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Some Institutional And Legal Prerequisites of Economic Reforms In India

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WHERE THERE IS NO ECONOMIST: SOME INSTITUTIONAL AND LEGAL PREREQUISITES OF ECONOMIC REFORM IN INDIA

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Kaushik Basu

1 Introduction

The issues confronting the Indian economic policy maker are legion. Should the fertilizer subsidy be scrapped? Do our rent control laws need to be amended? Does FERA need modification? Should cotton exports be restricted? Should import restrictions on consumer goods be removed? Is front-running in the stock market to be banned? The questions depend on the context. If it is a district magistrate trying to craft policy for a small rural economy, one set of questions may confront her. Very different bundle of issues are likely to be the bread and butter of a senior bureaucrat in the North Block. It is impossible to anticipate all the possible and potential questions that can arise in a complex, modern economy such as India. Fortunately, how we answer many of these questions and craft specific policy depends on relatively few basic principles.

I propose to outline and recommend two such basic principles. The idea is that a person who masters these will be able to work out many of the answers to questions that arise when one gets "down to the task" and craft appropriate economic reform, without each time having to refer to an economist. The principles I outline are implicitly taken for granted by most economists--and perhaps all good economists. This is the reason why, contrary to folklore, economists do agree among themselves on a whole range of issues. The agreement is of course not total because these principles are not exhaustive, their interpretations are not free of ambiguity and because a prescription involves both positive analysis and value judgements and the latter can always be subjective.

The first principle to be discussed here will be called the principle of contract[1]. I shall argue that this principle, often conflicts with the 'bureaucratic instinct' and, therefore, has been repeatedly bypassed in the drafting of economic policy in India, to India's detriment. If this principle were followed the endless succession of complicated legislation, acts and bills could be vastly simplified, to India's advantage.

The second principle will be called the principle of efficient pricing. This is as important to the bureaucrat as to the manager in the private sector. I would have taken it to be a most natural principle, which is instinctively adhered to by all, if it were not for the fact that it is so widely flouted.

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[1] I call it the "basic principle" in Basu (1993).

2. The Principle of Contract

The principle of contract says that two or more adults should have the right to freely enter into any contract, which does not hurt individuals uninvolved in the contract, and, further, that the contracting individuals should be able to get support from the state and its judiciary in the event of someone reneging on the contract.

To take an example, suppose persons A and B agree that they will both be better off if A supplies B 100 apples from his orchard now and B supplies A 200 oranges six months later; and so they sign a contract to that effect. If government adheres to the principle of contract, it will allow A and B to sign such a contract and, moreover, if B refuses to give the 200 oranges six months later, A should be able to get the judiciary to enforce his claim or to seek retribution from B.

This principle can be the basis of welfare enhancement or, to use the economist's jargon, effect Pareto improvements, and is the motivation behind legislation like The Indian Contracts Act, 1872. If A and B voluntarily agree to a contract, it must be that they are better off by virtue of the contract. And since this principle recognizes only those contracts where uninvolved third parties are not adversely affected, if this contract falls within the purview of this principle, its implementation must make some people better off (A and B) and no one worse off, which is the definition of a Pareto improvement. An example of a government that does not adhere to this principle is one which has a law which says, for instance, that no one is allowed to exchange apples for oranges or that the only exchanges that are permitted are 1 apple for 1 orange. It is easy to see that such a law may well thwart transaction between A and B. It is possible that A would not agree to such an exchange because, given his preference, it is not worthwhile giving up one apple for only one orange. Even if it were the case that they could secretly agree to exchanging 100 apples for 200 oranges, a different problem can arise. Note that, if B reneges at the end of six months (that is, when the time comes for him to deliver the oranges), A will not be get any help from the government because he will not be able to reveal the original contract, which is in contravention of the law. Since B knows this it is very possible that B <u>will</u> renege. Since A, in turn, knows this, A may refuse to get into this contract in the first place.

This example makes it clear that a government's non-adherence to the principle of contract can diminish social welfare by dampening trade and economic activity. Indeed, a market economy cannot function unless people can get into contracts and expect these to be enforced. And for this we need the government to provide legal institutions which are supportive of this principle.

This principle is not an unexceptionable one. There are some contracts which come under the purview of this principle but may have to be overruled--I discuss some such exceptions later; but what is astonishing is the extent to which this principle or rule is disregarded in India. Legislation after legislation override the Indian Contracts Act and tell us how we should behave, with scant respect for voluntary contract. This cannot but thwart economic progress and the result, to wit, the Indian economy, is fair testimony. The Hindu rate of growth owes much less allegiance to the scriptures than to this failure of our legal environment.

To illustrate an overt violation of the principle of contract, consider the Delhi Rent Control Act, 1958. It is replete with references to "standard rent", "fair rent' and "lawful increase" of rent. The following are quotes from Section 4.

> (1) Except where rent is liable to periodical increase by virtue of an agreement entered into before the 1st day of January, 1939, no tenant shall, notwithstanding any agreement to the contrary, be liable to pay to his landlord for the occupation of any premises any amount in excess of the standard rent of the premises, unless such amount is a lawful increase of the standard rent in accordance with the provisions of this Act.
>
> (2) Subject to provisions of sub-section (1) any agreement

for the payment of rent in excess of the standard rent shall be construed as if it were an agreement for the payment of the standard rent only. (my italics)

Observe that clause (2) above says that even if a landlord and a tenant voluntarily agree upon a rent above the standard rent, the state will not recognize the contract. For a large class of tenancies, the annual standard rent is calculated in a mechanical fashion. It is 10 percent of the actual cost of construction and the market price of the land on the date of the commencement of the construction. It is baffling why this should be treated as sacrosanct.

On the rules for rent <u>increase</u> the law is as severe. I quote from Section 6:

"Notwithstanding anything contained in this Act, the standard rent, or where no standard rent is fixed under the provisions of this Act in respect of any premises, the rent agreed upon between the landlord and the tenant may be increased by 10 percent every three years".

Every time the government sets up a commission to examine our rental laws, the members of the commission invariably spend a lot of time on such matters. "Is 10% every three years fair?" they ask. Some say that in these days of inflation this is not enough.

Some argue that, since tenants are generally poorer than the landlords, there should be no provision for a rent increase.

The rent control act and debates of the above kind reveal fundamental flaws in our thinking on policy. The question is not whether 3.3% per annum is sufficient increase but why the government should be fixing such things in the first place. These are matters which the tenant and the landlord should be free to fix at the time of entering into a tenancy agreement. Suppose a tenant and a landlord agree

(A) on a high initial rent but no further increases after that, or,

(B) on a low initial rent and an annual increase by the same percentage as the increase in wholesale price index.

The existing rent control law will not recognize (A) or (B). The rationale behind such wanton violation of the principle of contract is not evident. And, I believe, there is little. It stems from a failure to appreciate the principle of contract and the instinctive meddlesomeness of human beings or what may, alternatively, be called the 'bureaucratic instinct'.

The harm of ignoring the principle of contract and, equivalently, of exogenously fixing the terms of a contract can be very large. In the above example, at times of inflation, given the terms of the rent control act, it may be better for landlords not to lease out their property but simply benefit from the appreciation of value. I believe that, if in the matter of rental the principle of contract were recognized, many more houses would be available to tenants on the market and the increased supply would probably result in diminished average market rents.

Most Indian laws begin by saying "Notwithstanding any prior contract among the involved parties...." or something to this effect. What we need however are <u>contract-regarding laws</u>. Such a law would begin by saying, "In the event of the involved parties not having agreed to a prior contract...".

Thus a contract-regarding rent-control law, that is, one which respects the principle of contract, would urge every landlord and tenant to sign a contract at the time of leasing. Then it would specify a slim set of rules for cases where no such initial contract is available.

Given that so much of our laws are designed with the sole aim of trampling over voluntarily agreed upon contracts, the code of law would shrink vastly if the law were made to respect the principle of contract. The main purpose of such a legal system would be to enforce the contracts people sign instead of telling people what should be the nature of their contracts.

Before moving on, here are some more examples of contract-overriding laws. Suppose two ordinary citizens, A and B, agree to a contract whereby A (who has recently earned dollars but needs Indian money) will give B 100 dollars, and A will in exchange get 3000 rupees from B (who has the rupees but needs the dollars.) This contract would unfortunately be considered null and void because section 8 of the Foreign Exchange Regulation Act, 1973, disallows such transactions among ordinary citizens.

Suppose an employer, A, and a workman, B, have decided on certain compensation to be paid to the workman in the event of a retrenchment. Again this will be considered null and void by our judiciary unless it happens to coincide exactly with the terms written down in section 25F of the Industrial Disputes Act, 1947 which requires that:

> the workman has been paid at the time of retrenchment, compensation which shall be equivalent to fifteen days' average pay for every completed year of continuous service or any part thereof in excess of six months".

Once again a legal system which respects individual freedom of contract would say that, whatever the terms of contract signed between the worker and the employer, they must be adhered to. Exogenous contracts should be used only in the event of the employer and the worker having signed no contract.

This is the reason why I find much of the debate on exit policy misplaced. The debate presumes that there must exist exogenous rules for the dissolution of firms and industries. But a more efficient system is to encourage workers and employers to enter into contingent contracts about how workers are to be compensated and how the assets are to be split in the event of the company's closure. The main aim of the law should be to help the implementation of such contracts.

The defenders of status quo may argue that workers and tenants are generally in a weaker bargaining position; so to allow free contract would necessarily mean a worse deal for them. This argument is wrong. It can be shown that in many situations adherence to the principle of contract would not only enhance total welfare but actually make the worker better off and the tenant better off (Basu, 1993, Fields, 1993).

One simple fallacy in this argument is easy to see. In Calcutta's Salt Lake City plots of land were sold by the government below the market price. The idea was to enable the middle and lower-middle classes to acquire property which they would, otherwise, be unable to buy. This is indeed a desirable objective. Some thing similar is true of the land given to Delhi's ubiquitous cooperative housing societies. Having given this land, government was worried that soon the rich would buy up the land from the not-so-rich and would displace the latter from Salt Lake City. So what did it do. Through a variety of laws government has made it virtually illegal to sell land acquired from the government to other citizens[2].

If we were really serious about helping the not-so-rich then, after selling them the land, far from putting restrictions on what they can do with the land, we would give them as much freedom as possible. After all, if a person wishes to sell his land it must be because he expects to be better off by doing so. Hence, his not being allowed to do so leaves him worse off. He may, for instance, want to sell it because he has a good and permanent job offer from Bombay. The existing law hinders mobility and hurts him.

The right to sell, without the government placing hurdles, is a minimal right which can generate a lot of welfare with no resource cost. There are countries, such as Sweden, which from complicated restrictions on property sales, have rapidly moved to a system of nearly-free transactions. India should do the same.

Let me now try to explain how respecting the principle of

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[2] Of course, Indians get around it. Through various powers of attorney and false declarations they do buy land and sell houses, but this entails considerable transactions costs and enriches lawyers and government officials in charge of enforcing the law. Indeed. some laws, such as the <u>Monopolies and Restrictive Trade Practices Act</u>, 1969, seem to exist only to be "got around" (Singh, 1993).

contract in labour markets can help the labourers[3]. Let us consider a model where an employer and a labourer can freely choose a daily wage (piece rates being ruled out by assumption). After that, once the worker begins to work, he can choose to be "lax" or "hard-working". It seems reasonable to assume that, other things remaining the same, he prefers to be lax, though productivity is, of course, higher if he is hard-working. The law that we shall consider pertains to the employer's right to dismiss the worker from employment. Consider two alternative legal scenarios.

<u>Law 1</u> The Employer cannot dismiss the worker even if he is lax.

<u>Law 2</u> The employer and the worker have to agree on (a) or (b), below; and then they must adhere to what they have agreed upon.

(a) The employer cannot dismiss the worker even if he is lax.
(b) The employer has the right to dismiss the worker if he is lax.

Law 2 is closer to the principle of contract since it gives

[3] For a more detailed analysis the reader is referred to Basu (1993). For a discussion of the Indian law in the context of contracts in the labour market, see Chander (1993). I must emphasize that it is not being claimed that labourers invariably benefit from the principle of contract. What I wish to demonstrate is that the converse claim, that workers invariably lose out if the law gives them the freedom to enter into contracts, is false.

the involved parties some freedom of contract whereas law 1 gives no freedom. At first sight it looks as though this is a freedom to the advantage of the employer. Clearly, if law 2 is effective the employer will insist on (b). And this must hurt the worker.

Every sentence in the above paragraph is true, excepting the last one. To see this consider the data given below, where all numbers are rupee equivalents.

<u>Worker</u>

	Lax	Hard-working
Cost of worker	4	6
Output produced	6	10

Hence, it is being assumed that if the worker works all day in a lax manner the cost of sweat to him is 4 rupees. Hard work is more onerous than laziness; hence a day spent on hard work costs the worker more, namely, 6 rupees. The chart also shows that a day of lax work produces 6 rupees worth of output and a day of hard work produces 10 rupees worth of output. Finally, I shall, assume that a worker would prefer not to lose his job (as long as he get positive benefit from the job).

Let us now see what will be the outcomes under different legal regimes. If law 1 is effective, the worker will certainly not work hard. Once his daily wage is fixed, given that he cannot be dismissed, he is best off being lax. Hence, at the days's end there will be 6 rupees worth of output and 4 rupees worth of sweat lost by the worker. The net benefit of the enterprise is 2. Let me, for simplicity, assume that the worker and the employer will bargain to ensure that the wage is such that the net benefit is split equally[4]. In that case the wage will be 5. Let us denote the wage in a regime of law 1 by w_1. Hence, $w_1 = 5$. Note that this gives the worker a net benefit of $w_1 - 4 = 1$ and the employer a net benefit of $6 - w_1 = 1$.

Now suppose it is law 2 that is effective. If the employer and the worker opt for (a) the outcome will be exactly as under law 1. What happens if they opt for (b)? Since the worker knows that he will be dismissed if he does not work hard, he will choose to work hard. The cost of labour will be 6 and output 10, thereby creating a net surplus of 4. Hence, following the same reasoning as before wage, w_2, (that is, the wage that prevails under law 2)

[4] This is consistent with the Nash bargaining model. If, to capture the greater bargaining power of the employer, we assume that the employer gets a fraction, d, of the benefit and the worker the rest and $d > 1/2$, we could do so without affecting my claim. The assumption $d = 1/2$ is purely for simplicity.

will now be 8. This will give the worker a net benefit of $w_2 - 6 = 2$ and the employer a net benefit of $10 - w_2 = 2$ Hence, given a choice between (a) and (b), they will voluntary contract to abide by (b). If this contract is then enforced, they are both better off. What is surprising is that by relinquishing the right not to be dismissed the worker is actually better off.

A different way of viewing law 2 is this. Law 2 is like law 1 with the worker having the additional right to give up his right not to be dismissed. Hence to make my criticism in this light we could say that the Indian law gives individuals many rights but it typically does not give him the right to give up any of these rights[5].

If we are hesitant to go all the way to contract-regarding laws, an intermediate step would be to make <u>some</u> provision for the "right to give up rights". When I first came to Delhi in the late seventies, I needed to rent an apartment for a few years, but could not afford a large rent. If I could credibly assure the landlords I saw that I would leave their premises in three years, many would have happily leased their apartment to me at a low rent (the scope for taking in new tenants three years later, by when rents would have risen, being adequate compensation) but there was no way I could thus assure them. My right as a tenant - generously conferred

[5] I formalize the right to give up rights in a social choice theoretic framework in Basu (1984).

on me by the government - not to quit became for me an albatross that I could not shake off. There is hardly any provision in the law which gave me the right to give up my right. The right to give up rights is not however an unheard of concept in world legal systems. A student who gets admission into an American university has the right to demand to see the recommendation his professor has written for him. However, U.S. law also gives him the right to "waive this right" if he so wishes.

As mentioned earlier, I am not recommending the principle of contract as gospel. There may indeed be cases where we would want to violate it. One class of exceptions concerns very long-term contracts. Many societies consider it right to prevent workers from making contracts for life. Such contracts can lead to serfdom and bondage. It may seem to many that human beings are inherently short-sighted. Hence, they should be prevented from signing away all their rights for the rest of their lives. Thus we may agree--I do--that a voluntarily agreed upon contract which is the basis of life-long bondage should be disallowed by law. The Bonded Labour System (Abolition) Act, 1976, while notably poor in its drafting as a piece of legislation, is a law in the spirit of the above argument.

Likewise, even if a consumer voluntarily buys a watch, if it turns out that the watch breaks down in a day because it is made of unacceptably poor components, the seller may be held guilty of cheating. The sale of a product amounts to an implicit contract, which says that the product contains what it is expected to contain. Hence even though no explicit contract is violated, the sale of a dud commodity may be treated as an unlawful act. This is the basis of consumer protection laws.

Finally, there are indeed situations where the weaker party in a contract could benefit if the terms of the contract were exogenously specified or at least restrained by government instead of being left to be determined through free bargain, and equity may therefore demand such exogenous restraint. This must not however result in an open mandate to government to fix the terms of other people's contracts because well-meaning (and not so well-meaning) interventions can actually hurt the poor and the weak unless these are executed with great care and selectively. There are indeed certain prices which should ideally be kept low to increase the access of the poor. But in implementing a price ceiling it must be kept in mind that a lower price also means a lower incentive for the producer to produce and supply the commodity in question. Hence, there can be a cut-back in supply when a maximum-price legislation is brought into effect. If this happens too sharply, then, in trying to ensure that the poor do not buy the product at a high price, we will end up simply ensuring that the poor do not buy the product.

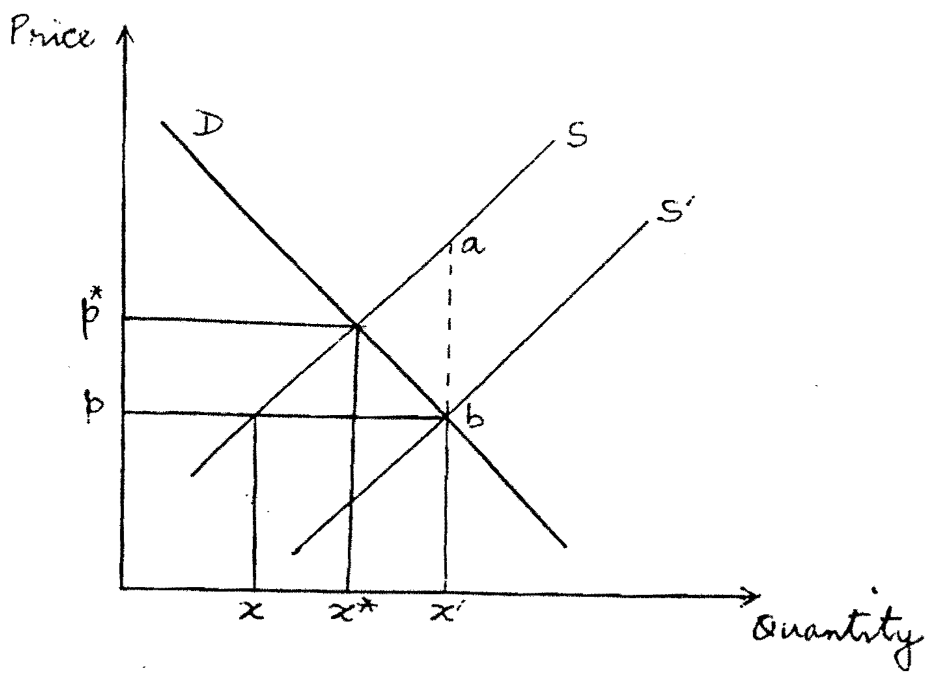
The more serious problem with the principle of contract is not that it has exceptions but that its applicability may be too slender. After all individual acts often have complicated general equilibrium effects and "third parties" are seldom unaffected. While this is true, it must be understood that the presence of a third-party effect does not mean an <u>automatic</u> right of government to overrule voluntary contracts. What the principle of contract suggests is a way of thinking. Instead of <u>beginning</u> by having <u>exogenous</u> or <u>imposed</u> contracts, I am recommending that we go about this the other way around. That is, we should in general allow free contracting, and stop this only when there is good reason to believe that there may be large and adverse general equilibrium effects or third party effects. To sum up, the basis of economic progress is a contract-regarding legal system. There may be cases where we want contract-overriding laws but these should be the exception rather than the rule.

<u>3. A digression on Price Control</u>

The principle of contract allows us to view the effect of price control in a different light. It is often argued that the price of essential goods should be controlled to ensure that everyone is able to buy them. What is not appreciated is that the success or failure of such a scheme depends critically on <u>how</u> price is controlled. I shall consider two mechanisms here. First, price can be controlled by decree, that is, by making it illegal to sell a product above a certain price. Secondly, price can be controlled by giving a subsidy.

If price is kept low by decree, it is true that many more people would demand the product. What is forgotten however is that a lower price would typically cause a lower supply. Hence a lower price may actually result in fewer people getting to buy the product. To understand this look at Figure I where D and S are, respectively, the demand curve and the supply curve. If price were not controlled, it would settle at p*, and x* units would be bought. Now suppose that the good, being an essential good, the government fixes its price at p. It is true that more people will now be able to buy the good and demand will now be greater, as x. However supply will drop to x. Hence the number of units of the good sold will be x, which is less than x*. In Russia, for instance, basic medicine is very cheap but it is frequently unavailable.

Figure 1



It is worth observing that a price control regime as just described violates the principle of contract, since there will exist individuals who would be willing to sell at a price above p and there will exist individuals willing to buy at that higher price. But since such transactions are illegal, such transactions or contracts would be disallowed.

Note now that the same p can be achieved without violating the contract principle if it is attained through a subsidy. If, for instance, a specific subsidy of ab is given for each good sold, the effective supply curve would be S′ and equilibrium would occur at b. Hence price would be p and the number of units sold would be x′.

For this reason the Dunkel draft proposal to prevent price fixing for certain goods like drugs does not mean consumers will have to pay a higher price. If the government suitably subsidizes the consumers purchasing this good, the price to the consumer could continue to remain low. This is allowed under the Uruguay round GATT agreement. Hence, the popular view that the consumer price of these drugs will necessarily rise is erroneous. What is true is that once the GATT proposals are implemented, the government will have to choose between allowing the prices of some drugs to rise and spending more money and keeping prices low by subsidizing the consumers.

To sum up, here are the pros and cons of the two methods of keeping consumer price down at p. If this is achieved through a subsidy, the government will have to spend ab-multiplied-by-pb units of money on subsidy, thereby risking an enlarged fiscal deficit. Here the consumers will get to buy x' units of the good. If, on the other hand, price is fixed at p by decree, government expenditure does not rise (except for the costs of enforcing the decree), but sales go down to only x units.

4. The Principle of Efficient Pricing

The reason why everything that is valuable in life comes with a price tag is that otherwise demand would outstrip supply. If apples were free (that is, of zero price) then the demand for apples would increase manifold and supply would shrink rapidly. Why would anyone devote orchard space, fertilizer and labour to growing apples if they know they will earn nothing from such activity. It is not even clear that anyone would grow apples for ones own consumption because if apples can be had for free one would be better off "buying" apples from the market and growing something else on one's own land.

While virtually all goods and services come with a price tag, it would be an error to think of the price of a good as comprising only of a direct money payment. Villagers often spurn education even when it comes for "free", because there are hidden prices. Four hours spent in a school is after all four hours of foregone labour. This labour could have fetched him or her income. Hence, the price of education is not just the fees charged by the school but also the income foregone during the school hours.

Similarly we often decide not to try to buy tickets for a cricket match not because the ticket is too costly but because there are too many hidden costs.--Either one has to spend long hours in queue or spend effort pretending to be a good friend of someone who is not a good friend but has easy access to tickets.

Likewise a company may decide not to set up a new plant in a certain region not because wages are too high but because there are hidden costs.--The labourers frequently go on strike, there are industrial disputes with costly litigation and there may be costly bureaucratic interference.

Hence the true price of a product, service or a venture is what one gets by adding up all the above kinds of direct and indirect costs. While there are many different components to the true price, these can be broken up into two important categories. 'transfer price ' and 'deadweight price'. A <u>transfer price</u>

is a price which the buyer pays <u>and someone else acquires</u>; so there is no social loss. When I pay my barber Rs.10 for a haircut, I lose Rs.10, true, but the barber earns it (as far as our local barber is concerned, this is money well earned). However, the half-hour that I have to wait for my turn at the barber shop, and which I notionally value at Rs. 20, is also a component of the price for a haircut, but this loss of Rs. 20 of mine, is no one's gain. I just waste my time, I do not give it to anyone. Hence, in my terminology Rs. 20 is <u>deadweight price</u>. If these were the only two components of the true price for a haircut, we would be able to say the following.

True price (30) = Transfer price (10) + Deadweight price (20).

The <u>principle of efficient pricing</u> (PEP) says that in organizing our markets we should try to keep deadweight price to a minimum.

As I said earlier, this should happen naturally. This is worth emphasizing <u>because</u> it does not. To see why it should happen naturally, return to the above barber example. Assume that each day the barber gets 25 customers. Hence his daily income is Rs. 250.

Now suppose the barber reorganizes his shop's management in such a way that customer waiting time goes to zero. This could be for instance, because he now gives haircuts only by prior appointment. Clearly he can now raise the haircut charge to Rs. 30 without losing any customer. This is because even after this reorganization the true price remains Rs. 30. This consists of a transfer price of Rs. 30 and deadweight price of zero. Hence by reducing deadweight price to zero the barber manages to raise his daily income to Rs. 750. Indeed, our local barber now has an appointments system and shorter queues and higher charges than he had earlier.

The moral is simple. It may not always be possible to reduce deadweight price to zero, but it always pays to reduce it to as low as possible. This is because every rupee shifted from the deadweight category to the transfer category is a rupee gained by someone since a transfer price is a price only to the buyer. Deadweight price, on the other hand, is a price to the buyer which goes to no one. Hence a good businessman extricates what the customers are willing to pay as transfer price.

At times we hear people say "I'd rather not go to that shop because the shopkeeper is always so grumpy". Hence, one component of the true price of buying from that shop is the cost of putting up with the grumpiness of the shop-keeper. Given that non-grumpy behaviour is usually costless and a matter of habit, the shop-keeper would be better off if he abandoned his grumpiness and raised the (transfer) price of the product he sells by an equivalent amount.

While I would not go out of my way to recommend PEP to barbers or shopkeepers, since their profit-maximization is not a major concern of mine, governments clearly ought to practice PEP and the Indian government practices it too little. Until recently, making an industrial investment was unbelievably expensive in terms of deadweight cost[6]. To make an investment an entrepreneur first needed approval from the Ministry of Industry, which took the form of issuance of a Letter of Intent. If there were any capital goods import needed, the entrepreneur would have to use the Letter of Intent to acquire a capital goods import license from the Chief Controller of Imports and Exports, Ministry of Commerce. For raising funds from the capital market he would need permission from the Controller of Capital Issues, Ministry of Finance. Further permission would be needed for the import of raw material. For each of these things a non-availability certificate would be needed from the technical wing of the Ministry of Industry. After all this was cleared, he would have to apply for a industrial license.

I do not know what the true price of investment in India was but clearly a very large component of it was a deadweight bureaucratic cost, as the above paragraph amply demonstrates. The length of red tape is shorter now as a consequence of economic reforms since 1991 but it is still long enough. If this deadweight price is removed and replaced with an equivalent direct charge imposed on the entrepreneur, the increase in social benefit can be

[6] The description that follows is taken from Mohan (1992).

large because now the cost to the entrepreneur will be tapped by government.

Similarly, when wooing foreign capital or when selling our products abroad, the aim should be to cut down deadweight charges to as little as possible and, as in the example of the barber, to extricate a part of the benefit, thereby imparted to the investor of capital or the purchaser of our goods, in the form of higher transfer price.

Likewise in the case of the labour market. It is very often said that Indian labour is one of the most expensive in the world. This is so not because wages are high but because other forms of cost--strikes, laxity at work, etc.--are high. Ideally we do want labour charges to be high. Labcurers are typically poor; and the purpose of economic progress is to benefit the workers. However, labourers should be high-cost by virtue of wages being high and not by virtue of high deadweight cost. An indisciplined labour is costly for entrepreneurs. But since indiscipline is not something that the worker can directly consume to the enhancement of his utility or sell in street-corner shops and enhance his income, it is a price that entrepreneurs pay and no one collects. In brief, it is a deadweight price.

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