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"India's Strategy for Economic Growth – Manufacturing Industry Reforms"

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ABSTRACT

India has great potential to achieve rapid economic growth in the next twenty years. In fact, it is in many ways poised to match or even exceed China's overall growth performance. This is partly because China is likely to slow down compared with its own rapid rates of economic growth during the past decade, and partly because India is likely to speed up. Yet sustaining high economic growth is not easy. Rapid growth can easily be derailed, as the East Asian crisis has reminded us yet again. For India, one key requirement to achieve sustained high growth is an appropriate growth strategy, one that recognizes India's unique situation in the world economy, and that best positions India in the emerging global division of labor. The macroeconomic stakes have obviously been raised in the past year. Current research paper elaborates India's Macroeconomic policies will be under scrutiny as perhaps never before following the onset of the East Asian financial crisis.

KEYWORDS- *India, Trade, Economic, Development. Industry, Growth.*

INTRODUCTION-

The Indian economic reforms of the early 1990s have stimulated much research and a host of academic papers. It is common to attribute India's recently accelerated growth to the reforms. An aspect that has remained relatively unclear is which policy changes within the reforms have led to which consequences for employment, incomes and poverty. There is also debate about which further policy changes and required to sustain the increased growth and to strengthen the diffusion of progress to the lower-income segments of the population. Most studies have analyzed the reform impact on macro aggregates, which leaves it unclear how different policies have worked. In order to examine this aspect it is useful to investigate at the firm level how different industries were affected by specific policy changes.

India's Business Environment

The World Economic Forum, in conjunction with the Harvard Institute for International Development, carries out an annual survey of business leaders in 53 countries of the world, to explore the comparative business environments of the major economies. The various economies are ranked on eight broad dimensions of the economic environment; based on dozens of detailed questions each scored on a scale of 1 (bad) to 7 (favourable). The eight dimensions are : openness of the economy to international markets; fiscal policy management; financial markets; quality of infrastructure; level of technology; performance of enterprise management; functioning of labor markets; quality of public institutions. The survey results are combined with other quantitative data (e.g. objective measures of infrastructure, saving rates, financial market depth, educational attainment, etc.) to produce an overall assessment of international competitiveness, which the study defines as the ability to achieve rapid growth over the medium term.

In the 1998 Global Competitiveness Report, India ranks a relatively disappointing 50th out of 53 countries in overall competitiveness, little changed from the rank of 49th in the 1997 report. Table 1 summarizes several sub-categories in which India stands out either as especially strong, or as especially weak. Regarding areas of strength, business respondents note four areas. First, the Indian stock market is seen as an important avenue for new enterprise financing, in contrast with many other countries with smaller and less effective stock exchanges. Second, India is regarded as having strong science and engineering capabilities, with a large pool of competent scientists and engineers, and strong education in basic science and math. Third, India is highly ranked for its relatively strong business schools and its vast labor force. Fourth, India is given high marks for judicial independence, including the government's compliance with court orders and the ability to challenge government decisions in court.

There are, alas, many more areas of weakness than strength, and these areas of weakness point implicitly to the most urgent points of the reform agenda. First, despite the importance of the stock exchange, India's financial markets were generally viewed as deficient. The overall sophistication of the financial system is regarded as low, a danger point in view of the East Asian financial crisis. Venture capital, which is key to the start up of new industries, is also viewed as particularly weak. Second, public administration is given especially low marks, in several notable areas : administrative regulations are viewed as strongly constraining business activities (the license raj continues); state subsidies are viewed as inappropriately protecting old industries; the civil service is viewed as unduly politicized; and tax evasion is judged to be rampant. Third, and perhaps most strikingly, the quality of infrastructure is judged to be abysmal. This was true in all areas : roads, ports, power and telecoms. India was ranked 53th out of 53 countries in overall infrastructure. Fourth, the research and development nexus is judged to be very weak, with little collaboration between business and academia, and little success in commercializing or adopting new technologies. This poor outcome is ironic in view of the praise for India's science and engineering prowess. Fifth, labor markets are judged to be ineffective, perhaps the most ineffective in the world. Business respondents not surprisingly point to the severe restrictions on hiring and firing. Finally, business respondents point to the high prevalence of irregular payments, i.e. bribes, connected with permits and licenses.

If we summarize, India shows the advantages of a vast labor force with a skilled engineering and scientific community. It also shows, however, deficiency in both the hard infrastructure, such as roads, ports and power, as well as the soft infrastructure of public administration, labor market practices and financial market depth. We now turn to our three pronged approach to high and sustained growth, seeking to turn India's advantages to best use. while overcoming the most extreme liabilities. However, we would like to stress that we are not trying to be comprehensive, for example, we don’t discuss social policy, but rather attempt to highlight some of the missing aspects of current policymaking.

OBJECTIVES –

Objectives of this Research Paper is as fallows

1. To study of Manufacturing Industry Growth in India.
2. To observe the situation and analyse the strategy for india's Economic Growth.
3. To Find out the challenges for Manufacturing Industry Growth in India.

METHODOLOGY –

This Research paper is based on secondary data like Reference book, Reports-economic survey and websites.

IMPACT OF ECONOMIC REFORMS OF 1991 : AN OVERVIEW OF EARLIER PERSPECTIVES

Several earlier studies have attempted to analyze the impact of the economic reforms of 1991 on the economy and industrial sector of India. In one of the earlier studies Nambiar et al. (1999) started from the expectation that trade liberalization "encourages economic activity and hence raises production and employment"; he then asked whether this was also true in the Indian case. Although this expectation may be justified in the longer run, it seems somewhat unrealistic to expect immediate benefits since trade liberalization always implies increased foreign competition, which in turn may lead to the closure of less competitive firms and therefore job losses and income reduction in the initial phase following trade liberalization. One may argue, however, that by 1999 it was possible to expect the longer-run impact of increased productivity, competitiveness and accelerated growth. This raises questions about the timing of the reforms and about the time lags necessary to achieve the longer-run changes. In spite of the accelerated growth figures of the mid-1990s being already available, Nambiar et al. (1999) concluded that "trade has over the years shrunk India's manufacturing base, both in terms of value addition and employment". Although the authors admit that "this 'high protection-high cost-poor quality' syndrome needed to be corrected by import liberalization", their assessment of the reform impact is rather pessimistic.

Chauduri (2002) also reported that the "expectations of rapid and sustained growth of output and employment …have not materialized". The author concluded that value added growth in the 1990s was inferior to that in the 1980s, that the industrial base had become shallower, that employment growth in the 1990s was negative in five out of nine years and that the labour productivity stagnated after 1995/96, after having increased in the early 1990s. Here again no attention is paid to the changes in protection, prices and costs that resulted from the reforms.

A much more positive picture was drawn by Panagariya (2004), who argued that growth in the 1990s was more robust than that of the 1980s and that it was achieved through important policy changes. The main policy changes held responsible for accelerated growth are the liberalization of foreign trade, the reduction in industrial licensing and opening to foreign direct investment.

Balasubramanyam and Mahambre (2001) attempted to relate different aspects of the reforms with changes in industry performance, in particular with productivity change. They first observed a decline in debt/equity ratios in the majority of industries, especially in new firms, which was seen as a consequence of financial reform. The observed changes in productivity (TFP decline) were mainly attributed to trade and licensing reforms. The authors concluded that in spite of declining productivity the industrial sector has benefited from the reforms by expanding its capacity.

Ahluwalia (2002) characteriszed the Indian reforms as gradualist, but less so by design than as a consequence of political constraints. He concluded that their cumulative impact was substantial and created the basis for accelerated growth. Although trade and industrial reforms were the most visible, the author cautioned that tariffs in India are still much higher than in China and other countries in Southeast Asia. Similarly, he also found that foreign investment had a much more limited impact in India than in China and Southeast Asia. The one area in which the trade policy reforms were most successful in his view is the sector of information technology-related services. Areas, where the reforms were found to need further progress are the labour market, agriculture, infrastructure and the management of fiscal balance.

Any assessment of the policy reform impact on industries has to start with a detailed evaluation and measurement or the incidence of specific policy changes. Das (2003) attempted such an assessment and computed effective rates of protection and import coverage as well as import penetration ratios for 72 three-digit industries for four sub-periods of the period 1980 to 2000. Although these ratios are useful they do not show the combined effect of tariffs and QRs on output prices. For that it would be necessary to estimate rates of protection based on price comparison, as had been done in the 1980s by Pursell (1988). The author concluded that the Indian level of protection remained high in comparison with several South-East Asian countries.

Pandey (2004) focused on the measurement of several trade reform variables, including the measurement of protection based on price comparisons. As to the impact of trade liberalization on industry performance he concluded that this link appears to be weak, given the presence of other factors. Among these factors, government controls in form of industrial licensing and public sector investments are singled out, but the author also points to the well-known ambiguity between protection and growth : High protection tends to generate growth in the initial stages, but declining protection may also lead to growth through competition-induced gains in productivity and exports.

Bajpai (2002) presented a detailed account of the reforms of the 1990s and focused on areas, in which further reforms are required, in particular fiscal consolidation, the labour market, but also trade and foreign investment. These conclusions are clearly based on a positive assessment of the reform impact on economic growth in India, although the author does not present an analysis of the impact.

One of the expected effects of trade liberalization is the reduction of profit margins following increased completion from imports. This hypothesis was examined by several authors with differing results. While Srivastava et al. (2001) and Kambhampati & Parikh (2003) did not find substantial evidence of this competitive effect on Indian industries, Krishna & Mitra (1998) and Goldar & Aggarwal (2004) concluded that the tariff reduction and removal of quantitative import restrictions had a significant and profit-reducing impact. However the latter authors also found that the reduction in cost price margins was mitigated by a reduction of labour's share in value added, which they attributed to declining union power.

Closely related to the competitive effect of profit decline is the reform impact on productivity. The longer-run expectation is of course increased productivity and competitiveness, but less dynamic enterprises may also disappear under increased import competition. While two recent studies (Unel, 2003; TSL, 2003) had found an acceleration of productivity growth in Indian industries, Goldar (Goldar & Kumari, 2003 and Goldar, 2004) re-examined the question by including further determinants, in particular capacity utilization. He concluded that trade liberalization had a positive influence on productivity, but this was counter-acted by a decline in capacity utilization and a declining growth in agricultural production.

A somewhat different conclusion was reached by Das (2003a), who found that total factor productivity growth in manufacturing was close to zero over the 1980-2000 period, that it was positive in capital goods, but mostly negative in consumer and intermediate goods, and that it slowed down from the 1980s to the 1990s. The recession of the mid-1990s as well as the continued labour market rigidity are held responsible for this outcome. Topalova's study (2004), on the other hand, is more supportive of Goldar's findings and also adds a distinction between private and publicly owned enterprises, with the former showing clearly more productivity growth than the latter.

Similar conclusions as for productivity were reached for real wages by Goldar (2003), who connected the adverse effect of trade liberalization on real wages with the reduction of rents and the weakening of trade union strength. Banga (2005) also examined the reform impact on wages, but focused on wage inequality. Analyzing the impact of three reform targets, FDI, trade and technology, on labour productivity and wage inequality, the author concluded that all three reform components contributed to increased wage inequality.

In a more recent paper Goldar (2005) examined to what extent India's commitments under the WTO have influences the manufacturing sector and concluded that changes in production, imports and exports are largely not attributable to the commitments arising from

WTO membership. He showed that for a number of consumer goods, especially in textiles and clothing, the increase in imports during the early years of 2000 were modest and largely matched by increases in exports.

Athreye and Kapur (2006) examined the level and determinants of concentration in Indian manufacturing before and after the regulatory and trade reforms. They concluded that after liberalization the concentration declined in some industries and increased in others. The expected outcome of general decline was not observed, partially because the penetration of new competitors is a process that may be completed only over longer periods of time and the duration of this process is likely to vary among industries.

Our own earlier study of industry competitiveness (Siggel, 2007), which uses ASI data at the two-digit level, revealed that large-scale manufacturing industries have largely benefited from the reforms. The potential effect of import competition leading to strong decline of formerly heavily protected industries thus inducing massive employment loss has simply not happened. Manufacturing employment has continued to grow at an average annual rate of 2.2% over the 1987/88 to 1997/88 to 1997/98 study period and most industries have improved their international competitiveness, some of them very substantially. In section 4 (below), which reports the survey findings on an industry-by-industry basis, we compare these findings with the prior findings from the competitiveness analysis.

Thus the existing studies suggest that a variety of impacts are possible but do not come to any uniform conclusion regarding the impact of economic reforms of 1991 on the Indian industry. Given this situation, it should be of considerable interest to survey the manufacturers themselves and find out what they felt was the impact of the economic reforms on their firms and what further changes in economic policies they feel are needed to maintain the high growth of the Indian economy and industry. This is the purpose of the rest of this paper.

GENERAL PERCEPTIONS OF INDUSTRY REPRESENTATIVES REGARDING THE IMPACT OF REFORMS OF 1990'S

In analyzing how the reforms of the 1990s have affected Indian manufacturers it is useful to start with the distinction of various policy changes rather than treating the reforms as a single act of reform. The sample enterprises were therefore asked which policy changes affected them most strongly. Also, the firms were asked to describe specific problems of their industry that were related to the reforms.

Twenty out of 51 responding firms described the reform impact on their industry as positive, eighteen as mixed, eight as negative and five as absent. The policy changes most often cited as affecting their industry were trade liberalization (35/50), while domestic policy changes were named in 15 responses. The problems that had most affected the industries before the reforms were trade-related issues, in particular the licensing of imports (21/33 responses), while the remaining 12 responses were split between domestic licensing (5), taxation (5) and other issues (2).

- **Trade liberalization**

Trade liberalization has the immediate impact of increasing imports of products that compete with domestically produced products. These imports may be either cheaper at similar quality or similarly priced with superior quality attributes. In either case the domestic producers are likely to face increased competitive pressure, to which they can respond in various ways, mainly by reducing their own prices and profit margins.

The firms were asked to remember what had happened to their output prices following trade liberalization. Only half of the responding firms (23/46) reported price reductions, while 15 representatives remembered their prices to have risen. This outcome is not totally surprising, although unexpected, because it is difficult to separate relative price movements from the general upward trend of prices. Respondents tend to remember more the upward trend in prices than the downward pressure of relative prices following increased competition from imports.

- **Taxation**

The Indian taxation system is known to be complex and to differ regionally. While income and corporation taxes, as well as the value-added tax (replacing the excise tax), are administered by the Central Government, the states and municipalities levy their own taxes and provide discretionary exemptions to attract investment (KPMG, 2005).

- Domestic reforms and the business environment

Three aspects of the business environment are considered here, first the bureaucratic side of doing business, then the supply of infrastructure and utilities, and finally policies furthering technological progress. One of the typical aspects of India's traditional business environment has been far-reaching regulation. Various authors have referred to it as the "licence raj" and identified ti as an obstacle to faster growth and development. The reforms of the early 1990s gave rise to policy changes in this respect and led to an alleviation of the bureaucratic burdens imposed on the business community.

A shift of policy focus towards changing the pattern of resource allocation and improving the resource base of states is critical for improving the financial situation of the state governments. On the tax front, sales tax is the single most revenue earning source for the state governments, and its reform is crucial so as to attain higher levels of revenue mobilization. While efforts to introduce state level VAT and other tax reform measures have begun, their implementation across all states is necessary in order to enhance the revenue productivity of the state tax system and to reduce its distortionary implications for the economy.

CONCLUSION

In the final analysis, fiscal control will require an overhaul not just in budgetary patterns, but in the basic functioning of the public sector in the economy. For example, we have noted that privatization is a key method for reducing the overhang of public debt. Similarly, the privatization of infrastructure services is a key way to relieve the growing burden on state budgets, which are heavily weighed down by losses of SEBs and other parastatal institutions. Greater autonomy for local and state-level governments in infrastructure reform and investment priorities will similarly allow the central government greater freedom in cutting back on transfer payments to the states (which will be in a better position to prioritize and economize on state spending). Until India resolves to push even farther in market reforms, the soft budget constraint of the public sector will continue to spill over into large public deficits and a growing burden of public-sector debt.

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