# INDUSTRIAL

# DEVELOPMENT IN INDIA

# Indian Industry in the International Context

Indira Gandhi

National Open University

school of social sciences Industrial Development

in India

Block 2

# INDIAN INDUSTRY IN THE INTERNATIONAL CONTEXT

## UNIT 4

Globalization and Indian Industry

UNIT 5

International Competitiveness of Indian Industry

## UNIT 6.

Privatization and Issues Relating to Disinvestment Policy

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# BLOCK 2 INDIAN INDUSTRY IN THE

INTERNATIONAL CONTEXT.

Block 2 of the course sets the stage for Indian Industry to be discussed in the context of international environment. It not only discusses in detail the relationship between globalization and Indian Industry, but also the international competitiveness of Indian Industry and the privatization and issues relating to disinvestments policy. Therefore, this block has three units.

Unit 4,discusses various aspects of globalization like its meaning, factors causing and indicators of globalization. It also explains the strengths and weaknesses of Indian Industry in the context of globalization.

Unit 5**,** delves into the issues of Indian Industry getting exposed to the severe competition with globalization. It explains the different measures of competitiveness, evidence of the competitiveness of Indian Industry and the causes of weak competitiveness. The unit also suggest some remedies for the greater competitiveness of Indian Industry.

Unit 6, enters into the debate on privatization in India. Starting with the definition of privatization; it gives reasons for the establishment of PSEs and Nationalization in India and the recent shift in the thinking and strategy justifying the need to privatize. It also explains the obstacles that come in the process of privatization and the critical issues involved rule process. The unit ends with the discussion of the privatization and the disinvestments policy in India.

# UNIT 4 GLOBALISATION AND INDIAN

# INDUSTRY

## Structure

4.0 Objectives

4.1 Introduction

4.2 The Meaning of Globalization

4.2.1 Factors Causing Globalization

4.2.2 Indicators of Globalization

4.3 Indian Industry in the Context of Globalization

4.4 Opportunities and challenges for India

4.5 Let Us Sum Up

4.6 Key Words

4.7 Some Useful Books and References

4.8 Answers or Hints to Check Your Progress Exercises.

## 4.0 OBJECTIVES

This unit will deal with the concept of globalization and the main factors responsible for the emergence of globalization. It will discuss the indicators of globalization and the likely impact on Indian industries. After reading this unit, you will be able to:

⦁ understand the meaning of globalization of production;

⦁ recognize factors causing the phenomenon of globalization;

⦁ identify indicators of globalization; and

⦁ learn strengths and weaknesses of Indian industries in facing the process of globalization.

## 4.1 INTRODUCTION

You are familiar with international trade i.e. trade between countries. Countries export those goods that they can produce at low cost and import those goods that they need or cannot produce domestically. You know that India is a major exporter of tea, coffee and jewelry among other goods. You are also aware that India imports crude oil and industrial machinery. Similarly, many countries import products that they cannot produce at low cost. One country's export is another country's import. Through trade economic interaction between countries takes place. Economic interaction also takes place when workers go to other countries to work. Foreign companies come to India and set up factories here to produce cars, TVs and other goods. That is called foreign direct investment. Multinational companies, which produce in India, also export their product to other countries. The increasing interaction of domestic economies with the world economy is generally called globalization. You may say at this point that international trade used to take place even in earlier years and multinational companies existed in India even in pre independence years. What is so new about this growing interaction termed globalization? How is it different from internationalization? What factors contributed to this increasing interaction? Or speeded up the process of globalization? Please note that here we are mainly concede with globalization of production activity.

## 4.2 THE MEANING OF GLOBALISATION

We defined globalization as a process of increasing interaction of domestic economy with the world economy. This interaction takes place through trade in goods and services and international investment. One important indicator of globalization is the increasing share of exports in world output. At present more than one-fifth or 20 percent of world output is exported. This was less than 10 percent in the 1950's. Similarly, large increase has taken place in the share of manufactured exports in world manufacturing output. This indicates the fast growth of globalization of production activity. What is new about this process?

Globalization is the next stage in the process of international division of labour. Producers have learnt the art of breaking up the production process in to a number of different stages. Now a good is produced in a number of stages and each stage is located in a different country. Let us consider a very simple example. The production of color TV involves three stages. First stage is the design of TV, second stage is to manufacture different components of TV and third stage is the assembly of TV using the components. A US company may do the design of TV and then it gives orders for the manufacture of components to producers in Malaysia. Why? Because it is cheaper to produce the component in Malaysia than in the US. Producers in Malaysia after they produce the components, export it to China. Why? Because wage cost of assembling TV is very low in China and the American company has asked them to send it to China. The Chinese company assembles the TV and exports the TV to the US Company. The US Company sells it to the final consumer. This type of disintegration of production takes place for many goods. Each stage in the production gets located in a country best suited for that stage. Multinational companies from the developed countries are the leading players in this process of globalization of production. You must know about the Ford Motor Company in the USA. It produces the car Ford Escort for the European market. The final assembly of the car takes place in Spain. The different components of the car are manufactured and supplied to the Ford Company by different producers. They are located as follows:

1. Clutch &Steering Wheel (United Kingdom)

2. Glass (Canada)

3. Fan Belt (Denmark)

4. Carburetor Lamp (Italy)

5. Speedometer (Germany)

6. Engine (USA)

7. Tyres (Netherlands)

In other words, globalization implies a strong linkage between production systems of different countries. Globalization has led to the emergence of a network of production units located in different countries. In this way developing countries gain from participating in international trade. They can specialize in the labor-intensive stages as they have large population and labor force.

## 4.2.1 Factors Causing Globalization

Why could this kind of international division of labor take place only during the 1980's and 1990's?It existed earlier but grew very fast in eighties and nineties. Two important reasons can be given First, wages costs were higher in developed countries much lower in developing countries. Producers in developed countries wanted to take advantage of the low cost of production in developing countries .Second, the barriers to international trade came down .What were the barriers?

I. Firstly, countries used to impose very high tariffs (taxes) on imported goods. Under the GATT developed countries on goods imported from developing countries slowly reduced negotiations tariffs. Tax on imported goods in developed countries used to be 50 percent in 1950's but it came down to 4 percent in the 1980's.

ii. Second, transportation costs were reduced. This helped international trade. For example, you know that goods have to be sent to other countries in ships. During 1980 to 1996, the cost of sending goods abroad using sea freight declined by 70 percent. The unit cost of airfreight also has fallen during last 15 years.

iii. Third, communication costs declined. The per minute cost of international calls fell greatly in the developed countries. It is very cheap for a producer in the USA to telephone and contact a producer in a developing country. In brief the cost of long-distance communication between countries was enormously lowered. This helped in establishing a global network of producers located in different countries. This came to be understood as globalization.

Check Your Progress 1

1) What do you mean by international trade?

2)Explain the difference between international trade and international investment.

3)Mention the three main channels through which interaction takes place between domestic economy and world economy.

4)What are the factors that cause globalization?

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4.2.2 Indicators of Globalization

An important indicator of globalization is the ratio of trade to GDP. The amount of foreign trade of a country is measured by sum of the value of exports and imports. This figure is divided by the gross domestic product (GDP) to get the trade to GDP ratio. In Table 4.1 the Trade/GDP ratio for selected countries is presented. Notice that India's trade to GDP ratio has risen over time but it is much lower than China and Sri Lanka. This indicates that China and Sri Lanka are much more integrated with the world economy than India. India is still relatively less open to the influence of the world economy. In Table 4.2 the data on the leading exporter countries and the importer countries are presented. Notice that all leading exporters in the world are also leading importers. This indicates that in the world economy countries need to import a lot of goods to become efficient exporters. Countries, which import less, are not necessarily good performers in terms of exports. Each country is dependent on the world economy for many goods that it needs to become a successful exporter.

Table 4.1: Trade/GDP Ratio ion selected Countries

|  |  |  |
| --- | --- | --- |
| Country/group | 1975-79 | 1990-94 |
| World | 34.7 | 39.2 |
| Developing countries | 31.8 | 42.8 |
| China | 10.0 | 35.8 |
| India | 14.1 | 21.0 |
| Sri lanka | 68.1 | 72.5 |

Source: World Bank, 1997

Table 4.2: Leading Exporters and Importers in

World Merchandise Trade, 1997

(Percentage share in world exports and imports)

|  |  |  |  |
| --- | --- | --- | --- |
| Exporters | Shares | Importers | Share |
| United States | 12.6 | United States | 16.0 |
| Germany | 9.4 | Germany | 7.8 |
| Japan | 7.7 | Japan | 6.0 |
| France | 5.3 | France | 4.8 |
| United Kingdom | 5.2 | United Kingdom | 5.5 |
| China | 3.3 | China | 2.5 |
| South Korea | South Korea | South Korea | 2.6 |
| Taiwan | 2.6 | Tiwan | 2.0 |

Source: WTO Annual Report 1998

The following examples help us understand the phenomenon of globalization of production:

a) The share of output of companies affiliated to MNC's (Multinational Companies), located in developing countries, in the GDP of developing countries, has increased. In 1992 their share was 4.3 percent and increased to 6.3 percent in 1995.

b) Trade in pans and components in the machinery and components sector is die fastest growing segment of world trade. The developing countries exported about S100 billions of these products in 1995.

c)About 80 percent of Hong Kong's re-exports from China were the result of: \_tv. ard processing arrangements. Under this system Hong Kong firms placed: racers with Chinese enterprises to assemble products. Then they provided e Chinese enterprises with design and components. The finished products supplied by the Chinese were exported by the Hong Kong firms.

## 4.3 THE INDIAN INDUSTRY IN THE CONTEXT OF GLOBALISATION

we will use the word industry and manufacturing as synonymous. Indian manufacturing sector contributes about 22 percent of GDP and about 75 percent of India's total exports. In this sense it is a significant sector of the Indian economy. However, India's share of world export markets is very low. The 4.3 shows the percentage share of different countries in world manufacturing exports.

Table 4.3: Percentage Share of Manufacturing Exports in World Exports

|  |  |  |  |
| --- | --- | --- | --- |
| Countries | 1980-86 | 1987-90 | 1993-96 |
| India | 0.29 | 0.4 | 0.51 |
| China | N.A | 1.84 | 3.74 |
| Thailand | 0.24 | 0.5 | 0.88 |
| Malaysia | 0.54 | 0.67 | 1.58 |
| Indonesia | 0.19 | 0.37 | 0.73 |
| Philippines | 0.17 | 0.16 | 0.28 |
| South Korea | 2.11 | 2.76 | 3.02 |
| Taiwan | 2.19 | 2.89 | 2.9 |
| Size of Market in USS billion | 1105 | 1997 | 3284 |

Source: Business World, June 25,2001

From the above table we can see that India's share has improved only by a small percentage. The share of India's manufacturing exports was only 0.29 in the period 1980-89. During the period it has improved to 0.51 percent. In contrast to India, many other countries have performed very well. For example, China's share has increased from 1.84 percent during 1987-90 to more than 3.7 percent during 1993-96.

Let us look at India's export performance in selected products. We have selected those products whose production is globalized. They are shown in Table 4.4. Except in women clothing, India's share in world exports is very small. How can India's share be improved? What are the strengths and weaknesses of Indian Industrial sector? How to make India an attractive source for foreign companies to purchase their requirements of parts and components? These are the questions you must start thinking about using the knowledge of industrial economics.

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## Table 4.4: India's Export Share in Selected Globalized Products

|  |  |
| --- | --- |
| Description | Percent Share |
| Women's Clothing, woven | 4.7 |
| Men's wear | 2.8 |
| Footwear | 1.7 |
| Toys | 0.3 |
| Motors Parts & accessories | 0.2 |
| Internal Combustion engines | 0.2 |
| Computer Equipment | 0.03 |
| Valves and Transistors | 0.1 |

Source: Ramaswamy (2000)

### Check Your Progress 2

1)What are the indicators that you will use to measure globalization?

2)Name the countries with lower share of world export than that of India in 1986.

3)What happened to their share in 1996?

## 4.4 OPPORTUNITIES AND CHALLENGES FOR INDIA

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Indian industry

India can gain by participating in the global economy. It can get access to technologies, managerial expertise and world markets. The advantage is that India has a large domestic market. India also has the advantage of cheap labor and a large pool of scientific and educated manpower. This should attract foreign investment to India. Then you may ask why foreign direct investment is flowing to China and not to India.

The critical problem areas are infrastructure and labor productivity. The quality of infrastructure available to Indian industrial producers much inferior. The power supply is not continuous and frequently breaks down. This causes work stoppages nd poor capacity utilization.

Secondly our ports and custom procedures are inefficient. It is observed that it takes only one month to import a product from China but takes more than two months from India.

Thirdly we need to improve the quality of our human capital base. Indian labor may be cheap but it is also true that the productivity of Indian labor is lower; compared to other countries.

To prove productivity, we need to absorb new knowledge and train our workforce. The number of people with secondary education is very low in India compared to so. South Korea. India needs more investment in human capital.

What attracts investment is the availability of electricity, transport and communication facilities. The two basic necessities to participate and succeed in the globalized economy are the quality infrastructure and productive labor. This requires more and more investment.

## Check Your Progress 3

1)Explain briefly the gains that India is likely to get by participating in the world economy.

2)What do you think India should do to attract more foreign investment?

## 4.5 LET US SUM UP

This unit clearly brings out the concept of globalization. After going through this unit, we know that the economies today are closely inter connected. This gives us a network view of the world economy. In the globalized economy the leading players are the multinational companies. They outsource production from different countries. Differences in the wage cost of production between developed and developing countries is one of the main factors behind globalization. Reduction in transport and communication costs is the other important factors contributing to globalization.

India with its large market has some advantages and disadvantages. India needs to make investment in infrastructure and human capital to benefit from participation in the global economy

4.6 KEY WORDS

Globalization: Growing interaction with the world economy

Trade to GDP Ratio: Ratio of the value of exports and imports to gross domestic product

Indicators of Globalization: Share of world exports in world output

Wage Costs and Labor Productivity: Wages paid to workers employed and output per worker

## 4.7 SOME USEFUL BOOKS AND REFERENCES

Kirit S. Parikh (ed.), (2000). India Development Report 1999-2000, Oxford University Press, New Delhi.

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World Trade Organization (WTO), (1998): Annual Report.

## 4.8 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

## Check Your Progress 1

1. See Section 4.1

2. See Section 4 1

3. See Sub-section 4.1.1

4. See Sub-section 4.1.2

## Check Your Progress 2

1. See Section 4.2

2. See column 1 in Table 4.2

3. See column 4 in Table 4.2

## Check Your Progress 3

1. See Section 4.4

2. See Section 4.4

# UNIT 5 INTERNATIONAL COMPETITIVENESS OF INDIAN INDUSTRY

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## Structure

5.0 Objectives

5.1 Introduction

5.2 Measures of Competitiveness

5.3 Evidence of Competitiveness

5.4 Causes of Weak Competitiveness

5.4.1 Competitiveness and Government Policy

5.4.2 Competitiveness and Economy-wide Factors

5.5 Suggested Remedies

5.5.1 Measures to Create Favorable Macro Environment

5.5.2 Measures at the Firm Level

5.5.3 Measures to Fight International Protectionism

5.6 Let Us Sum Up

5.7 Keyword's

5.8 Some Useful Books and References

5.9 Answers or Hints to Check Your Progress Exercises

5.0 OBJECTIVES

With the opening up of the economy, Indian industry has been exposed to severe competition. Globalization implies free play of market forces. Indian industry, in order to survive, would have to go global and fight competition in the international markets. After going through the unit, you will be able to:

⦁ understand the meaning and significance of competitiveness;

⦁ identify the measures of international competitiveness of industry;

⦁ judge the level of competitiveness of Indian industry in the international market;

⦁ identify the causes of weak competitiveness of Indian industry;

⦁ evaluate how far the macro-environment has been responsible for the present state of the Indian industry

⦁ make out a plan of action for strengthening the competitiveness of industry

5.1 INTRODUCTION

With the opening up of the economy and gradually increasing emphasis on exports both for balance of payments consideration as also as a means to create and expand markets, competitiveness of industrial units has acquired center-stage. Competitiveness is defined as a producer's ability to create customer preference for its own product over the rivals' products. Competitiveness is a function of many factors; among which, of course, the most important is the price at which a product is offered for sale. In a competitive market where many homogenous products are offered by different producers, price itself is determined by the cost of production.

The cost of production, in turn, reflects the productivity and efficiency of the use of the inputs. In addition, competitiveness is also affected by a whole host of other factors like credit facilities offered to the buyers, ability to service the overseas buyers at short notice, quality commitment and brand image, etc. It is in this context that we are interested in the study of the international competitiveness of Indian industry.

## 5.2 MEASURES OF COMPETITIVENESS

There are different measures to gauge the competitiveness in the global arena. Among these, the more important measures can be summarized as follows:

i) One way to measure competitiveness is by the extent of successful export performance. If we assume that exports are profitable, then export orientation and/or market share in the buying country/countries can serve as a measure of competitiveness.

This export success or competitiveness is in turn due to competitiveness in price as well as non-price factors.

Price competitiveness is usually necessary but never sufficient for export success, which also requires market knowledge, marketing skills and ability, quality of a high order, and the ability to adapt products according to demand. It is possible that owing to conscious product differentiation or otherwise, a product commands a premium in the market place. In this case, its competitiveness is based primarily on image and quality factors rather than on price.

The advantage of an export share measure of competitiveness is that it takes into account both price and non-price factors. However, this measure can be inadequate when exports are sold at unprofitable levels or if exporters deliberately do not export to their potential, perhaps because of the pull of the domestic market, i.e., they have the ability but not the willingness to export.

To take care of these problems a few other measures of competitiveness have been developed.

ii)Another measure is based on the price indicators. The most direct price indicator is an international price comparison in specific industries. But due to the lack of comparable data, this measure of competitiveness is of little practical value.

iii)A more sophisticated indicator is the effective rate of protection, which measures the extent to which value added in domestic prices exceeds value added at world prices.

iv)Another measure is domestic resource cost which assesses the efficiency of earning or saving a dollar.

Of all the alternative measures of competitiveness mentioned above the most simple and useful is to estimate a country's share in global exports. This single figure is easy to comprehend and useful to formulate a fairly good idea about a nation's competitiveness.

However, it need be added here that although we often hear of a nation's competitiveness, a nation as a whole is never competitive. Competitiveness is like a notion of comparative advantage, which translates into goods and services being exported and others being imported. Therefore, it is more useful to consider the competitiveness of particular activities, sectors, industries or firms.

### Check Your Progress 1

1)What do you mean by international competitiveness?

2)What are the single most important criteria of competitiveness

## 5.3 EVIDENCE ON COMPETITIVENESS

As stated above the single most important measure of a nation's global competitiveness is its share in global exports.

It is in this background that we will study the trends in India's exports during the last five decades. This will help us to formulate some idea about the international competitiveness of Indian industry.

The total value of exports from India in the year 1950-51 was estimated at Rs.606 crores. This is estimated to have increased to Rs.2,01,674 crores in the year 2000-01.

In relative terms, India's total exports constituted 6.8 per cent of India's gross domestic product during the year 1950-51; this ratio is estimated to have increased to 8.80 per cent in 2000-01.

Product-wise, India's exports can be divided in three categories, as follows:

i. Export-oriented manufacturers, viz., exports through industries which are significantly export dependent;

ii. Domestic-oriented manufacturers, viz., exports through industries, which largely cater to domestic demand;

iii. Non-manufacturers, viz., products, which are from natural or agricultural sector.

The relative share of the three groups in total exports has been 53%, 12% and 35%, respectively. Apparently, manufacturers, and therein too the export-oriented manufacturers, have come to dominate our export market. For a country, aspiring to industrialize a shift in favor of manufactured exports is good.

However, India's exports, as compared to the world exports, have been slow to grow.

As would be seen from Table 5.1 below, India's share in world's exports was as high as 2.20 per cent in 1950-51. It fell to a low of 0.42 per cent in 1980-81.

During the eighties and the nineties of the last century, there has been some improvement in the ratio, which has varied between 0.50 and 0.65 per cent.

Many developing countries have recorded export growth rates much higher than that of India's. Thus, whereas India's exports (estimated at USS 44.10 billion during

2001-01) increased at an annual average rate of 5.9% in dollar terms during 1980- 90 and 11.3% during 1990-2001; the corresponding growth rates for some other developing countries like China (19.9,13.0), South Korea (12.0,15.0), Malaysia (10.9,11.0), etc. were much higher. India's ranking among the world's exporting- nations slipped from 16th in 1953 to 20th in 1983 and further to 29th presently.

What this evidence brings out unmistakably is the fact that India's manufacturers have suffered from weak competitiveness.

|  |  |  |
| --- | --- | --- |
| YEAR | INDIA'S EXPORTS AS % OFINDIA'S EXPORTS AS % OF |  |
|  | WORLD'S EXPORTSWORLD'S EXPORTS | INDIA'S NATIONAL INCOMEINDIA'S NATIONAL INCOME |
| 1950-51 | - 2.20 | 6.80 |
| 1960-61 | 1.05 | 4.20 |
| 1970-71 | 0.64 | 3.80 |
| 1980-81 | 0.42 | 5.40 |
| 1990-91 | 0.52 | 6.90 |
| 1991-92 | 0.56 | 7.20 |
| 1992-93 | 0.52 | 7.60 |
| 1993-94 | 0.62 | 8.70 |
| 1994-95 | 0.58 | 8.70 |
| 1995-96 | 0.64 | 9.80 |
| 1996-97 | 0.60 | 9.60 |
| 1997-98 | 0.50 | 8.36 |
| 1998-99 | 0.50 | 8.20 |
| 1999-2000 | 0.53 | 8.50 |
| 2000-2001 | 0.55 | 8.80 |
| 2001-2002 | 0.60 | 9.00 |

\*Projections

## 5.4 CAUSES OF WEAK COMPETITIVENESS

The weak competitiveness of Indian industry is to be traced to the macroeconomic \* environment within which the Indian industry has to operate. There are two aspects of this environment as follows:

1. Government Policy, and

2. Economic-wide Factors

Let us examine both of these.

## 5.4.1 Competitiveness and Government Policy

The various policies that had an impact on the international competitiveness of the Indian industry could be divided in two categories, viz.,

I. Policies that restricted internal competition, and

II. Policies that restricted external competition.

A. I) Policies that restricted internal competition

a. The most pervasive industry policy was the one that restricted entry, location, expansion and

b. diversification. This was done through the instrument of industry licensing which was mandatory for all under the industries (Development and Regulation) Act,1951.

c. Growth of large business houses and concentration of economic power was: to be controlled by the Monopolies and Restrictive Trade Practices N CRT?) Act, which required larger or interconnected firms to seek prior approval before investment, and that too only in a selected list of' core' industries in which: hey were allowed to invest.

d. Foreign investment in domestic industry has always been channeled and controlled, and technical collaborations approved on a case-by-case basis. The Foreign Exchange Regulation Act, 1973 tightened the foreign equity policy and allowed a maximum of 40 per cent foreign equity except in the case of high technology or export-oriented ventures.

e. Another important feature of the industrial policy has been the various concessions given to small-scale industry, including reservation of over 800 products for exclusive manufacture by small-scale industry, fiscal and credit concessions, etc.

f. Preferential treatment was also given to public sector enterprises, including reservation of certain key industries, and purchase and price preferences.

g. The government also imposed administered prices for certain commodities, such as, sugar, steel, fertilizer, petroleum products, drugs and paper. Most of these as well as some other products were also subjected to distribution controls.

h. Locational policies sought to channel investment in backward areas.

I. Labor laws influenced remuneration to labor, labor relations, etc., and led to over-protection of organized sector workers, at the expense of those in the unorganized sector. The labor laws also contributed to barriers to adjustment and exit that all organized sector firms, particularly the larger ones, have to face.

j. Finally, direct and indirect taxes were rather high.

II) Policies that restricted external competition

a. Virtually all imports were subjected to some form of licensing, and the policy differentiated between the type of product imported and the type of user. Consumer goods, except a few essentials, were banned from import. Intendants, raw materials and capital goods could either be imported without a license or with a license under different categories. The licensing system was discretionary and each application was treated on a case-by-case basis.

b. The quantitative control system was complemented by a tariff structure that is amongst the highest in the world, and created an additional barrier to external competition.

Not surprisingly, all these policies resulted in an anti-export bias.

Impact of the Government Policies

There can be little doubt that the policies that evolved over the years were well

intentioned. They succeeded in encouraging the development of a vast and diversified

industrial base. But this came at great cost to the economy.

We will consider the impact of policies on some factors crucial to international

competitiveness.

II. II) Economies of Scale and Industrial Structure: Apart from factor growth, industrial policy in India has emphasized regional spread of industrialization, promotion of small industry and prevention of concentration of economic power.

ii. One fallout of this was that firms were often constrained from attaining optimal plant size.

iii. Even though average plant size was small, Indian industry has been saddled with high market concentration and prevalence of monopoly practices, despite policy efforts to the contrary.

iv. The problem, of course, lies not in concentration per se but in protection from competition. Barriers to growth, the lack of a threat of potential entry, and virtual absence of import competition that high concentration caused resulted in a proliferation of inefficient fins as well as monopolistic behavior.

v. Effective Competition: Ensuring productive use of the invested resources never really formed part of the explicit policy agenda in India until the eighties. It is, therefore, not surprising that the government had largely ignored the impact of its policies on the degree of effective competition, a vital ingredient in spurring industrial efficiency.

vi. The government exercised substantial control on the business decisions of firms. Entry as well as expansion were controlled. Firms across most industrial sectors became used to operating in a sellers' market. Even when there were a large number of firms in the industry, the industry could still be dominated by a handful of firms. Since growth was controlled, a more competitive firm's activities did not necessarily result in higher market share. The lack of import competition meant that there was no external check on monopolistic behavior.

vii. Technological Change: A certain amount of technological change is inevitable under any circumstances in an industrializing economy since technological change is required to operationalize the technology that is transferred from a more advanced country. This technological change includes adaptation of local inputs to manufacturing requirements, changes in production processes to suit scale and skills, and even adaptation of products to cater to local demand conditions.

viii. There is a clear consensus that promotion of technological capabilities requires an initial phase of protection. In this sense India's policies were on the right track, at least initially.

ix. However, this type of policy also generated a great deal of wasteful technological effort rather than motivating improvement in productivity through building up of more efficient technologies.

x. Another very necessary requirement in promoting technological change is investment in human capital. We did not pay adequate attention to this aspect. The result is that even when new technologies are introduced in India, the equally important process of technology diffusion suffers due to low level of general awareness, illiteracy, and a low ratio of technically skilled people. This in turn results in slow growth of productivity, and weak competitiveness.

xi. Entrepreneurship: The all-pervasive controls and regulations induced rent- seeking behavior amongst entrepreneurs. Industrialists would spend valuable time and retain expensive lobbyists in a bid to grab industrial licenses, import licenses, etc. to the detriment of economically useful activities. Such behavior has been termed by Prof. Jagdish Bhagwati as 'directly unproductive activity'. The other impact of controls was to drive economic activity 'underground', resulting in loss of government revenue, and creating distortions in the system.

Instability in policies has been another serious problem. This was caused either by

frequent policy change, usually in response to intense lobbying, or by the use of

substantial discretionary powers vested in the hands of government functionaries.

This led to uncertainty and has not been conducive to long-term investment planning.

High levels of direct and indirect taxation also reduced incentive for entrepreneurship. High direct taxes encouraged tax evasion and discouraged risk-taking by manufacturers. Along with incomplete enforcement, high taxes encouraged investment in sterile assets and in trading activities, rather than in manufacturing.

To sum up, the industrial regulatory systems in place, at least till the end of the decade of eighties in the last century, worked to provide protection of all kinds: of small-scale industry, of the public sector, of domestic firms from foreign ones, of sick firms, and of organized labor. The system was not conducive to efficiency. Operating in a sellers' market, productivity growth in Indian industry lagged behind those of its competitors, and India's share in world and developing country manufactured exports declined.

The onset of the decade of the nineties saw the beginning of the process of dismantling of this control system.

## 5.4.2 Competitiveness and Economy-wide Factors

Among the economy-wide factors that explain low competitiveness of the Indian industry, the major ones can be identified as follows:

1. The major factor here is the nature of domestic demand. In the domestic market, there is a premium on functional efficiency and the low price of products, and aspects such as safety, aesthetics, fit and finish and comfort are not given much importance.

2. In other words, firms in India do not make major investments specifically for export markets, because that is a high-risk strategy. Since firms were making considerable profits in the domestic market with very low risks owing to the lack of competition, it was natural for them to focus on this market. The product technology in use was usually outdated and also adapted to Indian conditions. However, in some cases, it was not so much Indian conditions as lack of competition that rendered products unexportable.

3. Another economy-wide factor constraining competitiveness is the quantum of demand, which prevents fins from reaping economies of scale. We can divide all firms into three groups as follows:

I. Those where the demand for the industry's products is adequate and firm scales are also adequate to reap sufficient economies of scale in marketing, R&D, quality control, etc.

ii. Those with adequate industry demand but inadequate scale, usually on account of policy factors; and

iii. Those with inadequate demand and inadequate scale of production.

It is only in the third group that market size per se is a constraint. In such products, Indian producers suffer from cost penalties vis-a-vis international standards.

4. There are a whole host of other India-specific factors that find mention as major constraints. India's complexity, its heterogeneity, its uniqueness, its chaotic democracy, occupation, colonial heritage, difficult labor, etc. are some of the factors that are said to prevent faster growth and efficiency.

To sum up, this section on the causes of the weak international competitiveness of the Indian industry, we have noted how government policies in India acted in a mutually reinforcing way to prevent competitiveness from taking root. High concentration, barriers to growth, lack of threat of potential entrants, non-existent import competition, barriers to exit, a maze of rules and regulations, etc. resulted in

a proliferation of inefficient firms, cost-plus pricing behavior, and directly unproductive activity. Since imports were not allowed, high cost domestic products had a cascading impact on the economy so that even efficiently produced goods were not price-competitive. Moreover, since many of the high cost products were in upstream sectors, their impact on the rest of the economy was disproportionately widespread. High costs also had a negative impact on demand, which in turn retarded dynamic gains in technological development and efficiency.

### Check Your Progress 2

1) Mention in brief the main features of the government policy that have adversely affected international competitiveness of Indian industry.

2)What are the economy-wide factors that affect the international competitiveness of the Indian industry?

## 5.5 SUGGESTED REMEDIES

With the onset of the decade of nineties, the policy framework governing the industry began to undergo a change. Various controls began to be loosened; different barriers have been dismantled; regulations have been made more flexible and less rigid. The earlier attitude towards private enterprise, both domestic and foreign, has undergone a paradigm change. The trade policy encourages export promotion in place of import substitution. Inward-orientation of policy has yielded place to outward-orientation.

India has set itself on the road to globalization. Globalization implies increasing participation in international division of labor.

To succeed in international division of labor, international competitiveness of industry has to be improved. To achieve this goal, different measures can be suggested. These measures can be divided in two groups:

1. Those measures, which aim to create a favorable macro environment; and

2. Those measures, which need to be initiated at the firm level.

## 5.5.1 Measures to Create Favorable Macro-Environment

Macro environment needs be so fashioned that we successfully create World-class industry. World-class industry cannot be created overnight. Steps need to be taken now itself to make it a reality within the next few years.

Two strategic paths must be followed: