After the Second World War a boom in the stock exchanges occurred between 1945 and 1946. This was the basis for enacting the present Securities Contracts (Regulation) Act, 1956. The main object of the SCRA, 1956 was to regulate the business of dealing in securities and for this purpose recognition and regulation of stock exchanges. The logic of the enactment was that trading in securities lead to undesirable transactions, which are *primarily speculative in nature.* The Act prohibits trading by "options". Further as these transactions were conducted in Stock Exchanges so it also sought to regulate the stock exchange itself.[61]

With a view of regulating Stock Exchanges the Act stipulates that transactions must be routed through a recognized stock exchange. The transaction must be made either between or through or with a member of a recognized stock exchange. All other transactions were made illegal not merely void as in the pre-independence enactment. Thus the new enactment of the Securities Contract (Regulation) Act, 1956 made the regulation of securities much stricter after

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[59] This type of embargo on free contracting is a typical feature of paternalistic welfare legislation. While the aim is undoubtedly commendable, they further reduce the flexibility of the parties involved in a wage bargain.

[60] A factory under the Factories Act is a manufacturing unit employing with either 10 workers with power or 20 without power.

[61] *Madhubhai Amathlal Gandhi v. Union of India* (AIR 1961 SC 21).

independence. The Act is a Central legislation, thereby ensuring uniformity of securities regulation throughout India. The basic trading environment remained static through the first two and a half phases of economic development till 1990. There was some expansion in the number of Stock exchanges but that was merely a consequence of the growth of other urban centers.

Further with a view to regulate the market for primary issues, the Capital Issue (Control) Act was enacted in 1947 which provided for control over the public issues of shares or stock in the capital of companies. This Act as we have earlier noted formalizes the war heritage of The Defence of India rules. The Act provided that no company, requiring issue of capital, could be incorporated, no company could make an issue of capital; make a public offer for the sale of any security, or renew or postpone the date of maturity or repayment of any security maturing for payment in the State except with the consent of the Central Government. Thus, there was complete control of the Central Government, exercised through the Controller of Capital Issues (CCI), on all matters relating to the primary market. The CCI tended to severely under-price equity, leading to a bias in favor of debt as it raised the cost of equity. In addition to the bias in favor of debt, substantial component of this equity was preempted by public financial institutions, who were also major creditors to these companies. In itself this is not a source of concern as much of Japanese growth was funded in a similar fashion, except that the quality of monitoring by public financial institutions was extremely poor. The closed economy phases of growth disguised the limitations of this institutional structure as there was very little scope to go wrong in either the functioning of corporate enterprises or banks as both were effectively insured by the state from inefficient performance. The problems only started getting visible with liberalization particularly in the late eighties and nineties.

Further recognizing the relatively primitive nature of capital markets the Government established a number of Financial Institutions starting with IFCI in 1948 The Unit Trust of India in 1963, The Industrial Development Bank, in 1964 and others is various states. They were established for the purpose of making medium and long-term loans available to industrial concerns and have come to play a significant role in the capital market.

Banking: Till Independence formal institutional banks served the industrial sectors, while the agricultural and rural requirements were served mainly by the indigenous banking system.

Central Banking: The Reserve Bank of India (hereinafter RBI), was established by an act in 1934 as the Central Bank in India. The Bank came into effective operation in 1937. The RBI was nationalized in 1948. Central Banking falls in the union List under the legislative and executive control of the Union Government. The Reserve Bank of India was initially designed on the pattern of the Bank of England. In England the legal prescription of subordination to the treasury was replaced to one of close cooperation through the establishment of sound conventions. In India on the other hand, this led to super control, where the RBI functioned as an adjunct to the Ministry of Finance.

In addition to conventional central bank tasks, the RBI has developed into one of the key players in a highly regulated economy. As the banker to the Central Government it manages the public debt of the Central Government. The long-term objectives of this are to ensure adequate

finance for the Government and avoid recourse to short term borrowings from the Reserve Bank as far as possible. Treasury bills are the main instruments of short term borrowing by the Central Government. A consequence of RBI functioning as a subordinate to the Ministry was effectively giving the Government an unlimited supply of Treasury Bills. The control of money supply thus effectively was subordinated to the exigencies of Government budget management.

Commercial Banking: The fifties and sixties saw both a expansion of the private banking sector but also a growth of the RBI's ability to regulate and control. However one major area of concern remained the poor spread of banking operations in rural areas. Further the ruling ideology of centralization and socialism sat uncomfortably with private control of Banking.

In the immediate post independence period there were two main sources of agricultural capital, the first was of course, public investment in Agriculture and the other was household savings channeled primarily through the vehicle of the rural cooperative banks. The Agricultural Refinance and Development Corporation, 1963 and Co-operative and Land Mortgage Banks were some of the 1nnovations between 1960 and 1965 for providing institutional finance to agriculture.

Business Organization

In India business can be organized as Proprietorships, Joint Hindu Family, Partnerships, Cooperatives, Private Limited or Public Limited Companies, Government Company, Public Sector Corporation. and as Government Departmental enterprises. The last three of these constitute the Public or State owned sector and the remaining are in the private sector. Each has its own peculiar characteristics and is regulated by provisions in the Constitution, Federal and state legislation and rules. Some of these laws and rules are from the pre-independence era.

The Constitution and Business Organization: Constitutional protection for the formation of business organization is contained in the right to practice any occupation, trade or business subject to reasonable restrictions in public interest. In addition there is a freedom of trade and commerce throughout India. These articles of the Constitution on the one hand must be contrasted with some of the Directive Principles of State Policy, which call for the distribution of the means of production so as to best serve the common good. Does this mean for instance that courts should sanction a more rigorous social control of trade and commerce? This dilemma is further compounded by the presence of Articles, which allows the creation of state monopolies to the entire or partial exclusion of the citizens. In 1963, the Supreme Court attempted to answer this question in Akadasi Padhan vs. State of Orissa,[62] where a State law that sought to impose a monopoly was challenged as violative of the freedom of economic activity. It was held that the Indian Constitution had chosen the doctrinaire version of Socialism in contrast to the pragmatic form of socialism. The Court defined the former to be the view that regardless of efficiency or

[62] *Akadasi Padhan v. State of Orissa*, AIR 1963 sc 1047 at 1053.

economy the nationalization of economic activity was an imperative, while the former, which the Court called the rationalist argument, favored nationalization or state control over enterprise only where it was economically prudent, a decision that had to be informed by an estimate of the level of efficiency, likely to be achieved. The Court stated that reasonability was not a reference point for judging measures taken to form public monopolies. While this did not lead to a situation of outright nationalization in the early phase it does give a very clear indication of the ruling ideology in favor of state control as being desirable in itself.

The nature of economic activity that has been recognized by the Indian Courts, subject to their satisfying monopoly and anti trust laws in India, have ranged from large corporate conglomerations to itinerant and pavement hawkers and traders who sell their wares on the footpaths of thoroughfares in Indian cities and towns. As we will see that the constitutional freedom enabled a vibrant small private sector especially in retail trade and a host of services. However as we turn to the more organized elements of the private sector we find that these freedoms were circumscribed by a number of other rules and regulations to which we now turn attention.

Proprietorships & Partnerships: Proprietorships are the easiest form of business organizations and typically does not require any license or permit except as may required under different acts for shops, factories or trade in specified goods. Similar laws apply in case of co-ownership (joint ownership of individuals) and partnership as well. The Indian law of Partnership, in the form of the Partnership Act of 1932, was built as a result of judicial decisions in the Court of Equity in England. No major amendments have been carried out in this act. The major shortcoming that has been identified over the years has been on the tax treatment of income, which gives this form of organization a disadvantage.

The Hindu Joint Family: Strictly speaking this is not a form of business organization but a variety of activities in the informal sector are conducted under this heading. In 1955-56, the Hindu law was codified. However the Hindu Joint family (Hindu Undivided Family or HUF) was virtually untouched by codification. It consists of a common male ancestor and all his lineal male descendants upto any number of generations, together with their wives and unmarried. Membership of the family is by virtue of birth, adoption or marriage. The property of the family together with any business that it may own belong to the male members of the first four generations called the co-parceners. To be eligible to become a coparcenar, the male member has to be within a lineal distance of four generations, from the head of the family, the eldest male member, known as the Karta. Ownership in the property of the family is through an equal share to which only the male members are eligible, and their respective shares are, normally determined at the time of partition of the property, equal depending upon the number of coparcenars who exist. Even with the growth of nuclear families, the family may still retain this structure to conduct business. There are many advantages in terms of access to family capital, tighter control and some tax benefits discussed below.

The Indian Income Tax Act, 1961 treats a HUF as an assessable entity. The Act grants to a member of a HUF, total exemption in regard to any sums received by him from the income of the family in his capacity as a member thereof. This position has continued virtually unchanged

since 1961 with the exception of the fluctuating prescriptions in the annual Finance Act on the rate at which the tax is to be levied. While similar to a partnership in many respects it has some critical differences that primarily arise out of its character as a family, limited access, longevity etc.

It is difficult to assess the exact role of the HUF in Indian business, as already noted it is the dominant organization in agriculture and a variety of unorganized activities, particularly retail or wholesale trade. In some areas it is virtually impossible to function except in this structure, a leading example would be jewelry trade. In the formal organized sector its direct control is limited accounting for less than 1% of the value added and 0.5% of the capital stock in 1992. But this would be misleading as it does not take account of the fact a significant portion of private corporate business is controlled by shareholdings of what are Hindu Joint families. It is difficult to estimate the total size of these but most private business houses function in this manner.

Companies: Like the Law relating to Partnership, the Indian Company law grew as a result of the influence of the principles of English law. In 1956 the earlier statute of 1913 was replaced by a new Companies Act (1956). The statute is one of the biggest in the country, it provides the legal framework to regulate both private and public limited companies. It also provides scope for formation of unlimited companies though that form of company is very uncommon in India. The Act also provides the regulatory framework for government companies, where government is the major shareholder. But the Act is not applicable to public sector units, which are formed and run under special statutes, and to organizations run by government departments. The major organizational development of this act was to prohibit the managing agency system. The act regulated both the public and private[63] limited companies with the same regulatory framework; standardizing for the first time the periodic disclosures necessary as well as general disclosure systems regarding the company, widening the power of the board of Directors establishing for the first time shareholders' democracy and providing rules of procedure in winding up of companies. The 1956 Act is also one of the most amended act so far. Most of the powers and functions that were initially entrusted with the Central Government in 1956 as regards company law administration were by 1963 vested in the Company Law Board

In addition to the Companies Act, the growth of private companies is regulated by one of the most important bureaucratic laws of this period - The Capital Issue Control Act 1947. The main object of the Act was to canalize the capital flow according to the industrial policy framed by the Central Government. The CCI played a critical role in defining the organizational structure of the Indian Corporate enterprise. Its functioning introduced a bias against equity finance and led to control with smallholdings of the manager/owner. The attitude of the company law board and the government was adverse to hostile takeovers. In 1960s and till now takeover and merger was always viewed as a monopolistic activity and the monopoly commission used to observe this with suspicion. The Companies Act does not have any effective mechanism to regulate hostile takeovers and mergers, excepting that the Companies Act allowed enough space for the directors to refuse registration of shares. Further since a substantial holding of equity was in the hands of

[63] A private limited company is one that is closely held amongst friends and relatives and its number of members can be between 2 to 50.

public financial institutions these issues also acquired political color. The act was rather weak in preventing conflict of interest particularly with regard to insider trading of the companies stock. The Act also was not clear on the exact nature of responsibility assigned to nominee directors.

The growth of Private business was also affected by a number of bureaucratic rules and controls. These had their origins in Rules 81 and 84 of the Defence of India Rules, which gave the state wide ranging powers for "regulating or prohibiting the production, treatment, keeping, storage, movement, transport, distribution, disposal, acquisition, use or consumption of articles or things of description whatsoever..", the rules also gave the power to the govt. to regulate the use and control of foreign exchange, the pricing and distribution of "essential commodities ". Specific acts and agencies later replaced a number of these rules. It is worth noting that a number of development agencies had their origins in wartime agencies of control. In a war scenario concerns of economic efficiency are secondary to the immediate short run goal of achieving fixed delivery targets. The same agencies were now expected to play a more developmental role, it is not surprising then that the final results were not entirely as may have been optimistically expected. There were often instances of the controls operating in contrary directions or with unintended consequences but they were until recently not regarded as fundamental weaknesses in the instruments but arising out of inefficient coordination. One of the key acts for this purpose is The Industries (Development and Regulation) Act 1951. It brings under Central Government's control the development and regulation of a number of important industries and activities. Over time the list was expanded to add new industries in its ambit ensuring that almost all major industries were under the control of the Union Government. The act was implemented along with Industrial Policy resolutions that specified the areas in which private sector activity would be allowed. The licensing regime set up under this act operated virtually un-altered in the first two phases of growth & stagnation. The process of getting a license was full of obstacles and pitfalls and anything but transparent. A study by the World Bank in 1987[64] pointed out that in the period between 1981-85 approximately 43% of license applications were rejected on the ground of adequate capacity. The bureaucratic assumption was that all sanctioned capacity would be installed and in fact utilized. The allocations of licenses were subject to substantial delays. This virtually mirrored the assessment of the Dutt committee in 1969, which said that there were inordinate administrative delays in granting license and there had been an over emphasis on the concept of capacity in the Plans that obstructed growth. Further in an independent assessment the Hazari committee (1966) had found that the process of getting licenses favored the large industrial Houses. However in spite of such scathing criticisms the reaction of the structure was typical. The Dutt Committee for instance concluded that what the system needed was more licensing and more detailed quantitative controls![65]

The combined impact of all these rules was that the structure favored incumbency. Radical changes in structure and organization were frowned upon. While on the one hand large business

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64 *India: An Industrializing Economy in Transition,* World Bank 1987.

65 In fact in response to the Dutt Committee the Govt. announced a new Industrial Policy Regime of 1973. The Govt. did in fact allow some private investment in the "Core Sector" but as this was hemmed in with so many constraints and ancillary restrictions as to make little change.

face hurdles in expansion and investment in new areas, on the other their stakes were protected and were allowed effective control with low stakes.

Public Sector: The Public Sector in India consists of three organizational forms: Public Corporations established under independent statutes; Government Companies established under the companies act; and Departmental Enterprises. The Public Corporation is an enterprise set up by a separate act of parliament. The organizational structure will be described in the act. The enterprise is usually 100% owned by the state it may function as statutory monopoly or in competition with other private enterprises. Public Corporations are subject to control of both the relevant ministry and the Parliament, as well as the Bureau of Public enterprises. The organization is technically independent but in practice the concerned ministry or department can and does play a significant influence on its decision making. Government Companies are established under the companies act and are Public Limited companies with at least 51% ownership by the Govt. Both these forms have been used to create public sector enterprises. The difference between the two forms is mostly formal with virtually no substantive content. The main reasons for preferring the latter in recent years have been in either nationalization, where the advantage is obvious, or since the company does not need parliamentary approval it is easier for the ministry to set up and control. In addition to creation of new PSU's several corporations were formed through nationalization. In 1953, air transport in India was nationalized through the passage of the Air Corporations Act, 1953. In 1956, The Life insurance Sector was taken over and the Life Insurance Corporation was established through a statute of the Indian Parliament. In 1969, fourteen commercial banks were taken over by the State. General insurance and coal mines were nationalized in 1972 and 1973 respectively. In addition to the developmental goals the government also took over a large number of units from private hands to prevent them from closure "with a view to protect the jobs of the workers". Departmental enterprises are adjuncts of government departments and function entirely inside the budgetary framework of the Govt. During the period from 1956 to 1977 government departments too played an important role controlling some key sectors of the economy, such as the post and telegraphs, railways, power (deregulated in 1991), communications, (deregulated in 1994).

While there has been considerable stability in the institutional character of most State sector enterprises there have been some attempts to convert departmental enterprises into independent corporations. Earlier this was done in order to endow them with greater autonomy and a more commercial basis for functioning. In recent years these has been done in order to enable them to raise capital from both domestic and foreign sources. Some key examples of this process were the creation of Coal India (Ltd.),[66] MTNL and VSNL were carved out of the Department of Telecommunications,[67] and recently the conversion of IFCI to a limited company[68]. However

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[66] Coal was nationalised in 1969, when the existing private companies were taken over and the enterprises were run as adjunct to Govt ministries. Later the earlier private units were organised into groups and formed into various subsidiaries of Coal India (Ltd).

[67] These relate to telephone operations in the major metro's and International communications respectively. The rest of the telecommunications sector is still functioning as a departmental enterprise inspite of recommendations to corporatise its functioning.

[68] This does not however change its non-departmental character.

these changes are more superficial than substantive as they do not effect the key operational character of these enterprises. The control of the ministry and parliament continues in virtually the same manner. Audit is still under the Comptroller and Auditor General (CAG). Further even in regard to most matters of labor relations and also on issues of social welfare the judgment in *Bangalore Water Supply (SC 1978)* would hold which characterizes all these enterprises as extensions of the state. Therefore the growth of corporate or non-corporate state enterprises are dictated more by general considerations effecting the growth of the state sector rather than considerations of corporate governance.

Sectoral Laws

Agriculture: Agriculture and all related affairs are in the State list in the Constitution. The legislative and policy effort in agriculture has had a number of dimensions. Land and Land Reform has been a central area of legislative attention for agriculture. In general since agriculture is outside the ambit of the application of companies' law, limited liability institutions in agriculture are limited to HUF's and cooperatives. However, plantations are not subject to this restriction, corporate enterprises have functioned in this area. Further given that this is a state subject it is possible to encourage corporate forms in agriculture through a wider notion of plantations. Since agriculture is a State subject almost all states have passed their own legislation on Agricultural Income Tax, Agricultural Loans, Prohibition of Land Alienation, Pest and Diseases, Produce Marketing etc. Most of these have similar provisions.

The most important of these relate to marketing of agricultural goods. States has theirs own marketing laws that are more or less similar in nature, with some minor variation based upon local customs. These statutes provide for establishment of market, define the market jurisdiction and stipulate the control of the market over the agricultural produce likely to be marketed. A license from the marketing Committee is also made a pre-condition for operating in the market. The Governments have the power to notify the areas for setting up markets. Once such markets have been set up then the produce has to be marketed only in those areas. The states have used these acts to restrict operation of agricultural markets to defined geographical regions. In the early sixties there were phases when even inter-district trade in specified products was ruled out. Subsequently these were relaxed to restrict interstate trade. These restrictions were in operation through out the first two phases of economic development. Their impact was partly to blunt the incentives in surplus regions, but they may have operated to improve incentives in deficit regions. However, as these prevented the growth of a national agricultural market, it hampered the insurance aspect that a large market would provide.

One of the key institutional characteristics of agricultural development in India has been the virtual absence of forward markets for agricultural produce. Forward trading in India has been regulated from independence, and in fact the restrictions date to the operation of the Defence of India rules. The Forward Contracts (Regulation) Act, 1952 regulates forward contracts and options in relation to goods. The Act empowers the Center to prohibit forward contracts and options in public interest. The Act also outlaws forward contracts in notified goods. In view of the seasonal character of the product and the likelihood of wide inter season and inter-region variation in prices the growth of forward market could have played a crucial role in providing

insurance to the cultivators. As an interesting sidelight not only was there very little speculative trading in India, the Indian Govt. when buying agricultural commodities abroad did not use the vehicle of forward contracts to ensure that it got the best deal. In fact discussions on imports are often conducted in open allowing speculative traders to anticipate India's demand and take anticipatory advance positions. Recent examples of this were the decision to purchase Sugar in 1994 and even more recently in Dec 1996 the discussion and decision to import wheat in response to the shortages in North India.

Law Governing Private Economic Activity

This is an area where there has been little legislative effort, the relevant laws either did not exist in 1960 as in there are no competition laws, laws relating to agencies, environmental protection or dated to the colonial era with virtually no changes. The major presumption was that giving powers to the state to intervene and regulate would automatically imply that interests of the public would be taken care of, regulation and control were treated as synonymous with public welfare so the need for additional market regulatory mechanisms was not seen. In any case the belief was that if the market was imperfect it could be rectified by the presence of state agencies.

The colonial insolvency laws governed insolvency and bankruptcy. The Constitution of India provides for insolvency and bankruptcy in Entry 9 of the Concurrent List. So states have made many amendments to both the Statutes. The insolvency act is not applicable to companies. In case of partnership firm, the act operates only when all the partners failed to meet the debt of the firm. In a sample survey[69], it was found that an insolvency petition and its complete proceeding require more than five thousand days. Since the district judges' court is the insolvency court. The study concentrated on the district court and found that a major district court gets about 100 petitions annually which has changed from an average of 60 in 1960s. Besides this increase of workload, there has been no fundamental change in the law structure. It was found that there is no professional or, educational requirement for persons to be appointed as official receivers or liquidators in the District Courts and High court respectively. There is no in-service training as well. In the sample survey, it has been observed that the concerned officials were not adequately informed even about the legal structure.

Companies can be wound up under the provisions of the Companies Act, but here too the requirements of public interest imply that the state or the court can block up winding up proceedings. The procedural aspects of formal liquidation are a major source of delay in winding up companies.

Contracts are governed by the Contract Act of 1872, derived from English Common Law principles. The Act also provides some new principles like: a contract can be challenged on the ground of coercion and undue influence and can be voided,[70] consideration can move to a third party and burden of proof shifts on the nature of unsoundness of mind as well as undue influence.

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69 Mitra NL, *Commercial Disputes* Legal Dimension of Economic Reforms, Allied, 1995, pp 191-194

70 Section 15 and section 16 read with section 19 of the Act.

Also over the years the courts have widened the scope of undue influence or coercion and thus gradually restricted the effective freedom to contract.[71]

The most interesting aspect of Indian Contract Law occurred silently and due to changes in society. In a contract society, freedom of contract is fundamental, but that is not so in a society where contract sometimes takes a mandatory form. The acceptor has only one option either to accept or reject. With increased organization mandatory contracts became a major fact of life. The basic format of the contract its conditionalities and performance are not matters of interaction between these parties. Thee basic format of the contract, its conditionalities or terms of performance are not subject to negotiation but uni-laterally decided by one party.

The Negotiable Instruments Act is an old Act passed in 1882, with very few amendments to date. The definition[72] of negotiable instrument under the act has been very rigid which stands in the way of development of modern security market. In the commercial market, there are many indigenous as well as modern instruments, which change hand to hand almost like negotiable instruments, while the indigenous instruments based upon market custom are treated as negotiable instruments. Other instruments do not get this status. Laws relating to checks in India under the Negotiable Instruments Act are similar to the provisions of Cheques Act of England. One of the major changes to the Negotiable Instruments Act was by the Amendment Act of 1988 incorporating Chapter XVII for criminal penalties in case of dishonor of certain checks for insufficiency of funds in the accounts. Before this chapter was incorporated, the drawer of a worthless check could be at best be charged under the criminal law, under Sec.420 of the Indian Penal Code, on the ground of cheating. The main difficulty with the Negotiable Instruments Act is that the law does not facilitate easy transferability posing difficulty in securitising of non-functional assets.

MAJOR CHANGES TO LAW 1965-1995

The Indian Parliament legislated profusely through positive prescription between 1951 to 1965. Incidentally this was also the period of rapid economic growth. In contrast there has been a stupendous growth in administrative law (delegated legislation) between 1965 and 1985. This considerably enhanced the power of the bureaucracy on the presumption that higher growth in productivity would be possible through growth of a strong administration.

There are two clear distinct phases in legal change, the first is primarily in the period from 1965 till 1980 (or 85) which sees a growth of centralization, administrative controls and the public Sector; and the second is from 1991 with liberalization and the associated change in legal structure. The period between 1980 and 1990 is a hybrid, with different tendencies present. We examine some of these changes in detail.

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71 *Central Inland Water transport Corp Ltd. v. Brojo Noth Ganguly & others* SC 1986

72 Section 13 of the Negotiable Instrument Act defines Negotiable Instruments as "a promissory note, Bill of exchange or cheque payable to order or to the bearer".

1965-1980

This period as we have noted was marked with two broad tendencies, a general increase in the control of the state, and secondly the concern for social inequalities & welfare on the other. We examine this process in some key areas:

Exchange Control: Probably the most significant development of this period has been in relation to measures associated with exchange control. In 1973, in the aftermath of the first oil price shock and the attendant immediate difficulties in Balance of Payments led to the creation of a more rigid and new Foreign Exchange and Regulation Act. The Act creates a regime of prohibitions, permissions, licenses and exemptions in relation to activities dealing directly or indirectly with foreign exchange. The Act effectively prohibits all private transactions in Foreign exchange unless approved by the RBI. Apart from these general provisions the act also contains various specific provisions in relation to transactions or activities which affect foreign exchange. The important ones are as follows:

Transactions relating to goods: the Act prohibits all exports unless the exporter furnishes to the RBI or the prescribed authority a declaration disclosing the full export value of the goods. If the RBI feels that the value of the goods is not equal to the market value then it may direct withholding of the shipping documents unless steps are taken to ensure payment of the correct value. The Government may also prohibit export of goods to particular places if it feels that such export will not fetch the full value of the goods.

Export and Transfer of Securities: The Act prohibits taking or sending of a security outside India, issuing, transferring or creating of an interest to any person outside India of securities registered or to be registered in India, and acquire, hold or dispose of any foreign security, unless the RBI has permitted otherwise.

FERA -1973 also prohibits acquisition, holding, transfer or disposition of immovable property in India, practice of profession or carrying on of any trade or occupation in India, by persons resident outside India without the permission of the RBI. It prohibits Indian residents from settling their property in a manner that vests an interest in a person resident outside India without the permission of the RBI. In addition to these restrictions the act also restricted the operation of Foreign owned companies under the concept of the so called "FERA Companies" with more than forty percent foreign investments". The implication was that specific clearance had to be sought in order to function as a "FERA Company" and such permission was in general not forthcoming.[73] As a consequence a number of companies in fact disinvested their holdings in India.[74] Where permission was given these companies had to function in a restricted

[73] For example in the pharmaceutical industry, certain specific types of drugs had been identified, to which the "FERA Companies" were permitted to enter.

[74] The examples of IBM and Coca-Cola are well known in this regard. A number of other companies, like Levers, BAT etc. divested substantial amounts of equity. This however did lead to a small boom in the equity market, as there was a rush to pick up these underpriced (due to CCI) shares.

environment and were not completely free to expand or diversify. In any case Foreign equity in Indian Companies could not exceed 74 per cent, except in case of 100 per cent Export Oriented Units.

Remittances of technical fees, interest, and dividends etc. were however freely permitted, subject to prior payment of the taxes payable in India. Repatriation of capital (along with appreciation in stock) was also permitted, similarly subject to prior payment of taxes. Foreign Share Capital was required to be contributed by way of cash, and not by way of supply of machinery and equipment, or remuneration for technical know-how and technical assistance fees.

This act acted as a cornerstone for the control regime. As a consequence in addition to the restrictions on the growth of private corporate enterprises, this legislation significantly dampened new foreign investment in India. A number of existing multinationals indianised their operations, the later relaxation in the nineties has created some interesting corporate battles for control. The most visible being between BAT and ITC. The liberalization of the eighties and nineties has seen little change in this act, though the provisions on foreign investment both direct and indirect have been diluted, as well as permission for Indian companies to sell equity abroad through Global Depository receipts. However in the 1997 budget the govt. has proposed that the Act itself be replaced with a more market friendly legislation.

Land: The tussle between the Judiciary and the executive/legislature on the nature of the right to property continued till 1978. The major difference was in the area of compensation, in. Vajravelu v Sp.Dy.Collector,[75] and Union of India v The Metal Corporation of India, and the Bank Nationalization Case.[76] The Court held: The *Constitution guarantees a right to compensation equivalent in money of the property compulsorily acquired.*

Parliament reacted to these decisions by amending the Constitution by way of the Twenty-Fifth Amendment, 1971 and the Forty Second Amendment, 1976, in which the right to compensation was diluted and the scope of the section protecting laws implementing the Directive Principles from judicial challenge. The former was upheld by the courts in Kesavananda v State of Kerala wherein the Court accepted the social values involved in enforcing property rights while protecting individual rights but the latter attempt was rejected in Minerva Mills v. Union of India.[77] The debate was sought to be closed with the Forty-Fourth Amendment, 1978, which removed the right to property from the Fundamental rights reinserted it in a modified form as an ordinary constitutional right[78]. The matter appeared settled but it seems that judiciary is still keen to ensure that the individual possesses some rights against the state.

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75 AIR 1965 SC 1017.

76 R.C.Cooper v Union of India, AIR 1970 SC 564.

77 AIR 1980 SC 1789.

78 Art.300A reads as, *`No person shall be deprived of his property save by authority of law*' which incidentally is the reincarnation of Art.31 (1), which was also removed along with Art.19 (1)(f).

The Bombay High Court in Basantibai v. State of Maharashtra[79] gave vent to such a thought by observing that the word *Law* in Art.300A means a just and reasonable law. The Court relied on Art.21 to come to such a conclusion. The Supreme Court however has not accepted this argument so far.[80]

Another important development related to the passing of the Urban Land (Ceiling and Regulation) Act, 1976. The Act was created with a view to preventing the concentration of urban land and to bring about an equitable distribution in urban agglomerations to subserve the common good. It also seeks to impose a ceiling on the vacant lands in urban agglomerations. Land over the ceiling is treated as excess and vests in the state. Transactions in such excess land are not permitted. This act has been identified as a key factor in undermining the operation of land markets in urban areas and for the spiraling urban land prices in major metros. The operation of the act has been such as to cause major impediments to effective corporate restructuring and relocation.

Intellectual Property: By 1970 India took a number of steps to bring its Patent System partly in line with the Stockholm Convention. Thus it established the Patents act, 1970 (Act 39 of 1970) incorporating all the general principles and most of the major features of the Paris Convention, 1883 (Stockholm Act, 1967) and offered Assistance to the 1970 Washington Patent Co-operation Treaty (PCT), and the 1971 Strasbourg Convention regarding International Patent Classification. Followed by amendments to the copyright act in 1983 and 84 to bring it in line with the revisions to the Berne Convention.

The period from the late seventies saw a revived international interest in the issue of Intellectual Property and Patents. GATT was a very convenient forum for raising such issues. Thus, through the forum of GATT Uruguay Round of Negotiations initiated in 1986, the Government of India was forced to tackle the issues related to protection of Intellectual Property Rights according to international agreements, which it had avoided facing for more than 100 years by keeping out of the Paris Convention 1883. The whole period from 1984 to 1990 saw the evolution of a national debate and a national policy relating to IPR issues.[81] The Uruguay Round of negotiations came to a close in December 1993, and the Marrakesh Final Act 1994, were also signed by India. By becoming a party to the Trade Related Intellectual Property Rights (TRIPs) Agreement India has had to do much more than what mere accession to the 1883 Paris Convention would have required it to do. While India has amended its copyright acts in line with the TRIPS agreement the amendments to the patent acts have run to political trouble.

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[79] AIR 1984 Bom 366.This has been overruled by the Supreme Court later. *See, State of Maharashtra v Basantibai,* (1986) 2 SCC 516.

[80] Art.21 on the Right to Life has been interpreted liberally and is today the fountain of unarticulated rights of the citizens. See, for e.g., *Maneka Gandhi v. Union of India,* AIR 1978 SC 597.

[81] The National Seminar on "Indian Patent System and the Paris Convention Legal Perspectives" Faculty of Law, Delhi University, and the National Institute of Science, Technology and Development Studies (NISTADS), New Delhi.

There has been a gradual rise in the volume of cases heard in areas related to Intellectual Property. A special IPR Reporter has started being printed from 1995 every quarter, reflecting this growth. The Reporter reports on all decision on Patent, Trademark and Copyright cases in High Courts and the Supreme Court.

Table2.1: Cases Reported in Patents and Trade mark Reporter

Year							
	SC	Bombay	Delhi	Calcutta	Madras	Allahabad	Kerala
1995	-	1	50	-	3	2	-
1996 (3rd Quarter)	2	1	20	1	-	-	1

The above table reveals a preponderance of these cases in Delhi, while this is in part no doubt a reflection of the important role of Delhi in trade and commerce, it is also a reflection of the fact that some of the very few legal firms specializing in these cases are based in Delhi. Thus leading one to suspect that the lack attention may be as much due to inadequate knowledge of rights as with infirmities in the law it self.

Labor: While the basic structure of Labor legislation did not change its coverage was considerably widened. The Court in a number of cases,[82] while interpreting the definition of `in-dustry' in fact, extended its scope to cover a number of non-manufacturing activities. The ability of companies to remove workers was affected by two distinct trends. The first was a series of judicial decisions[83], which narrowed the scope of termination from service. Ordinary termination was limited to cases of proven misconduct and required elaborate domestic enquiries before being implemented. And secondly, retrenchment and layoffs were hedged by a number of bureaucratic controls and judicial decisions, the former requiring state permission before retrenchment could be carried out and the latter widening the definition of cases covered under retrenchment[84]. For example, no workmen who was in continuous service for one year can be retrenched (1) without a prior three months' notice (that is quite logical) and (2) without prior permission being obtained from an appropriate government. Again, an employer who intends to close down an undertaking of an industrial establishment has to serve a ninety days' notice for obtaining the permission of closure from the appropriate government and such a permission has to be obtained before the closure, and such permission is rarely forthcoming. The scope of judicial intervention is not fully appreciated until one sees the relevant judgements that have extended the scope of protecting "weaker sections". Further retrenchment was effectively forced

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82 As for example, in *Bangalore Water Supply and Sewerage Board v. Rajappa* (1978) 2 SCC 213.

83 *Chandulal v. management of Pan American Airways* SC 1985, *Central Inland Water Transport Cooperation v. Brojo Nath Ganguly and others* SC 1986

84 See for example *State Bank of India v. Sundra Money* SC 1976 and again *Delhi Cloth and General Mills v. Shambu nath Mukherji* SC 1977.

to follow a mechanical, last in first out, principle as the burden of proof for a deviation was not feasible to meet for any concern. Both of these trends effectively precluded a unit from carrying out large scale restructuring, relocating or exiting from the industry. This has not prevented units from shutting down, there are a number of simple expedients by which a unit can be closed, e.g., not paying electricity dues. What it does do is to prevent the assets being formally liquidated and the work force reorganized[85].

The other major development in this period expanded the scope of labor welfare by enacting laws against forced labor and child labor. An Act passed in 1976 tried to abolish bonded labor system and finally in 1986 a Child Labor (prohibition and regulation) Act was passed. This is partly due to the intervention of the courts in the Asiad Case and Bandhua Mukti Morcha[86] the Supreme Court was critical of the executive and directed it to take measures bringing the child and forced labor system to an end. However the effectiveness of these legislation depends on effective enforcement. Here the dependence on State Govts, with varied commitments to the issue has not made for uniformly effective implementation.

Capital Markets & Banking: There were no major changes in capital market regulations through the seventies and eighties. The major changes, which occurred, were in Banking. Initially, social control was sought to be enforced over the commercial banks in 1967 with a view to make the banks contribute the balanced economic management growth, and areawise Lead Bank Scheme was framed on the advice of the Nariman Committee. This was not considered adequate. In 1969 the govt. promulgated the Ordinance on Bank Nationalization, nationalizing 14 Banking Companies with a deposit of 50 crores or more,[87] followed by the Banking Companies (Acquisition and Transfer of undertakings) Act 1970. In 1980, this practice was continued with six more banks being nationalized. It is only in 1991 that the Govt. declared that no more nationalization will be done.

The impact of nationalization was to bring the muscle of the state into the banking sector. The period after nationalization saw a rapid increase in the deposit base, from 4669 crores in 1969 to 14182.3 crores in 1988. The number of branches went from about 10,000 in 1969 to 60190 by 1991. Average population per bank came down to 11,000 in 1991 from 65,000 during 1969. A substantial part of this growth was in the rural sector, with both rural branches (1833 to 35187), lending to agriculture and other priority sectors seeing rapid growth. Credit surveys of the RBI reveal that dependence on non-institutional credit declined from 93% in the fifties to under 40% in 1981 This period has also seen a rapid growth of a complex structure of administered rates of interest covering virtually all bank advances. The rates of interest to govt.

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[85] There are number sick Textile Units in the heart of Bombay or Ahmedabad, which testify to this reality. A classic example of unintended consequences.

[86] *People's Union v. Union of India,* AIR 1982 SC 1473; *Bandhua Mukti Morcha v. Union of India,* 1984 SC 802.

[87] This process was also associated with a tussle between the courts and the executive. The court on a number of technical grounds struck down the original Ordinance and Act. While these loopholes were plugged in 1970, this exchange re-established the important role of the courts in checking administrative action.

and other priority areas were kept low. This was managed by requiring the banks to lend 40% of their credit to the priority sector, and by pre-empting a substantial portion for Govt. borrowing through the Statutory Liquidity Ratio (SLR)[88]. The CRR and SLR requirements rose from around 25% in 1969 to nearly 63% in 1992-93. In combination with restrictions on priority lending this meant that almost 80% of bank credit was at subsidized interest.

Poor credit appraisal procedures, quantitative targets, functioning of priority lending, and the poor accounting norms for sub-standard assets meant that the banking system saw a rise in the proportion of non-performing assets. The impact of the changes in labor laws and trade unions also contributed to the proliferation of restrictive practices in terms of work norms; resistance to mechanization and computerization; and a rational policy in respect of staff promotions and transfer. The emoluments of bank staff were no longer directly related to their productivity or profitability. These in association with the restrictions on earning capacity under the regime of administered rates led to a situation of poor profitability and efficiency of the banking system. This scenario was spelt out in some detail in the Narasimham Committee.

Business Organization: There were no major structural changes in the basic law relating to business organizations. A number of amendments were made to the Companies Act, with a view to improving disclosure standards, improving audit procedures and to limit remuneration to top executives as well as composition and structure of the board of directors. While these changes were undoubtedly important from the viewpoint of improving corporate democracy, their overall impact was rather limited. The essential structure of organizational control and the bias in favor of incumbent promoters did not significantly alter corporate structure. The Industrial Development and Regulation Act was amended in 1972 to give the State greater powers to intervene in price fixation by companies.

The operation of the licensing system had been widely criticized for not meeting the desired objectives and led to increased concentration of economic power. With a view to improving this and increasing competition in the market place the Monopolies and Restrictive Trade Practises Act was passed in 1969. While the act is in the realm of competition policy its major effect was to regulate the growth of large industrial houses. However the act also created an additional bureaucratic regime, firms with assets over 20 (later 100, in 1985) crores or dominant undertakings with assets above 1 crore were subject to additional clearances before getting a license. While this did little to reduce concentration, as it protected those large firms already in the business, it did make these enterprises's diversify into many areas, which were not in their core competence.

Competition Laws: The concern for developing fair and equitable market outcomes are clearly present in the constitutional directives to attain a policy of equitable distribution of material resources to subserve the common good and secure the operations of economic system in such a way that it does not result in the concentration of wealth and means of production to the

[88] In combination with the Cash Credit ratio (CRR) the SLR acted to reduce the amount of credit available to the non-governmental sector. This had the effect of partly negating the increase in priority sector lending.

common detriment.[89] However, as we have noted in our discussion on the regulatory regime the first phase of economic development till 1966 did not have any explicit anti-monopoly legal regime. It was felt that the operation of the licensing system would prove an adequate check on the growth and use of monopoly power. The reports of the Monopoly Inquiry Commission, 1964 and the various committees examining, the licensing regime indicated that this hope was clearly belied. The Monopolies and Restrictive Trade Practice Act was passed in 1969, and enforced from 1st June 1970. The MRTP Commission can investigate Restrictive Trade Practices and Monopolistic Trade Practices. The Commission has been given very wide power and is vested with the power of a Civil Court while trying a suit. However its powers of action are quite limited. In the case of restrictive practices the commission issues Cease and Desist orders and in the case of Monopolistic Practices the Commission makes a report to the Central Government for necessary action. The range of limited range of its powers, ambiguous notions of "reasonable" behavior have reduced the effectiveness of the commission in checking growth of anti-competitive policies. The impression of collusive price fixing is quite widespread, e.g. automobile tyres. [90]

Major Developments in 1980-1995

The period of the eighties has been associated with increased liberalization and market friendliness. This is in part reflected in attitudes in the Judiciary as well. We had already noted the opinion of the court in Akadasi Padhan in support of a doctrinaire version of Socialism. A bench of five Justices in 1979 in Excel Wear v. Union of India,[91] while reiterating the views expressed by their predecessors, stated that regard had to be had at the same time to private ownership of resources. It ruled:

"The concept of Socialism or a socialist state has undergone changes from time to time. But some basic concepts still hold the field. The difference between doctrinaire and pragmatic socialism is very apt and may enable the Courts to lean more and more in favor of nationalization and state ownership of an industry after the addition of the word 'Socialist' in the Preamble of the Constitution. But as long as private ownership of an industry is recognized and governs an overwhelmingly large proportion of our economic structure is it possible to say that principles of socialism and social justice can be pushed to such an extreme so as to ignore completely or to a very large extent the interests of another section of the public namely the private owners? Their interests should be taken care off".

The Court then emphasized the importance of private economic activity to the growth of the national economy by the formation of more and more capital. However the impact of this judgement has been limited because later judgements of the Supreme Court in Workmen of

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89 *See Srinivasa v. State of Karnataka,* AIR 1987 SC 1518, *Keshavanand v. Kerala,* 1973, 4 SCC 228, *State of T.N. v. Abu,* AIR 1984 (SC) 326, *Sanjiv Coke v. Bharat Cocking Coal,* AIR 1983 SC 239.

90 Sen, Gita 1992 Margin, Costs and Competition: The Tyre Industry 1974-83 In *Indian Industrialisation* (Ed) Arun Ghost et.al Oxford

91 AIR 1979 SC 36.

Meenakshi Mills v Meenakshi Mills *(SC 1992)* and Papanasan Labor Union v. Madura Coats *(SC 1995)* the court has rejected attempts of the High Court to use the *Excel Wear* doctrine to intervene in issues relating to entrepreneurial freedom versus workers rights. We have developed this theme to illustrate the peculiar mix of ideologies that continue to permeate Indian policy formulation. Even at this date there are some who argue that the New Economic Reforms embarked upon in 1991 are in violation of the Constitution.

Capital Markets: The capital market in India has been small due too relatively low importance to private investment. Since 1980, the capital market has been growing with the rise of the equity culture. From 1988 we see the beginning of a long bull phase in the stock market, the BSE Sensex was at 398 in March 1988 and rose steadily to 4285 in May 1992. This was the sharpest increase in the stock market in the post independence period. This growth cannot be entirely attributed to the effect of liberalization in rules related to equity funding. The investigations into the stock market scam of 1992 reveals that there was significant diversion of bank funds earmarked for statutory liquidity ratios and funds of public enterprises to fund speculative ventures in the market. In addition there have been numerous instances of marked speculative bubbles in process of companies clearly reflecting insider trading. Most of these were because of the absence of market oriented regulator. In this background with the onset of formal liberalization in 1991, a number of dramatic changes were made in the organized capital markets. The Capital Issue (Control) Act was repealed. The Security Exchange Board of India was established in place of the Capital Issue Controller, under the SEBI Act 1992.

Security Exchange Board of India has been given extensive power to oversee the operations of the stock exchanges. Stock exchanges were given power to make rules to be observed by its members as well as bylaws for the transactions in the stock market. SEBI has been given the power to amend these bylaws. Several ground level rules were made by SEBI for the last four years including compulsory listing of securities of public companies ensuring free transferability and registration of securities of listed companies; insider trading regulations; guidelines for market makers; share transfer regulations; underwriters' rules and regulations; debenture trustees' rules and regulation; guidelines for money market operations for mutual funds, multiple membership criteria; criteria for monitoring the requirements of merchant bankers; guidelines for grading of prospectus; take-over regulations; etc. This process is not without its own hiccups as the inherited values of over 40 years of policy formulation have inertia of their own. the best example is the on-off dialogue on Badla vs. Forward Trading vs. Derivatives. In part due to the hesitant process of change and also the confounding effects of the various Scams it is difficult to assess the impact of these changes on the long-term structure of Industrial capital.

There were changes in banking structure as well. After the Narsimahan Committee report in 1991 there have been reforms in a number of areas. These have included introduction of international Norms for asset classification. A phased reduction in the structure of administered rates, reduction of subsidized interest, lowering of the SLR. The implantation of the asset norms has a number of loopholes particularly in relation to state guaranteed advances.

The Recovery of Debts due to Banks and Financial Institution Act 1993 and the corresponding Debt Recovery Tribunal Procedure Rules 1993 is a recent attempt to speed up the

process of security realization. The debt recovery tribunals have just started functioning in a hesitant manner.

In spite of the wider definition of Banking Business, post 1988, there are still number of lacunae e.g., leasing has been a distinctive banking service but there is no specific law addressing leasing or hire purchasing business. The definition also includes a wide area of activity, which is now regulated by Security Exchange Board of India. Thus banking institutions now attract dual control. How the banks shall manage this legal dualism is yet to be seen.

Business Organization: The period of liberalization has not seen major changes to the law relating to business organizations, though there is a growing recognition that the functioning of the Companies act is not completely consistent with the requirements of a market economy. Thus recently a committee has been set up to overhaul the companies act and its recommendations are subject to public debate. There were however a number of relaxation in the licensing regime, starting with some modest changes in the mid 1980's. Firms with fixed assets of less than 5 crores were exempted from licensing. Expansion of capacity was simplified under a variety of schemes like *Broadbanding, Modernization, Regularization* etc. But these were at best limited and partial. Some cosmetic changes to the company's act providing for compulsory listing and on accounting standards were also done. The major changes however came in 1991 when licensing was abolished except for a short list of 16 Industries. Further the Industries reserved for the public sector was pruned from 17 to 11 (and later 6). With plans to reduce these even further. Further while there is still not plan to effectively privatize the public sector, limited dilution of govt. equity to provide a cushion to the budget has been done. The Committee on divestment has recently argued that some Public Enterprises, which are not in core areas, could be privatized.

The gradual liberalization from the early eighties as well as the inconsistencies in the regime of controls had led to a growing incidence of sickness through the late seventies and eighties. The major impetus for change came from the burgeoning Credit locked up in these units by Banks and Financial Institutions. With a view to contain this problem, the Sick Industrial Companies Act was passed in 1984 and The Board of Industrial and Financial Reconstruction (BIFR) was constituted in 1985.

The functioning of BIFR and the causes of Industrial Sickness has been dealt with in great detail elsewhere and will only be summarized here. *Poor Definition*: The definition of sickness in the Act is weak, amenable to multiple interpretations by lawyers and accountants, and is not conducive for effective intervention. The SICA definition of negative net worth implied that a company was being examined at a point where it was in a terminal state of health. *Poor Procedures:* Under SICA and in the procedure followed by BIFR the procedure is one of Debtor in Possession until a rehabilitation scheme is worked out. Further with no clear ranking of priority of claims, further claimants with small or no claims on the firms assets could hold up the process because of the requirement of consensus and a unwillingness to exercise the power to windup. A combination of these meant that the process took an average of 2 years to settle a

case.[92] *Poor Restructuring Plans*: In the early years of BIFR till 1991, the combination of poor banking practices and revive at any cost implied plans were put into place which did not meet minimum economic requirement of covering costs.[93] Table 2.3 gives the details of cases dealt with by the BIFR up to end of December, 1995.

Table 2.3: Cases before the BIFR

Total number of Cases referred	2497
Total number of references registered	1756
Number of cases dismissed as not maintainable	383
Cases are herein revival scheme is sanctioned	530
Recommendations for winding up made (to the High Court)	407
Sale ordered	1
Draft scheme formulated	57
Show Cause Notice issued for winding up	54

Source: Economic Survey

Even with the liberalization after the nineties, there is an inadequate understanding of the interrelated nature of reform. The reforms in the banking sector, with introduction of prudential norms and risk weighted asset classification has meant increasing reluctance of banks to increase exposure in marginal or failing units. However the restructuring processes of BIFR were not modified in step with the changes in the financial sector, leading to an anomalous position of a company not being sick but ineligible for additional finance from the Banks.

Environmental Law: The eighties have significant growth in environmental consciousness and as well as improvement in the law. A major impetus to this process was the Bhopal Gas tragedy in 1984. After the Bhopal tragedy, the Factories Act has been amended in 1987 and a whole chapter on provisions relating to hazardous processes inserted. In addition there are other specific laws like the Water (Prevention and Control of Pollution) Act 1974, Air (Prevention and Control of Pollution) Act 1981 and finally the Environment (Protection) Act, 1986. The last of these was created in order to meet the obligation of Stockholm Conference. This Act provides definition of environment, environment pollutant and environmental pollution. The Act empowers the central government to take all measures for protecting and improving the quality of environment and preventing, controlling and abating environment pollution. There are

[92] Recent data from BIFR suggests that spurred in part by these criticisms, the board has streamlined itself to cut delay to a year and 8 to 10 months.

[93] TCA Anant, Tamal Datta Chaudhuri, S. Gangopadhyay and O. Goswami *Industrial Sickness in India: Corporate restructuring - its agency problems and Institutional Responses*, Studies in Industrial Development # 17, Ministry of Industry

number of other related statutes on the book. Enforcement of these acts has been poor leading to considerable damage to the environment.

However much more than the legislative process it has been the judiciary which has played a crucial role in defining and enforcing environment law since Bhopal. The Court in M.C. Mehta v. Sriram Fertilizers and Food Industries and another, even stipulated prior conditions requiring Sriram industries to fulfil in order to reopen its caustic chloride plant which was closed on the order of the Court. The court has been very creative in treating even letters of complaint as the basis for Public Interest litigation. This process is till continuing and has led to a number of initiatives on environmental control. Some notable examples of executive action in response to judicial intervention have been in relation to the regulation of leather tanneries, establishment of aqua farms near coastal areas and recently unchecked commercial logging. This activism has strengthened the hands of environmentalists and non-governmental environmental protection agencies .

3. ECONOMIC DEVELOPMENT IN INDIA, 1960 - 1995: An Overview

The three and half decades of development experience in India since 1960 can be characterised into two broad phases. The first, of centralised governance, from 1960 till approx. the early eighties was characterised by a extensive and a increasing role of the state in virtually all spheres of economic activity. This role arose, in part, from the pre-independence ideology of conflict with the colonial power which had generated a distrust of "free market" mechanisms and also in part due to the constitutional imperatives contained in the directive principles of state policy, which enjoined the creation of a welfare state. The development strategy of the state was implemented through the mechanism of central planning and the regulatory framework. The two were highly complementary. The period of planned development started in 1951, though it is only with the second plan in 1956 that we have an well-articulated strategy of development. It is around this time that the political process had agreed on the central role of the Govt in creating a "socialistic pattern of society"[94]. The first phase has two clear distinct sub-phases, the first a high growth phase, which lasted till 1965, and the second of relatively slower growth and Industrial stagnation from 1965 till 1980. While there were major policy developments over this entire period the principle character of the development strategy was not significantly changed until the early eighties**.** It is difficult to identify an exact point at which a shift in strategy occurs, it can be assigned to as early as 1980 with the return of Mrs Gandhi to a second phase of Congress government or as late as 1991 to the frank liberalisation under the Congress and now United Front govts. For a number of reasons that will become clear as we go along we will identify the beginning of this change to 1980.

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[94] The phrase socialistic was first formulated in the Avadi resolution in order to distinguish it from the better known concept of socialism to reflect our experiment with the mixed economy.

Table 3.1: Composition of Net Domestic Product

	1960	1965	1970	1975	1980	1985	1990
Primary	52.2	49	50.1	44.5	41.3	37.1	34.1
Organized	2.8	3.2	2.7	2.8	2.9	3.6	3.1
Unorganized	49.4	45.8	47.4	41.7	38.4	33.5	31.6
Secondary	19.1	20.3	19.6	21.1	23	24.1	25.6
Organized	10.9	12.4	11.4	12.4	12.5	14.3	14.8
Unorganized	8.2	7.9	8.2	8.7	10.5	9.8	10.7
Tertiary	28.7	30.7	30.2	34.4	35.6	38.8	39.8
Organized	11.8	13.6	13.4	15.4	14.4	17.	18.2
Unorganized	16.9	17.1	16.8	19	21.2	21.7	21.6
Agg. Unorganized	74.4	70.8	72.5	69.4	70.1	65	63.9
Public Sector	10.7	13.2	14.5	18.3	20.4	24	23.9

Source: National Accounts and HL Chandoke (1991)

The development over the thirty period has seen a reduction in the contribution of Agriculture in gross domestic product at the expense of manufacturing and services. The decline in Agriculture however did not lead to a rapid growth in the Organized Sector, as it was associated with a rise in the services sector with a large unorganized component especially in Trade Hotels and Restaurants. As a consequence we can see that there is a very small decline in the unorganized sector between 1960 and 1980. Further when we take account for the fact that a significant part of the growth in the organized segment is more than accounted for by the rise in the public sector, we can see that there is in fact a decline in the share of the private organized sector in the economy particularly between 1960 and 1980. The reason for this lie in the basic character of socialistic development followed during this time.

Centralized Governance: 1956-1990 The overall objectives of state policy were supposed to be implemented through the mechanism of a central planning mechanism,[95] inspired primarily from the success of the Soviet experience. These plans were to be implemented by a mix of instruments that combined a regime of administrative restrictions and controls with an expanded role of the public sector. The plans were themselves guided by certain premises about the development process that directed the choice of strategies and instruments. (Byrd (1990)) These were *Export pessimism*, It was believed that demand for Indian exports would not grow fast enough to be a major source of growth; *Savings Pessimism*, it was believed that private savings would not be adequate to finance capital accumulation and would need to be supplemented by public resource mobilization; *Investment Pessimism*, the private sector was considered not able or willing to come with large investments in key basic industries, thus providing the economic rationale for public sector involvement; *Employment pessimism*, it was envisaged that growth of the organized industrial sector would not on its own provide for adequate employment creation,

[95] There has been an intense debate and re-examination of the role of Planning in the Indian Economy in recent years. Some of the parties to the debate are those who were key players in the planning process: Chakravarty (1987,), Bhagwati (1993,), Tendulkar (1991), Srinivasan, Bhagwati and Srinivasan are some of the key examples.

and thus there is a need for direct programs for employment creation and to reduce the impact of market forces on employment; *Distrust of Multinationals*, this is best described as the East India Company Complex, a consequence of which was to limit the role of foreign direct investment and technology transfer into India; *Distrust of large private industrialists*, In a manner similar to the distrust of foreign companies there has been a distrust of domestic industrial houses, this distrust may not have been as much in the political class as with the bureaucratic & intellectual community. Further combined with a *Distrust of the Market* there has been a tendency to place much greater faith in the ability of the administrative system to allocate resources. These then laid the basic foundation for an elaborate system of direct controls in a market economy that intervened in almost all levels of decision making.

Structure of Controls [96]: The regime of controls had its origins and rationale in Rules 81 and 84 of the Defence of India Rules. These give the state wide ranging powers for "regulating or prohibiting the production, treatment, keeping, storage, movement, transport, distribution, disposal, acquisition, use or consumption of articles or things of description whatsoever..", the rules also gave the power to the govt. to regulate the use and control of foreign exchange, the pricing and distribution of "essential commodities'. A number of the rules were later replaced by specific acts. It is worth noting that a number of the development and regulatory agencies had their origins in the war time agencies concerned with the needs of ensuring adequate supply of resources to the allied war effort. In a war scenario concerns of economic efficiency are secondary to the immediate short run goal of achieving fixed delivery targets. The same agencies were now expected to play a more developmental role, it is not surprising then that the final results were not entirely as may have been optimistically expected.

High Growth Phase 1956 - 1965: The period associated with the second and third plans are often viewed as the golden years of planning. The focus of planning effort was in building up infrastructure and basic industries. Agriculture, Small Industries received less importance. This was not because they were considered unimportant but it was felt that these were in the nature of "Bargain Sectors" (See Chakravarty (1987) where relatively large gains could be made with small investments. The success of this phase is measured partly due to the higher aggregate growth and the sharp rise in organized manufacturing output compared with both the colonial past as well as the immediate future. (See Table 1) This growth was not evenly distributed across all components of manufacturing; intermediate goods and capital goods saw relatively faster growth, whereas some of the more traditional areas like cotton textiles had much poorer growth. The public sector grew quite rapidly expanding its share in GDP from 10.7% in 1960 to almost 13.2% in 1965, and in manufacturing it almost doubled from around 5.4% in 1960 to 10.8% by 1965. This was largely due to the fact that most of the key areas of growth, namely basic goods and capital goods, were reserved for the public sector under the Industrial policy resolution of 1956.

Agriculture grew at a respectable 2% per annum. This growth was significantly larger than the pre-independence average of less than 1%. This growth was largely achieved by an expansion in area and yield due to increased irrigation facilities. The growth was however slightly less than

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[96] For a more detailed discussion see Mohan and Aggarwal (1990): “Commands and Controls’ Journal of Comparative Economics

2.1% growth in population thus worsening the already meager food availability situation. The restrictions on private trade and the dependence on cheap subsidized imports under the PL 480 program both contributed to reduce incentives to increase yield and marketed surplus. However by the end of this period growth in agriculture was looking like running out of steam as the prospects of continued growth in acreage looked less likely.

Table 3.2 : Trend rate of Growth: Key Sectors[97]

Sectors	1956-65	1966-80	1981-94
GDP at Factor Cost	4.0%	3.5%	6.2%
Manufacturing	7.0%	4.5%	5.5%
Agriculture	2.0%	2.4%	3.1%
Transport	16.1%	5.9%	6.7%
Banking and Financial Services	3.2%	4.2%	7.3%
Population	2.12%	2.26%	2.09%

Source: National Account Statistics- CSO

Capital formation in both the public and private corporate sectors grew at a rate faster than that of GDP. The growth in investment in Infrastructure (railways, electricity, mining and communications) was almost 9.6% (Table 3)

Table 3.3: Rate of Growth in Capital Formation

	1956-65	1966-80	1981 -93
Public Sector	8.1	5.5	2.8
Pvt. Corporate Sector	7.5	3.1	7.7
Agriculture	5	5.4	4.4
Infrastructure	9.6	5.7	5.1
Aggregate	4.8	4.9	5.8

Source: National Accounts

The assumptions of export pessimism led to a greater emphasis on import substitution and a marked bias against exports. The share of exports in GDP fell from over 7% to around 3%. This

[97] These growth rates are from fitting a semilog trend to the data, which may give lower numbers than simple annual average growth rates.

decline was also accompanied by a sharp decline in India's share in world trade declined from over 2.4% at independence to just under 1% by 1965. While there is a decline in the share of imports it not as marked and the gap between imports and exports widens quite significantly through the period, leading to a recurring weakness in the balance of payments. For the first time after the war we see a systematic introduction of quotas [98] in response to a Balance of payments crisis in 1957. The quotas were used systematically to provide protection for any domestic activity that substituted imports. The quotas were accompanied by import duties to mop up the premia on imports received by licensed importers. The entire trade imbalance was financed by subsidized external assistance from both multilateral and bilateral sources. There was virtually no private or public commercial borrowing. The trade balance was further exacerbated after 1962, with the changed attitude to defence purchases after the Indo-Chinese conflict in 1962.

[98] Srinvasan (1995)

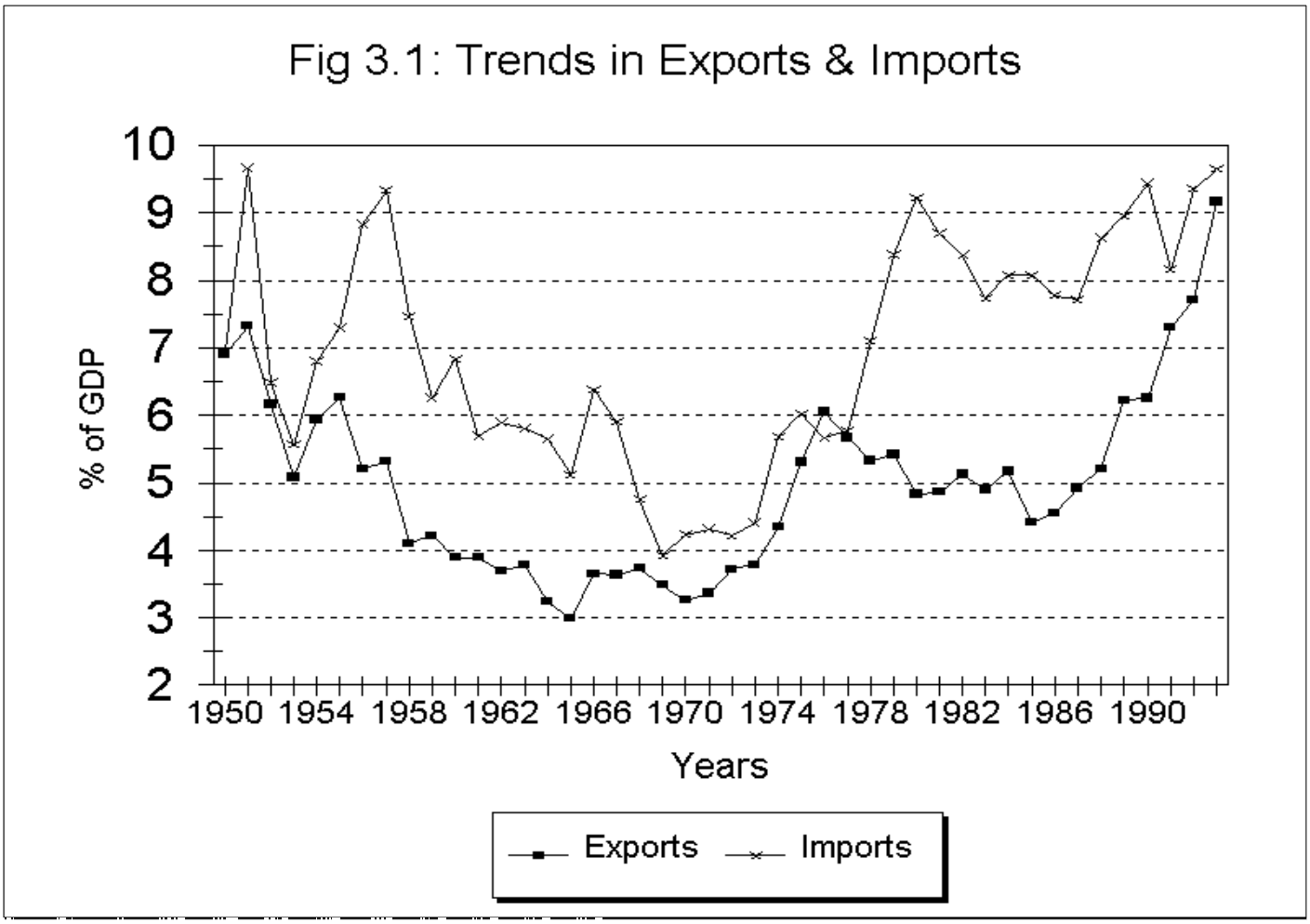


Fig 3.1: Trends in Exports & Imports
10
9
8
7
6
5
4
3
2
% of GDP
1950 1954 1958 1962 1966 1970 1974 1978 1982 1986 1990
Years
Exports
Imports

There are a number of reasons for the perceived success of this period. First, the import substitution strategy was clearly in line with private profitability as it allowed increased domestic production in a protected market. The adverse incentive effects on productivity would become visible only much later. Second the large expansion of public investment in infrastructure and basic intermediates would have the effect of raising domestic demand. Third the overall credibility of the planning process[99] would have helped in reducing the coordination problem in private sector growth, increasing private investment as well. However we should note that this success story did have some limitations. First this period saw a rapid increase in the rate of population growth at 2.16% in the fifties and 2.48% in the sixties compared to a maximal rate of 1.43% in the pre-independence period. Therefore the impact on percapita growth was much milder.

Stagnation Phase 1965-80: 1965-68 were three of the most disastrous years for the economy. Starting with 1965, and the second war with Pakistan, 1966 and 67 saw some of the worst droughts in living memory. The combined effect of all these were to worsen the already precarious balance of payments crisis, increasing dependence on Aid. There was a sharp drop in rates of growth in all major sectors. The beginning of this period is also associated with a political transition from Nehru to Indira Gandhi. The political economy saw increased use of administrative controls and nationalization. While the Public sector had grown in the earlier phase there was a limited use of nationalization. But from 1969, there were a series of major nationalization in Banking. Insurance and Mining. The govt. for a while nationalized whole sale trade in foodgrains. Large segments of the international trade in bulk goods were bought under state control of the various Trading Corporations.

The aftermath of the drought saw agricultural growth pick up and largely due to adoption of new high yielding varieties. In fact most of the increase in productivity in this period comes from increases in yield rather than any increase in acreage. There was a marked increase in capital formation in agriculture, mostly on account of increase in private capital. A consequence of the increase in yields of the principle foodgrains was the reduced dependence on imports.

The picture on trade and balance of payments did not materially change till the mid seventies. Exports as a % of GDP declined till almost 1974. The degree of protection through tariffs was stepped up sharply during this period a trend that was not reversed until the nineties. The aftermath of the first oil price shock led to the recognition that import substitution would not be enough to reduce dependence on key imports and the need to boost exports was felt, thus numerous incentives for exports and exporting units were provided. Exporting units were freed from a number of the rigors of the licensing and control system. These policies did have some impact and there was an improvement in exports as can be seen in figure 1. However the oil price shock had an unexpected consequence. There was a large outflow of skilled and semi-skilled labor to the Middle East. This led to a dramatic improvement in the balance of payments picture from about 1975 due to the sharp rise in remittances from abroad. Thus for a brief period till the second oil price shock India actually had a small currant account surplus in the balance of

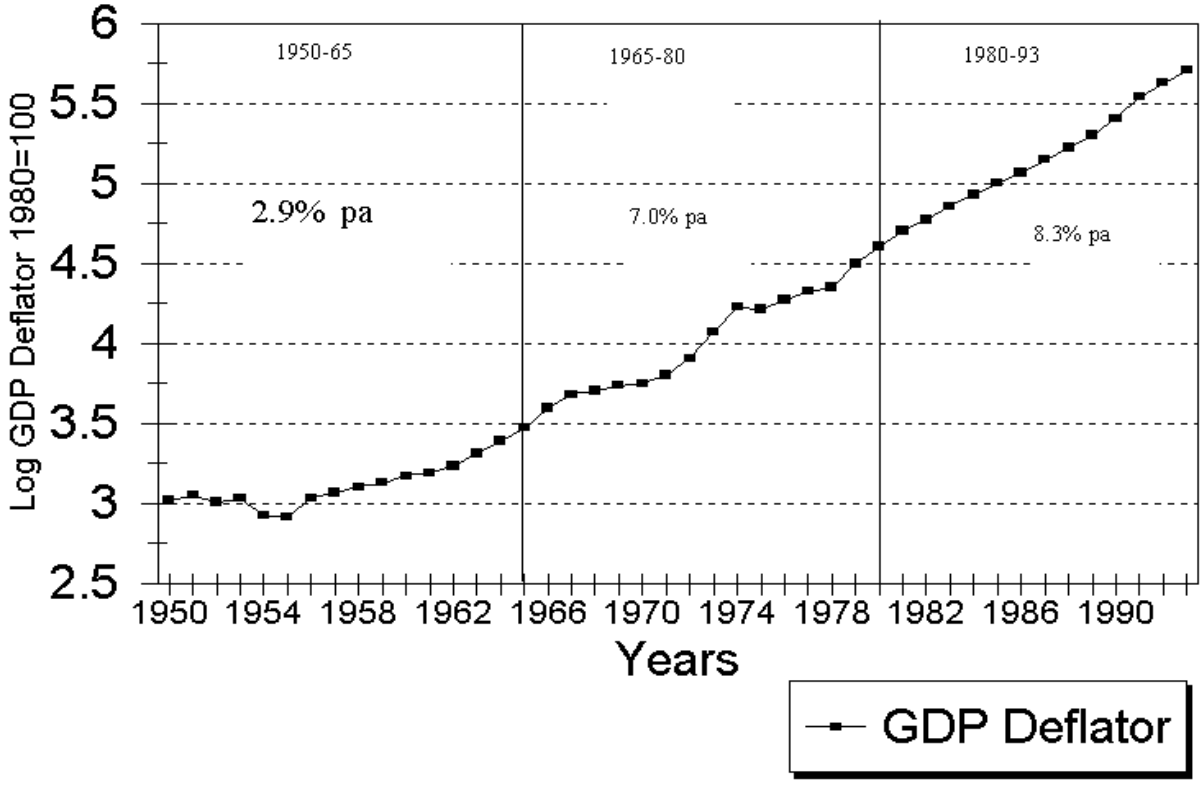
[99] See the discussion in Tendulkar for an elaboration of this point.

payments. The honeymoon did not last for by 1979 the export drive had run out of steam and the second oil shock had sent the import bill soaring.

Industrial growth however did not pick up and was at an average of 4.5% for the whole period. Capital formation particularly in the private corporate sector stagnated through out this period, the growth being at 3.1% a rate slower than the average GDP growth rate.

The entire period from 1956 till almost 1975 was essentially marked by a degree of fiscal conservatism. The fiscal deficit was at an average of around 5.5% to GDP the rate of money supply growth at around 11%. Not surprisingly the rate of inflation as reflected by the GDP deflator was quite low. There were small surpluses on current expenditure in the Govt. accounts, which were used to finance the capital account expenditures. Borrowing domestically and abroad met the bulk of the requirements of capital formations but these were largely at concessional rates. However we see a change after 1975 with an increasing share of fiscal deficits to an average of 7% of GDP rising even higher in the eighties, and a more rapid rate of money supply growth. Therefore the rate of inflation also picked up.

Fig 3.2: Trends in Prices



The essential character of the whole period from 1956-80 period was one of increased bureaucratization and state control. The Licensing & Control system covered almost all aspects of business decision. There were numerous indicators that state control and licensing were not yielding the desired results and this was pointed out by a number of official committees set up for this purpose from the early sixties onwards. The response however was always to increase the degree of bureaucratic control. The crises of the mid sixties led to increased rigidities in the system. The import control system was draconian in nature but clearly ineffective in checking the systemic weakness on the balance of payments. India's poor performance in international trade can be almost certainly ascribed to the operation of the control regime, for example even in products where India had a comparative advantage, namely cotton textiles, India lost ground largely due to a complex web of policies which was biased against large scale factory production in favor of small scale production.

The bias in favor of import substitution led to a decline in the relative importance of consumer goods industries in favor of capital goods and other basic goods. In 1956, consumer goods accounted for close to 50% of all manufacturing, whereas capital goods were only 5% of the total. By 1980, the figures were 33% and 15% respectively. It is interesting to note that the major change had in fact occurred in the sixties.

Table 3.4: Weights in the index of Industrial Production

	1956	1970	1980
Basic Goods	22.3	32.33	33.2
Intermediate Goods	24.6	20.9	21.3
Consumer Goods	48.4	31.5	30.5
Capital Goods	4.7	15.2	15.0

Source: Ahluwalia (1991)

Liberalization and Growth 1980-1995: Finally the eighties has seen a revival of Industrial growth. The period has also seen a number of attempts at gradually loosening the rigors of the control regime. However full and frank liberalization does not in fact occur till 1991. The selection of the turnaround point at the beginning of the is partly from considerations of political economy, the return of the Congress party to power in 1980 and partly to a consideration of statistical data on productivity (e.g. Ahluwalia 1991).

The analysis of productivity growth[100] from 1960 to 1986 is quite revealing. The first phase which had very high growth rates in output and value added and the second phase of stagnation both see very low rates of growth in total productivity and capital productivity. In other words the

[100] Productivity measurements are used to track sources of growth. Total Factor Productivity Growth (TFPG) is a residual- it captures the effect of unexplained factors, beyond the conventional capital and labor inputs, in determining growth. It includes in it concepts like technical progress and improvements in human capital through learning as important components. The partial productivities, labor and capital, reflect the changes in output per unit labor and capital, and the underlying technology choice between capital and labor.

entire growth in this period was accounted for by the growth in factor inputs (mainly capital) and the efficiency with which these inputs were used may have declined marginally. It is only in the third phase which begins in the eighties that we see a reversal of this trend with a improvement in both total and factor productivities (particularly labor).

Table 3.5: Trends in productivity Growth

	Total Factor Productivity			Labor Productivity			Capital Productivity		
	I	II	III	I	II	III	I	II	III
Manufacturing	0.2	-.2	3.4	4.9	1.4	8.3	-3.8	-1.7	0.0
Intermediate Goods	-.9	-.6	1.4	4.4	1.6	5.6	-5	-2.3	-1.1
Consumer non-Durables	0.4	-1.1	5.2	4.2	-.1	10.9	-2.9	-2.0	0.4
Consumer Durables	2.6	0.4	6.6	4.8	2.8	11.5	-0.4	-2.7	2.8
Capital Goods	2.7	2.8	3.4	6.2	4.9	7.4	-1.2	0.4	0.4

Source: Ahluwalia (1991)

The low rates of capital and total factor productivity in the first two phases from 1960 till 1980 and the high rates in the eighties are due to a complex mix of factors which include, the restrictive bureaucratic regime, the lack of internal and external competition, and bottlenecks in the quality and quantity of key infrastructure

There were many elements determining the reform process. In 1981, because of the continuing balance of payments crises India turned to IMF for support under the Extended Fund Facility. In part due to this and as well as a recognition that export promotion without improving conditioned for domestic industrial growth and competitiveness would not go very far led for a series of attempts to liberalize the economy. Starting from the policy resolution of 1980, the govt. introduced in 1982 a number of relaxations in the control regime to encourage production in the "core sector" and in areas with export potential. This was followed by delicensing of 32 groups of industries in 1985, followed by elimination of licensing in all but a specified list of 26 Industries. There were also incentives given specifically for exporter to get reductions in duty, easing of restrictions on holding foreign currency, interest subsidies and etc. There were also relaxations for the operation of MRTP and FERA concerns. However the exemptions from licensing and relaxations of other controls were subject to a number of caveats and exemptions to significantly reduce their effectiveness. Even so these limited attempts at liberalization along with the stepping up of investment in both public and private sectors from the mid seventies led to a revival of growth in Industry.

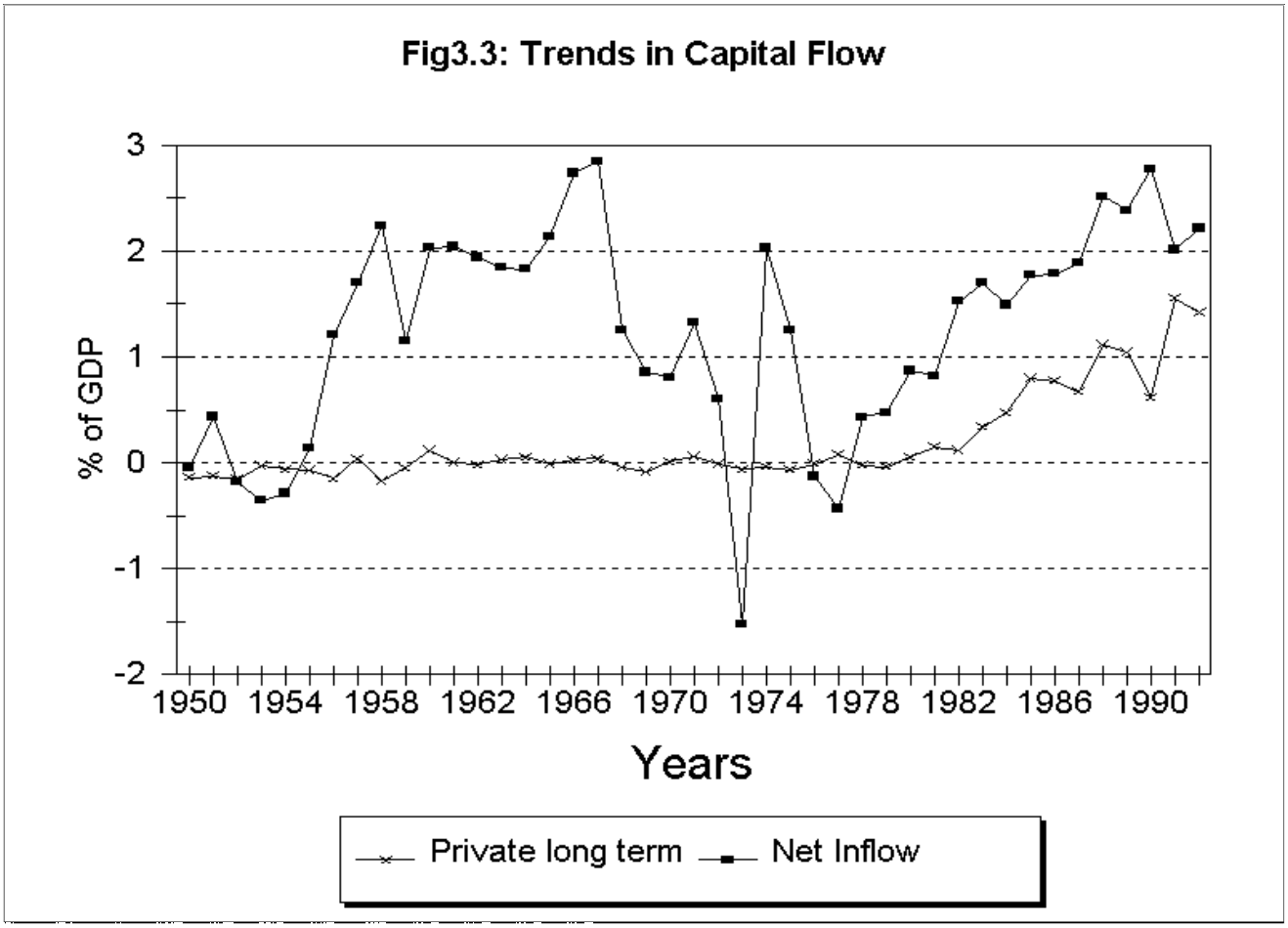


Fig3.3: Trends in Capital Flow
3
2
1
0
-1
-2
% of GDP
1950
1954
1958
1962
1966
1970
1974
1978
1982
1986
1990
Years
Private long term
Net Inflow

The balance of payments position continued to be precarious as the revival of industrial growth had led to a continue rise in imports. There was a small improvement in exports but not as much as the rise in imports and hence the trade deficits increased. The availability of cheap multi-lateral and bilateral financial assistance was considerably reduced. The support extended to the trade deficit from inflows under invisible also got reduced, partly as there was stagnation in the remittances and a rise in interest payments. As a consequence the country resorted to increased commercial borrowings on both govt. and private accounts. In fact for the first time private capital inflows become significant and by the liberalization of the 90's quite significant in total capital inflows. As the reforms initiated were merely relaxations of the control regime not a full dismantling of the regime. The intrinsic instability continued. The rising balance of payments deficit led to a crisis position by 1990. This crisis required India to turn once again to the IMF for support.

In 1991 with the country engaged in a phase of what may be termed as full liberalization. As a consequence number of far reaching changes have been made in the Licensing & Control regime. Most import quotas were abolished and tariffs have been bought sharply in successive budgets. In addition there has been a reduction in the sol called canalized, or public sector, imports and in the negative list of imports. However there are still restrictions on most consumer goods and agricultural goods. The list of industries reserved exclusively for public sector activity has been pruned from 17 to 6 and even in the six remaining industries Govt. is considering relaxation. Virtually all Industrial Licensing, MRTP clearances have been removed. The operation of FERA has been liberalized by raising the stake foreign companies can have. This last process however is subject to a number of hiccups as is evident from the on-off debate on foreign investment in the Airline sector. The banking sector has been reformed with a statement on no further nationalization, relaxed conditions for private entry. On the operations side banks are expected to conform to the more scientific prudential norms for asset classification. Banks are also being made to improve capital adequacy in a phased manner. Public Sector enterprises have been brought under the purview of BIFR for restructuring and maybe their eventual winding up.
The tax system is being rationalized to increase the base of coverage and reduce the effective rates as a consequence. The Govt. has appointed committees to reform the company law and as of the last budget promised to replace FERA with a more market friendly statute consistent with an eventual convertible currency. There has been a number of far reaching changes in the capital markets as well.

The impact of these rapid changes has been to raise expectations of growth and has implied a sharp increase in foreign direct investment from around US$ 0.4 billion in 1992-93 to $4.9 billion in 1994-95. The growth rate GDP in the last five years has been at an average of over 6.5 % per annum. There has been a sharp rise in the share of exports, exports as a % of imports rose from 66.2% to an estimated 88% in 1996-97. These changes were accompanied by a number of emerging constraints on critical infrastructure inputs of power, transportation, telecommunication etc.

We now briefly look at some other key features of India's development experience.

Table 3.6 India's Population and its residence

Year	Population	% Urban
1951	361	17.3
1961	439.1	18
1971	548.2	19.9
1981	683.3	23.3
1991	846.3	25.7
1995*	916	31.3*

Source: Census
Note: the definition of urban area was changed from 1951 to 1961. In the new definition % in 1951 would be 16.7 (estimate)
* Mid year estimate

Urbanization: In these last 35 years urban population has increased in relative size by almost 12%, from 19% to 31.3 % of the total population between 1960 and 1995. This relatively small change hides the fact that in absolute terms urban population has grown by nearly 360% in the same period to a total urban population of 287 million in 1995 equal almost to the total US population. The rise in urban population is largely due to the natural process of increase in urban areas and partly due to the reclassification of rural areas to urban areas. The role of rural urban migration has been small amounting to around 20% of urban growth. (See P. Visaria *Population* in The Indian Economy (ed.) by Bimal Jalan 1992, penguin).

Employment: Agriculture has remained the principle source of employment to the population: In 1961 approximately 75% were in agriculture this number decreased to about 65% in 1992. This small change in proportion of agriculture was primarily accommodated by the growth in employment in construction and services, the growth in employment in manufacturing has been rather small and almost non-existent in the late eighties. Further of the non-agricultural employment only about 30% is in the organized sector. In side the organized sector there is a clear shift from manufacturing to services. The survey data from NSS reveals that between 72-73 and 87-88 that employment in organized manufacturing grew by only 1.16 million people which is less than 12% of the total growth in organized employment.

The real wage rate of in agriculture has tended to rise at around 3.3% per annum (Annual average rate of growth 1973-91); similar growth is available for the rest of the unorganized sector. This growth is variable and dependent on the growth in food grain prices. The growth is primarily associated with a rise in labor productivity. However this growth in real wages must be

tempered by the fact that in absolute terms these wages are quite low and a recent ILO-study[101] argued that these would not be able to meet the poverty norm assuming two dependents per earner. The figures reveal two important characteristics of the Indian workforce, first the sharp link between agricultural productivity and poverty levels, and secondly the pressure on starting work early. Further independent studies of poverty have suggested that growth, particularly in agriculture is much more effective in raising employment and reducing poverty.

In the organized sector real wage growth was at approximately 3% per annum. The growth was sharper in the case of public sector employee where the ratio of wages in the public sector to that in the private rose from 1.25 in 1973 to almost 1.7 in 1991. The eighties have in fact seen faster growth in labor cost in both public and private sectors, associated with a slowing down of employment growth in the organized sector. The slow growth in organized employment and the gap in organized and unorganized wages have heightened the dualism inherent in Indian labor markets.

The aggregate growth in employment and labor cost hides the sharp inter-regional differences in these. For example in the eighties while Tamilnadu and Gujarat have seen positive growth rates in organized employment while West Bengal and Kerala have seen either no growth or a decline.

Education and Literacy: India has the largest illiterate population in the world, The growth of literacy has been small as can be seen in Table 3.7. This growth was also accompanied by a rise in the proportion of population with higher education the total population with over 15 years of schooling rose from 3.3 million in 1971 to 14.8 million by 1991. As usual in terms of percentages this change is less significant showing an increase of about 1%. The data are described in table 3.8.

Table 3.7 Literacy Rate

	Male	Female	Total
1951	27.2	8.9	18.3
1961	40.4	15.3	28.3
1971	46	22	34.5
1981	56.5	29.9	43.7
1991	64.1	39.3	52.2

Source: CMIE Feb 1996

[101] ILO -SAAT (1996): *India: Economic Reforms and Labor Policies*

Table 3.8 Educational Composition of Population by years of schooling

		1971	1981	1991
No education or less than 3 years	Male	172.1	187.1	201.5
	Female	214.7	247.9	278.7
	Total	386.8	435.0	480.2
3 - 6 years	Male	73.6	99.1	122.4
	Female	36.9	55.4	78.5
	Total	110.5	154.5	200.9
7-11 years	Male	24.0	39.1	63.7
	Female	9.0	17.6	29.1
	Total	33.0	56.7	92.8
12-14 years	Male	11.8	22.0	40.7
	Female	2.8	7.1	16.9
	Total	14.6	29.1	57.6
15+ years	Male	2.6	6.0	10.9
	Female	0.7	2.0	3.9
	Total	3.3	8.0	14.8

Source CMIE Feb 1996

Thus we see that with economic development there has been a small but distinct change in the composition and educational level of the population. These changes are small in relative magnitude but quite large in absolute numbers. As in the case with employment there are sharp inter state differences with some states having achieved near 100% literacy and the others languishing with percentages well below the average.

4. INTERRELATION BETWEEN LAW AND ECONOMICS

The interplay between Law and Economics in India has been rather complex. In a number of areas legal institutions and judiciary have acted to check the use of arbitrary state power. The most important illustrations of these have been in regard to the long debate on the importance of property rights. The recent interventions of the Judiciary on Environment and the overall protection to basic freedoms. The increased importance to the executive and bureaucracy as a consequence of the control regime has also seen mounting use of `writ petitions' against arbitrary action. The Supreme Court of India used to receive about 500-600 writ petitions every year during late fifties and early sixties. But the number has gone up more than 15 times in nineties (L.C. Reports). In the absence of a time series and proper classification of data, it is difficult to assess the percentage of cases decided in favor of the private parties. There is reason to believe that the ratio is in fact very adverse to the State. There are several empirical studies indicating this. In one case of such an investigation one of the authors (Mitra) showed that in 55 to 60 percent cases of appeal which are filed by the State against the decision of the I.T.O. or I.T. Commissioner, in not more than 5% cases, decision go in favor of the State. In service matters almost 80% decision of the Central Administrative and State Administrative Tribunals go in favor of the employees. In land matters decision go in favor of private persons to the extent of 60-65 percent. In custom and excise matters about 6% decisions go in favor of the government.

However in a contrast to this trend of limiting state power, we also find that the Judiciary has taken serious note of the directive principles and acted to enhance state power to implement these principles in a number of cases. The most notable example is from the discussion on labor laws. The legislature and executive in turn have except for a brief period of two years from 1975-77 recognized the value of laws and have tended to use law making as a mechanism for social change. This was certainly the case in the sixties when laws were formulated to enhance the social control and now when the mood is to relax the role of the state.

The process of economic growth, urbanization and growth in the organized sector has implied a decline in the role for the non-formal dispute settlement mechanisms. This can be seen due to some broad indicators. Historically we find that the areas of Bengal, Bombay and Madras presidencies, where the impact of British colonial rule was for the longest period and hence also have the longest exposure to urbanization, industrialization and formal education also see the least role for these traditional bodies of dispute settlement. Further as these mechanisms tend to be local in their coverage and customary in their operations with urbanization and growth of inter-regional trade their effectiveness would have reduced. This process was further accelerated by the fact that immediately post-independence there was a rejection of a number of traditional institutions due to a belief that they were iniquitous and reflected traditional power hierarchies. A consequence was to reject a number of traditional practices in managing common property and resources. There are numerous examples from management of community forests, village tanks and other natural resources[102]. The formal ownership of these was vested in the state and in the name of conservation and development, traditional rights and practices were discontinued along

[102] Sengupta, Nirmal 1996 *Common Pool Resources*, Indian Legal System and Private Initiative Proceedings of the International Conference on law and Economics. Project LARGE

with extensive over use. Finally, and probably most significantly, we have noted in the discussion on the economy the rapid increase in the size and share of the public sector in economic activity between 1960 and 1995. This change implies a rise in the role for formal dispute settlement mechanisms. The reason is due to the nature of their organization and requirements for public accountability and audit imply that it is difficult to accept the solution offered by an informal body. This is further corroborated by a study conducted at the National Law school that found that in almost 60% of all civil disputes the Government is plaintiff, defendant, respondent, or appellant. In fact the study further identified that the bulk of the civil litigation relates to just five areas: taxation, credit, rent control, urban land ceiling. In all these cases the govt. policy either directly or indirectly is central to the dispute.

In addition to the distinct overall character of interrelationships there also some specific interrelations in specified sectors or growth factors. We turn our attention to examine some of the key areas of interaction.

Land: The market for land in India is highly fragmented with a number of restrictions on ownership, transfer and use. The market has a highly regional character with different states having distinct laws governing ownership, & transfer of land. There are nevertheless some uniform characteristics in the market for land.

Agricultural land cannot be owned by corporate enterprises nor transferred to non-agricultural purposes without state permission. In notified areas land cannot be transferred except to members of certain tribes or of communities. Ownership is subject to ceiling restrictions though this has not been effectively imposed except in recent times in West Bengal, Kerala and to a limited extent Karnataka. Tenancies are protected and inheritable. The only mechanism for converting land for Industrial use is through the acquisition power of the state. The power of the state in this regard is quite large and after enhanced in the post 1977 period. The state decides the amount of compensation in these cases, and it is linked primarily to the value in its current use rather than to potential market value or the value in its most productive use. Land use restrictions have been used to limit the impact of market forces in helping farmers decide what crops they may grow. As recently as in the eighties the state of Kerala, imposed restrictions on farmers shifting land from the cultivation of rice to coconuts because of concern for dropping rice acreage.

The urban real estate market was made even more restrictive after 1975 with the passing of the Urban Land Ceiling Act (ULCRA). Under this Act excess holdings were not transferable and would notionally vest in the state. This act has had the effect of restricting supply of land as holdings exempted from ceiling in one use may attract provisions of the act if the use were to be modified. Further, while existing ownership is difficult to dispossess, it creates a major hurdle for transferring land to new owners.

Taken in themselves the operation of these rules would have been a major impediment in the growth of Industry. However the state has traditionally been an active player in developing and providing land for industrial and corporate growth. Typically this has been done by providing corporates with long-term leases on land for designated industrial uses. Further development of

urban areas has been done by specific urban development boards and authorities with the powers to acquire land for real-estate development. Thus the impact of these on capital formation has not been discernable. As we have noted earlier, capital formation in the private corporate sector has tended to grow from around the late seventies a period associated with increased restrictiveness of the land market due to the passing of ULCRA and the forty fourth Constitutional Amendment. We also note that the share of the Organized or Formal sector in both secondary and tertiary sectors of GDP have increased in the same time period.

However the lack of statistical evidence does not imply that the functioning of real estate markets has not played a role in organized sector developments. The discussion so far has pointed out the state mitigated the impact of restrictions on corporate ownership and development of land by providing land for new corporate developments using its powers to acquire and develop property. However as we have noted this has done by leasing land to enterprises with very specific use restrictions. The restrictions on change in land use and also the vesting of vacant excess urban land in the state is proving to be a major handicap to the restructuring and reorganization of industrial units. Some states notably Maharashtra and Gujarat, have come up with guidelines which permit change in land use but these have occurred to recently to have a discernible long term impact Thus to conclude we note that while real estate laws have not directly hindered growth in corporate activity, they operate in a manner to restrict flexibility in industrial structure and one of the major impediments to corporate restructuring.

In case of agriculture, the long legal battle on property rights not with standing most states have not been successful in implementing land reform legislation. However, inspite of the failure of land reforms, inequality in agricultural holdings did not increase significantly. The following table reports the data from Various NSS estimates of Land holdings. We can see that the there is a clear increase in the percentage of land held by Marginal operators (less than 1 hectare) rises from 7.6% to 12.2% similarly the percentage of large holding (above 10 hectares) falls from 36% to about 18%. These results are borne out by a detailed analysis of Rudra and Chakravarty (1990) that the Gini coefficient for holdings, both operational and ownership, declines systematically from 1962 to 1982. And in this size class there is no major difference in inequality between ownership and operational holdings. Further no such trend is visible if we look at the distribution of all non-zero holdings. In other there has not been a tendency to equalize at very low levels. The reasons for this are probably more in the operation of the inheritance structure and possibly in the breakup of larger holdings to avoid assessment under land ceiling.

Table 4.1 Size distribution of Household Holdings: Rural India

Size of Holding (Hectares)	Cumulative Percentage of Land owned		
	1961-62	1971-72	1982
Below 0.21	0.54	0.69	0.9
Below 0.41	1.59	2.07	2.75
Below 1.0	7.59	9.76	12.22
Below 3.0	31.55	37.14	42.55
Below 6.1	54.49	60.93	66.73
Below 8.1	64.15	70.19	75.55
Below 10.1	71.75	77.09	81.92
Below 20.2	88.87	92.14	94.57

Source: Srinivasan (1992)

Finally it is worth commenting that, to some extent changes in land holding did not directly effect agricultural growth and productivity because most of the new technologies were scale neutral.

Labor: As we have seen considerable legislative & judicial effort has gone into providing for a social welfare net and a system of fair wages to workers. The effect of these has not been as anticipated. First the protection to workers in the unorganized sectors is quite meager and at times not even consistent with basic norms of "need based wage". On the other hand the work force in the organized sector has been well looked after and protected. This has tended to create a dualistic labor market with an elite set of jobs in the organized sector and the bulk in the unorganized sector. A recent study for the ILO[103] has pointed out that the share of the organized segment in the labor force has not increased, it has in fact fallen in most key areas of Manufacturing, Trade and Transport. Only in the case of services has there been an increase. While the Manufacturing sector has seen a small rise in its share of employment, the share of the high productive organized segment has actually declined over the period (from 1972 to 87). In contrast, the evidence suggests that there has been a rise in the real wage rate over the same period.

[103] Tendulkar and Sundaram (1994): Social Exclusion: Mechanisms. Processes and Labor Market Outcomes, An Indian Case Study.

Through the sixties and particularly in the seventies the employment in the organized sector was governed by a pair of "implicit contracts[104]". First, since the Government had granted protection to the employers in the product markets through trade restrictions, entry barriers (licensing) etc, it expected employers to protect employment levels and thus to justify all involuntary separations however defined, except for proven misconduct. Further since markets were protected and often price competition was limited in domestic markets and technology across industries was regulated to be similar, prices could be raised to pass on the costs to consumers. This then laid ground for the second contract between workers and employers and employees on employment security. Finally a measure of compliance was ensured with this structure where the workers in the Public Sector and in the government were protected for cost of living increases. These contracts led to a structure of slow growth in output and employment as demand growth is constrained due to prices and employment by the implicit guarantee of a "job for life". In the eighties these contracts were undermined with the opening of the economy to foreign trade and by the relaxation of licensing and price controls. This aggravated the situation leading to on the one hand the problem of sickness, slow or even negative growth in organized employment on the other.

Turning to the Unorganized sector, a recent study identifies a number of deficiencies in the functioning of the Minimum Wage legislation.[105] Some key aspects of which are: There are differences in the statutory minimum wage across states, which is understandable if we allow for differences in cost of living, but also across occupations in a given state. This latter difference is partly due to differences in Job description but partly also in consideration for factors of political economy and ability to pay. Secondly despite the provision in the act for revision at least every five years, there are many instances of breach, e.g., in the powerloom industry in Uttar Pradesh or in the case of Oil Mills in West Bengal. Secondly except until the eighties, in most states, the wages did not provide for any indexation. Thus we note that in fact Minimum wages actually declined in real terms in a number of states and industries. Further as the ILO reports out the wages may even have been below poverty line wages in most cases. Further, the study by Anant and Sundaram (1995) compared statutory minimum wages with those actually paid in certain occupations (as described in the occupational wage surveys (OWS)). The results suggest that the actual wages were less than the statutory minimum suggesting weaknesses in the enforcement of the act. Further in the OWS while the differences in the wage rates for men and women are probed from the perspective of the requirement of equal pay for equal work, no such probes seem to be made in respect of the statutory minimum wages.

Credit and Security: The growth of organized credit has primarily been determined by the growth of the public sector and the needs of development finance. This growth from 1956 to 1995 has taken place in a regime of controls. The major financial institutions were all in the public sector and functioned as adjuncts of state policy. Thus concerns on security interests and quality of security have not influenced volume of credit. But security-interest influences the

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104 *India; Economic Reforms and Labor Policies* : ILO-SAAT (1996)

105 See the discussion in Anant and Sundaram (1995) Wage Policy in India, and the associated discussion in India: Economic Reforms and Labor Policies: ILO-SAAT (1996) Chapter 2.

character, classes and types of the borrowing. It also determines quality and volume of security required. For example, working capital on floating charges is avoided. Banks prefer more credit facility for creating assets. Security-interests also determine the quantity and composition of security to be demanded. Example, floating charges are supported by personal guarantee

The usual securities used for this purpose are:

i) Personal guarantee by the client including submission of a promissory note as a security; or a post dated check;
ii) Personal guarantee by third party, which may either, be based on definite transaction or over a definite period of time, including bank guarantee;
iii) Security on immovable property such as:
    a) Registered mortgage;
    b) Simple mortgage;
    c) Equitable mortgage;
    d) Fixed charges;
    e) Usufructuary mortgage.
iv) Security against movable property such as:
    a) Pledge;
    b) Hypothecation;
    c) Floating charges against current assets like closing stock, sundry debtors and bills.
v) Other securities like:
    a) Stocks, shares and loan bonds;
    b) Assignments of life policy, etc.

However these are utilized in a framework of laws, which are incomplete because of limitation of definition, or inadequate because rights and duties of the parties are not clearly specified or absent. To illustrate, in India there is no law for mortgage on movable goods. However, hypothecation is a common form of security in case of vehicle loan. In absence of a clear statutory prescription, contract terms must clearly lay down bi-partite position especially in case of default. Often, law being absent/unclear/uncertain and time consuming, institutions are compelled to take extra-legal means to recover the possession.[106] Charges on movables can be registered for corporations with the registrar of companies but even here time taken for registration by RoC is extraordinarily high. In all other cases there is no mechanism for registering charges.

Turning to more specific issues Security on immovable property is the most preferred form. Charges on immovable property are registered with the Registrar of Land Records but the registration does not conclusively prove anything in India. The land records are incomplete and inconclusive. Stamp duty, under the State Laws, can range to 2% of the borrowing amount. Besides, on account of absence of conclusive registration of ownership, lawyer's cost are to be added with processing fees like `searching fees for at least fifty years' and the cost of time taken

[106] There have been instances where banks have employed collection agencies with dubious backgrounds.

for that purpose. Equitable Mortgage, where borrowing is possible by depositing the title deed with the Bank, is very popular, but it is permitted only in a few notified areas. But even this easy method, is limited because of defective land registration, character of registration law, and the right of the owner to sell the property even when the title deed is deposited with the Bank, etc.

Indian law on security-interest is inadequate and sometimes uncertain due to absence of codified laws or explanations imparted from common law even when there is a codified position. Added with that is a cost of `legal delay' cost involved in creation of the security as well as enforcement. At the time of creation, the application of natural justice upto the threshold of the execution of the contract (*Radha Krishna Agarwal v. Bihar*, AIR 1977 SC 1496) created legal hurdles for all public sector banks. As for example, notice for selling of the hypothecated goods taken possession shall entail a writ petition.

Insolvency and Bankruptcy Laws in India: There is no bankruptcy law in India There is only the Insolvency Law for individuals and the option of winding up for companies under the Companies Act. Insolvency is rarely used as a measure for recovery of credit security, In a State of Karnataka with a population of more than 40 million, having 4344 bank offices as on 1995 and claim arrears of Rs.3, 367 crores (rough estimate) falling due each year in the agricultural sector, average number of insolvency petition in a year is less than 100 per year. Average claim collection in agricultural sector is only 57%. Similarly, in the city of Calcutta or Bombay average number of petitions per annum for insolvency rarely goes higher than 70 to 80. Time taken to settle an insolvency petition is very high, from an average of 3000 days in Karnataka to 10-12 years in Calcutta and Bombay. The reasons for delay in insolvency cases are (i) inexperience of the judges (ii) direct handling of the insolvents' property by the Court through ad hoc appointments (iii) absence of skill oriented training available to judicial officers as well as Receivers and (iv) complexities due to varied nature of claim and preferences and the evidential system in an adversarial jurisprudence and (v) lawyers' interest in delaying the settlement.

The Court can wind up companies if they are unable to pay their debts [Companies Act, Section 433(e)]. However after 1985, Security of secured creditor is subject to a pari passu charge in favor of the workmen to the extent of the workmen's portion therein. Even this process is not without major hiccups the company may come under the jurisdiction of the Sick Industrial Companies (Special Provision) Act, 1985. In which case the ordinary course of rule of law stops with a view to protect `public interest'. Winding up proceedings and recovery of security thereafter can be moved only at the behest of the BIFR. All creditors including the secured ones are then forced to be a partner of the reconstruction game. Section 25-O of the Industrial Disputes Act is another limitation, according to which no industry can be closed without the prior approval of the State Government concerned. After a winding up order is passed the company is send to the liquidators and as we have already noted this process may take over 10 years to complete.

The procedural aspects of loan recovery are very complicated and time consuming. The adversarial procedure is at its worst. For example, the procedure permits the debtor to make simultaneous contradictory pleas in one written statement. Thus prolonging the debate until all of

the grounds are met. The enormous burden of proof prolongs the litigation and delays settlements.

Financial Institutions and Banks were insulated from the implications of these lacunae because of implicit state guarantees. But by the late eighties most banks had severe problems of undervalued assets. In 1993 almost a quarter of all advances were classified as non-performing. As per the recommendation of the Narsimhan Committee banks are now required to make provisions for these assets. A consequence has been a marked reluctance of the banking sector to increase lending exposure. Non-performing assets or poor recovery of credit is not only because of lacunae in the security structures but also due to increased politicization of credit decisions. Priority sector lending below Rs. 25,000 was often given without collateral security. Also mandated targets for lending made for poor assessment of credit worthiness.

Industry: We have already noted the fact that the period from 1965 - 1980 was associated with slow growth in productivity in the Industrial sector and a fall in the share of the private corporate sector in value added and capital formation. This can entirely be attributed to the policies which favored public sector over the private and the various regulatory rules which inhibited growth in capacity. In addition to these overall trends there are some more specific features of interest.

Reservation for small-scale industries: In keeping with the ethic of socialism and widening the base of production the govt. reserved a number of items for "small scale production". A SSI is defined as a unit with a given capacity size not exceeding Rs. 750 Thousand in 1965 (the limit was gradually raised to Rs. 3.5 million in 1985. The number of items reserved for such units was raised from 66 items to over 800 plus items in the mid 1980's. In addition to reservations these units were provided with subsidized credit and various concessions on indirect taxes. These concessions and reservations did help in creating a large class of small and petty entrepreneurs, but their economic implications were some what mixed. Bhavani (1991) found that policies of reservation and incentives instead of encouraging growth were in fact acting as disincentives to grow. It is however true that given the structure of labor laws small units did have lower labor costs, but this did not translate to a implication that there was in fact substitution of labor for capital.[107] In some cases, as in the Textile Industry, capacity restrictions on the Mill Sector in order to encourage handloom production set the stage for their eventual obsolescence and eventual sickness. On the other hand attempts to create small units where there are no scale benefits as in the case of the numerous Mini Paper and Steel Mills set up in the seventies, led to their eventual sickness when these sectors were liberalized in the eighties.

Winding Up: The companies Act provides for three modes of winding up a company. Voluntary; ordered by the court; and under the supervision of the court. It is not surprising that in view of the contentious issues raised in Industrial units most of the cases end up in the latter two groups. Before the court can order a winding up it had to examine whether it was in public interest to do so. There was no clear-cut definition of what constituted public interest. This led to

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[107] See Bhavani (1991)

a vast degree of confusion. For example in a number of rulings the court has held "loss making" is not adequate to direct winding up! After the passing of Sick Industrial Companies Act 1985 and Board of Industrial and Financial Reconstruction established this problem shifted from the courts to the BIFR The Government thus took on the responsibility of not allowing any industry to die without considerations of the welfare of the workers and other issues of Public Interest. The philosophy was that if the BIFR recommended it would be deemed to be in public interest to do so. After it was decided that it was in the public interest to allow a company to be wound up the court would appoint a official liquidator who would follow a lengthy, sequential procedure in winding up the company. A recent study for ADB[108] the examined the state of winding up cases in different High Courts of the country, the data is shown below. The results suggest it takes on average 10 years for a company to be wound up and in some difficult cases it could go on forever. The actual sale of assets is in itself substantially late in the day and may take 5 to 7 years. Which implies that by the time sale takes place the company may have no usable asset, other than land left. Further the welfare objectives of preventing loss to workers are mostly notional.

Table 4.2 Delays in Liquidating Indian Firms

Delay in Years	Number of Cases	Percent of Total
0 to 10 years	774	41%
10 to 20 years	506	27%
20 to 30 years	346	19%
30 to 40 years	186	10%
40 to 50 years	44	2%
More than 50 years	3	1%

Note: Data is from Ajeet Mathur 1992. The data relates to 14 out of 19 official liquidators

Private Corporate Structure: The growth of the private corporate structure was stunted from the early sixties to the early to mid eighties. From the data in the accompanying table we see that in 1992 almost the entire private corporate structure was in just two sectors manufacturing and construction, these two accounted for almost 82% of all private corporate activities but only 24% of NDP. In a large part this was a cumulative result of the operation of the whole spectrum of policies of control and the general bias against private capital.

[108] Ajeet Mathur, 'Industrial Restructuring and the National Renewal Fund', ADB, 1993.

Table 4.3 Sectoral Composition of GDP

Industry	1990-91 Rs Crores at current prices			
(1)	NDP	Public Sector	Unorganised	% Pvt. Corporate
1. agriculture, forestry & fishing	139298	3022	133978	1.6497
1.1 agriculture	127259	2203	123230	1.43487
1.2 forestry & logging	8095	816	6807	5.83076
1.3 fishing	3944	3	3941	0
2. mining & quarrying	8419	8899	0	-ve
3. manufacturing	77187	12250	30162	45.0529
4. Elect. Gas & water supply	4178	6126	152	-ve
5. construction	27222	4299	15096	28.7525
6. trade, hotels & restaurant	60138	2270.08	55280	4.3033
6.1 trade	57026	2196	52581	3.94382
6.2 hotels & restaurants	3112	74.08	2699	10.8907
7. transport, storage & communication	25078	11340	13128	2.43241
7.1 railways	4369	4369	0	0
7.2 transport by other means	16633	3157	12927	3.30067
7.3 storage	407	145	201	14.9877
7.4 communication	3669	3669	0	0
8. financing, insurance, real estate	32673	16444	13271	9.05335
8.1 banking & insurance	20452	16441	1167	13.9057
8.2 real estate, ownership of	12221	3	12104	0.93282
9. community, Social & other services	51409	37290	10077	7.86244
9.1 public administration & defence	24520	24520	0	0
9.2 Other services	26889	12770	10077	15.0322
10. Net domestic product	425602	101940.08	271796	12.1865

Source: National Accounts

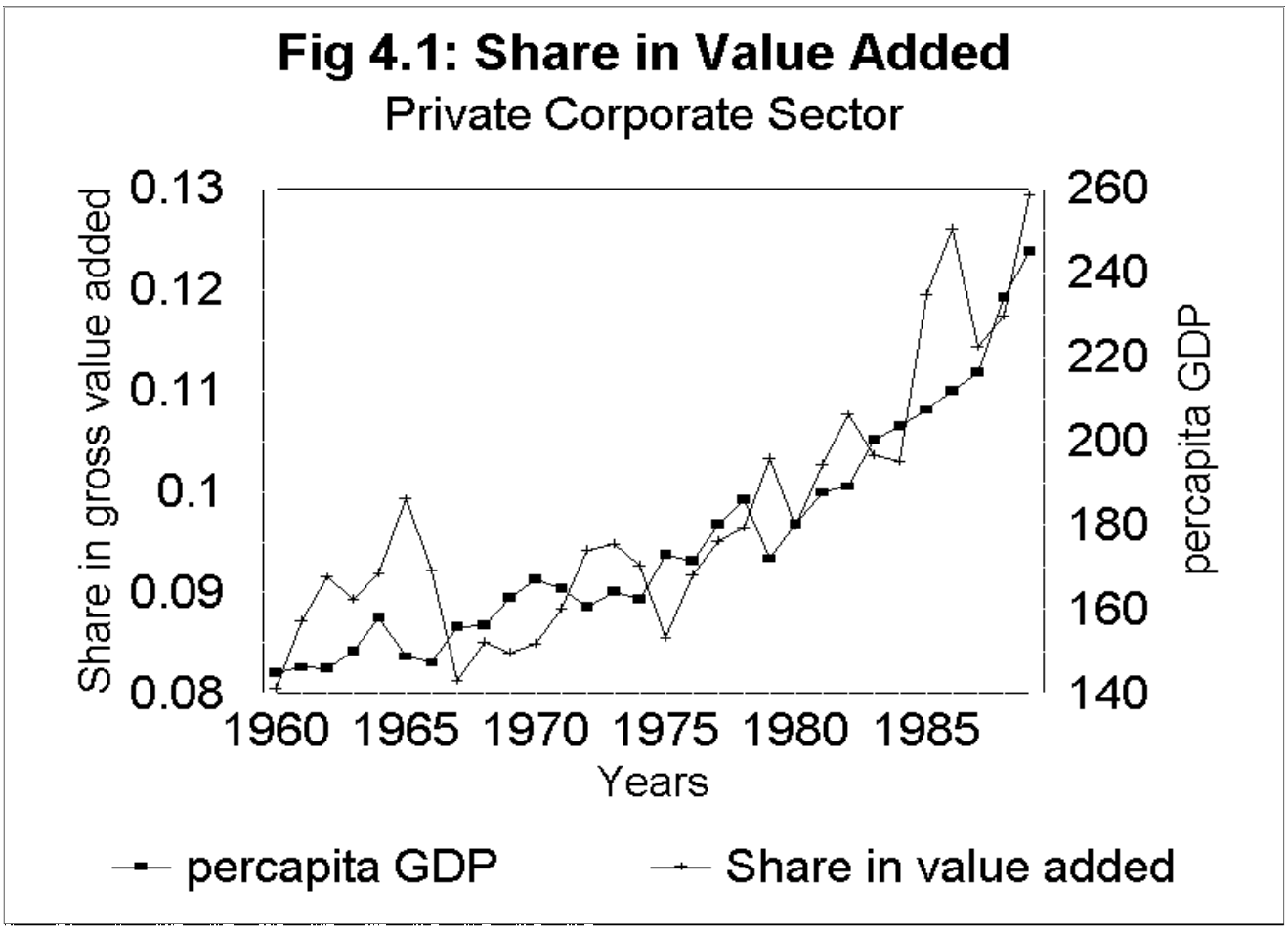
Fig 4.1: Share in Value Added
Private Corporate Sector
Share in gross value added
0.13
0.12
0.11
0.1
0.09
0.08
260
240
220
200
180
160
140
percapita GDP
1960 1965 1970 1975 1980 1985
Years
percapita GDP
Share in value added

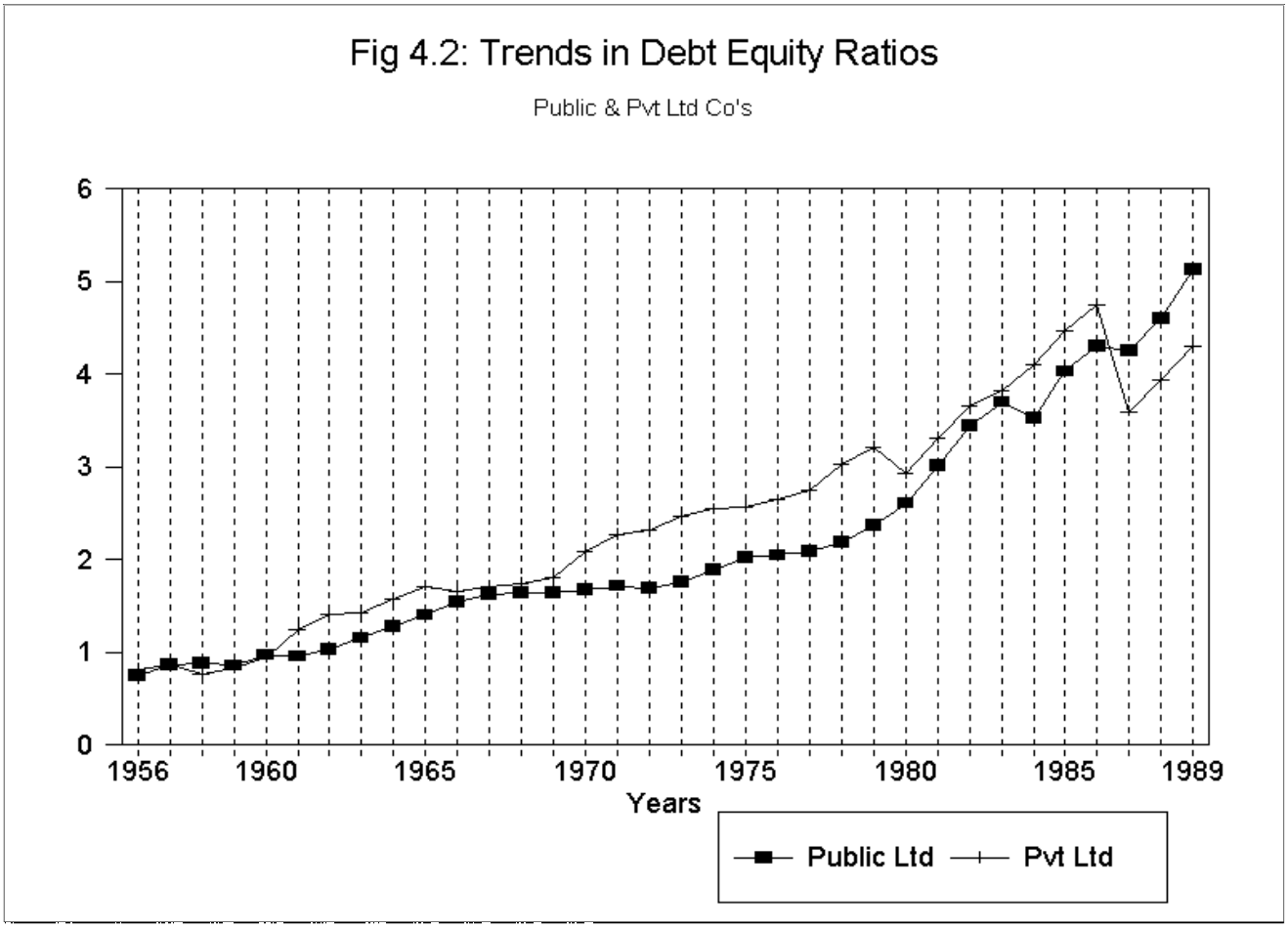
Fig 4.2: Trends in Debt Equity Ratios
Public & Pvt Ltd Co's
6
5
4
3
2
1
0
1956
1960
1965
1970
1975
1980
1985
1989
Years
Public Ltd
Pvt Ltd

The data depicted in figure 1 as well as the discussion in the section on the economy, one can see that from the mid sixties to the mid to late eighties there has been a stagnation in the private corporate structure. The changes in law on corporate structure and functioning which have occurred have taken place after the mid eighties. In view of the short period of time it is difficult to relate the improvements in private corporate functioning to changes in the legal framework because there have been a number of confounding effects like the stock market boom beginning from 1988, the general improvement in productivity due to a relaxation of controls and etc beginning from the early eighties.

The operations of the CCI and as also the underpricing of debt created a situation with a rapid increase in the debt -equity ratios of Indian companies, depicted in figure 2. The rise in the ratio is not alarming in itself it is higher than what prevails in America and Europe but is certainly closer to the corresponding values in Japan. Superficially the Indian position resembled Japan in another characteristic, the Financial Institutions were also substantial shareholders in the companies and in fact had nominees on the board of directors. But unlike in Japan, these directors did little to monitor performance of their companies. This poor monitoring was due to both poor incentive structures inside the institution as well as an excessive faith in the ability of the control system to regulate firm behavior. In any case as the controls weakened in the eighties and nineties, accommodating changes in the role played by nominee directors were not made leading to some spectacular scams.

Rent Seeking and the Underground Economy: It is important to note that the operation of a system of bureaucratic rules and controls have had their effect on corruption and rent seeking behavior. Govt. monopolies along with restrictions on supply, the wide discretion enjoyed by administration in making rules and allocations, the lack of effective accountability, this was created by two overlapping phenomenon, parliament has no investigative power of its own and collusion between the supervisors and their subordinates, and the restrictions on flow of information, through the extension of Official Secrets Act to activities of the Govt. in the commercial domain. The extensive role of Govt. in providing number of basic services has implied that corruption in fact operated at the retail level rather than being limited to rent seeking on large public contracts. This process had a symbiotic link with a related phenomenon of the growth of the Black or underground economy. This is largely in response to evasion of taxes, both direct and indirect. Evasion of excise duties, smuggling in response to import restrictions and currency restrictions, underpricing and under reporting of land transactions due to high rates of capital gains and the operation of land ceiling.[109]

While the widespread and extensive nature of this behavior has been widely commented upon[110] there is no agreement on its size in the economy. Estimates range from 18% to 50% of

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[109] There is an interesting example from the land market in Delhi. As we had noted earlier that almost all property sales took place as power of attorney transactions. As a consequence the actual price of transfer was notional and a large black component. While Black money payments are common in real estate deals, the additional factor here was that there was no record of the transfer price.

[110] *Aspects of Black Money in India* Shankar Acharya et. al. al. NIPFP 1985, *Black Income in India* Suraj Gupta 1992 Sage and *Corruption: Who will bell the cat?* Samuel Paul, 1997, Vikram Sarabhai Foundation

GDP in 1983-84. The problem with these estimates is that they are highly speculative and often confuse between the gross value of illegal transactions and components of GDP. Significant elements of what are termed as black transactions are rent seeking in nature and merely reflect transfer payments, further evasion of capital gains or underpricing of land also have no implications for value added and thus GDP. Further since a large part of the GDP arises in the informal sector, its contribution is not directly dependent on what is reported to official statistics but is in fact indirectly estimated. Finally, in the case of most public enterprises, these activities lead to inefficiency rather than under reporting. Taking all of these factors into account the black economy even though significant in its real impact on activity is not likely to be larger than the share of the private organized sector in GDP.

To conclude we would like to point out that while legal institutions have played a critical role in both protecting civil liberties and checking the use of arbitrary power in the hands of the state. This process is handicapped by limitations of infrastructure. The growth of the economy and the decline of informal dispute settlement mechanisms have increased the burden on the courts. The following table illustrates this process for the Supreme Court.

Table 4.4: Quinqennial Input-Output: Supreme Court of India

	No of cases instituted	Disposal
61-65 (8)	3705	3713
66-70 (8)	6383	5418
71-75 (14)	8992	7695
76-80 (14-18)	18143	13602
81-85 (18)	46212	36051
86-90 (26)	56210	42711
91-95 (26)	65790	52603

Figures in brackets are number of Judges

Note that except for the first five years the court has in fact always fallen behind increasing arrears. The picture in High courts and subordinate courts is in fact much worse. In 1981, the arrears across all high courts were 6,68,619 cases by 1987 this had more than doubled to 14,82,450. The number of judges did not rise in proportion increasing from 348 judges in 1977 to 538 in 1995. In combination with the various infirmities in the systems of legal education that we have noted earlier in our discussion on the profession act as major impediments to the process of development.

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