Impact of Global Economic Dynamics on Growth of Indian Industry

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It is a matter of great pleasure to be invited by the Bombay Chamber of Commerce and Industry to participate in the Seminar on 'Growth Resurgence: Expectations and Strategies'. The Bombay Chamber, being one of the oldest has been on the forefront in promoting the industrial growth of the country through the ages. I am, therefore, particularly delighted to have the opportunity to share some of my views on globalisation and Indian industry. May I underscore that views expressed are entirely my own and should not be attributed to the Reserve Bank of India.

As many of you might agree, 'Geography is history!' is the new maxim in today's *milieu*. The breath-taking changes in information, communication and technology (ICT) are now redefining the national borders, even rendering them irrelevant. Rapid technological change, shorter product cycles, and developments in ICT have combined with privatization and liberalization of trade and investment to produce a global economy, which is distinctly different. Today, even a localized cyclical downswing could get protracted into a structural one in the wake of global competition (Rajan and Zingales, 2003, p 302).[1]

Powered by the ICT revolution, trade-capital flows and cross-country exchanges have seen explosive growth in recent times. Indeed, the last two decades have witnessed a policy shift towards openness in a number of emerging market economies – either spontaneously so as to reap the benefits of greater trade and investment or under compulsions out of their unsustainable domestic imbalances. Although the growth performance of Western Europe and Japan was rather lackluster during most of the 1990s, the strong revival of trade was led by the US with support mainly from China and East Asia (especially prior to the 1997 crisis).

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[1] Rajan, R. and Zingales, L. (2003), *Saving Capitalism from the Capitalists*, Crown Business, New York.

The decade of the 1990s has also been marked by a series of financial crisis in several open economies engendered by volatility in capital flows. This has also prompted a re-look into the conventional wisdom of gains from cross-border trade and investment as also the international financial architecture.

Be that as it may, the emerging interdependent world has finally shifted the debate on globalisation from the realm of a theoretical possibility to one of inevitability. Surely, globalisation is not a manna from heaven but an outcome of actions of the billions across the boundaries. As the world community at large is learning and grappling with the on-going process, here I'm with you today, not to question the process *per se* but to focus on the art of calibration so as to harness the genie of globalisation to our advantage. And I believe, globalisation can add a Midas touch to the Indian industry, if wielded properly.

Against this backdrop, the remainder of my presentation is organised in three broad parts. In the first part, I shall take you through the policy and institutional environment, both domestic and international. Next, I shall trace, in some detail, the impact of globalisation in its various dimensions on the Indian industrial sector. I shall then flag a few issues which have assumed increasing significance in the context of the changing industrial environment. Finally, I shall sum up the foregoing discussion and present a few suggestions for policy action. Let me now turn to the policy and institutional environment.

I. Policy and Institutional Environment

India's New Industrial Policy, 1991

India's embarking on trade liberalization and openness in the 1990s coincided with her announcement of a new industrial policy in 1991. The new industrial policy reaffirmed the 'pledge' to build a modern, democratic, socialist, prosperous and forward-looking India in line with the earlier policy statements since 1948. In terms of instruments, however, an altogether different discourse for industrialization was set out. The reaffirmed 'pledge', the new industrial policy declared, could be redeemed 'if India grows as part of the world economy and not in isolation'. It was explicitly recognized that technological dynamism and competitiveness are predicated upon swift responses to the fast changing external conditions, which have become characteristic of today's industrial world. Alongside, the pursuit of 'self-reliance' was reinvented as the country's 'ability to pay for imports through foreign exchange earnings'. Accordingly, foreign investment and technology collaboration were sought to be promoted towards higher exports and expansion of production base. The role of government policy and procedure was sought to be transformed from control to one of assistance and guidance by way of transparency practices and elimination of delays.

Policy Environment and Implementation Since 1991

In pursuance of the new industrial policy, the process of unshackling of the industrial economy from the 'cobwebs of unnecessary bureaucratic control' began with a bang in 1991. Today, the industrial licensing is confined only to six items, of which three are reserved for the public sector. As economies of scale provide the foundation for competitive edge in an integrated world, capacity expansion by large companies was initially taken out of the purview of the MRTP Act, 1969 before its replacement by an industry-friendly Competition Act, 2002. The new Act has recognized the need for business to secure the scale advantage to compete with MNCs in the global market place. The envisaged regulation of companies including mergers and acquisitions, only beyond a particular size, has created an enabling environment for the Indian corporate to emerge on a global scale.

In a similar vein, the Foreign Exchange Regulation Act (FERA), 1973, which focused on conservation of forex has given way to the Foreign Exchange

Management Act (FEMA), 1999. The new Act aims at facilitating external trade and payments including orderly maintenance of forex market. The country has since moved ahead by rendering Rupee virtually convertible on the capital account for foreign nationals and NRIs with similar move well on course for the domestic residents. FDI is now permissible under the automatic route and foreign ownership is allowed upto 100 per cent in most of the sectors. Foreign technology agreements are, in general, eligible for automatic permission.

In an open economy framework, non-tradables, in general, and infrastructure, in particular, make the difference in competitive edge in contrast to tradeables. Accordingly, provision of adequate and qualitative infrastructure has come to occupy a central concern in India’s public policy making. Financial intermediaries have been incentivised to channelise resources to the infrastructure sector. As a result, progress is discernable in the areas of roads, ports and telecommunication. The supportive role of finance for industry as visualized in the new industrial policy has been followed up with softening of interest rates and greater access to finance at competitive prices. Besides, the EXIM policy has outlined an aggressive exports strategy with trade facilitation measures, especially for the competitive sectors for effective participation in the global economy.

Clearly, India’s participation in the globalisation process has been envisioned from a position of strength, built on sustained productivity, efficiency and competitiveness. The industrial policy-making has, thus, responded to the challenges of globalisation, not by abandoning the national policy, but by internationalizing it while retaining its national character.

WTO and Industrial Policy

Let me now move on to the much talked about institution in the international arena – the World Trade Organisation (WTO) – and highlight India’s policy response in respect of the industrial sector.

Before the onset of the reform process in 1991, the Indian industry was protected from foreign competition through high tariff and non-tariff barriers. On successful turnaround of the balance of payments, India removed, as part of the process of structural reform and in line with the WTO commitments, all quantitative restrictions (QRs) by March 2001, enabling access to the domestic market on the principle of the Most Favoured Nation (MFN). Alongside, India has successively brought down the weighted average tariff to 28 per cent (29 per cent for manufacturing) in 2001 from as high as 56 per cent (71 per cent for manufacturing) in 1990. Notwithstanding the removal of quotas and rationalization of tariff, India's average tariff level continues to be one of the highest in the world. Similarly, the share of items with peak tariff by international standard (i.e., exceeding 15 per cent) continues to be as high as 92 per cent in 2001 as against 97 per cent in 1990. In general, finished goods attract far higher tariff rates than intermediates and machineries. Moreover, the tariff rationalization process was carried out alongside Rupee's depreciation, thereby circumscribing the effect of a tariff cut. Indeed, there is empirical evidence of higher level of protection for Indian manufacturing in the second half of the 1990s (Das, 2003)[2]. At the sectoral level, placing of the reserved items for SSI on the OGL (i.e., open general license) has coincided with a graduated de-reservation process coupled with a number of supportive measures, enabling a smooth transition of the sector.

Surely, the WTO rules have rendered many a policy instruments such as quantitative restrictions and explicit export subsidies invalid. However, anti-dumping duties are permitted as a countervailing measure and the Government of India has already set up a Directorate of Anti Dumping Duties. Indeed, the country has initiated during 1995-2000 the third largest number of anti-dumping cases in the world next only to the US and the European Union (EU) (Aggarwal, 2002).[3] The WTO rules also allow imposition of ban up to seven years in the wake of sudden surge in imports affecting the domestic industry. Accordingly, an Inter-Ministerial Group along with a Directorate of Safeguard Measures has been set up for close monitoring of imports. Besides, compliance of quality standards by way of registration with the Bureau of Indian Standards has been made mandatory for foreign exporters. Furthermore, printing of MRP (i.e., maximum retail price) in Indian Rupees has been stipulated. The WTO rules also allow subsidy for R&D activities, up to 75 per cent of such expenditure. In the area of Trade Related Intellectual Property Rights (TRIPS), India has already fulfilled her obligations by effecting appropriate amendments to the Patent Act, 1970. Nevertheless, the Doha declaration has reaffirmed the member countries' right to use the compulsory

[2] Das, Deb Kusum (2003), 'Manufacturing Productivity under Varying Trade Regimes: India in the 1980s and 1990s' ICRIER Working Paper No.107, July 2003.

license with flexibility and accepted the case for parallel import for public health. In other words, the WTO rules notwithstanding their tightening continue to have breathing space for the domestic industry.

Thus, contrary to the popular perception, in terms of policy environment, India has been largely successful in managing her engagement with the rest of the world in the post-globalisation decade of the 1990s. Nonetheless, as the old adage goes, test of the pudding ultimately lies in eating. Therefore, I now turn to an impact analysis of the domestic industry.

[3] Aggarwal, Aradhna (2002), 'Anti Dumping Law and Practice: An Indian Perspective', ICRIER Working Paper, May.

II. Impact of Globalisation on the Indian Industrial Sector

Global Prospects

In recent months, the world economy has seen the emerging signs of a recovery in economic activity, particularly in the US, Japan and emerging Asia. In the US, which dominated the world growth in the previous years, the pace of growth has picked up, assisted by expansionary macroeconomic policies and supportive financial conditions. In the process, US has accumulated twin deficits –current account deficit at five per cent and fiscal account deficit at six per cent. Equity and bond markets have responded with optimism to prospects of recovery with investor interest returning to technology stocks more rapidly than to other sectors. In Japan, there are stronger signs in the third quarter that a cyclical upswing is underway, led by industrial activity and exports. In the UK and Australia, signs of recovery are clearly evident with rising household spending reflected in retail price inflation, prompting monetary authorities in these two countries to raise key policy interest rates against inflation surprises. China continues to grow at a remarkably strong pace while activity in other parts of Asia is bouncing back from the effects of SARS. There is nevertheless considerable uncertainty regarding the durability of the pick-up. Despite the prospects of stronger growth, Japan continues to experience deflation. The ongoing concerns relating to structural weaknesses in the financial system remain. In contrast to the rest of the world, the euro area remains conspicuously weak although there are tentative signs of a modest recovery in recent months. Household demand remains sluggish and the unemployment rate for the area as a whole has risen.

The recent evidence through data and forward-looking indicators, particularly in financial markets, point to a strengthening of global growth outlook. IMF (World Economic Outlook, 2003) projected world output to grow by 4.1 per cent in 2004 as against 3.2 per cent in 2003. Recently, the IMF has upgraded its forecast of India's gross domestic product growth for 2003-04 to 7.5 per cent. Its earlier projection was 7.0 per cent. According to the World Bank, India could achieve eight per cent economic growth, provided the government steps up reforms, hikes investment in infrastructure and carries out major policy changes to make capital more productive and contains fiscal deficit and wasteful subsidies. Keeping in view the positive developments, the Reserve Bank of India raised its estimate for economic growth in the current fiscal year to March 2004 to seven per cent, with an upward bias, from 6.5 to 7 per cent earlier. The improved prospects for real activity globally should add strength to the upward momentum in growth. There is room at this juncture for greater optimism in growth prospects than before. The Centre for Monitoring Indian Economy (CMIE) has upped its real GDP growth forecast to 8.2 per cent from its earlier forecast of 7.4 per cent. NCAER projected growth in GDP at 8.1 per cent for 2003-04. If one goes by these projections, India will be one of the fastest growing economies among the emerging markets.

Indian Growth Scenario

The adverse impact of the unprecedented balance of payments crisis of 1991 was perhaps most pronounced in the case of the industrial sector, which experienced a negative growth of 0.6 per cent in 1991-92. Following the reforms and opening up of the economy, the industry bounced back shortly, with double-digit growth during 1994-95 and 1995-96, and 7.1 per cent in 1996-97. Indeed, primarily on the strength of industry, the GDP growth exceeded 7 per cent, for the first time since Independence, for a consecutive period of three years during 1994-95 to 1996-97. However, the industrial slowdown, set in 1996-97, intensified and elongated subsequently interspersed by a brief recovery during 1999-00 and 2000-01. Finally, the signs of recovery, which were first noticed in 2002-03, have since turned stronger with 6.2 per cent growth in the current financial year so far (upto November). On the whole, the industrial growth decelerated to 6.1 per cent in the 1990s from 6.8 per cent in the 1980s.

The 1990s witnessed a shift in the production structure in favour of registered manufacturing as against the unregistered manufacturing. While the share of registered manufacturing in industrial GDP increased from 38.6 per cent in 1990-91 to 41.5 per cent in 2001-02, the share of unregistered manufacturing declined from 22.5 per cent to 21.6 per cent during the same period. Even within registered manufacturing, traditional industries such as textile, jute and other vegetable fibre textiles witnessed a decline in their respective shares in the reform period while the modern segments like metal products and electrical machinery forged ahead. Six industry groups viz., beverages and tobacco', 'textile products', 'leather and leather products', rubber and plastic, petroleum and coal products', 'chemical and chemical products' and 'metal products and alloy industries' with a combined weight of 36 per cent in the IIP withstood the slowdown 1996-2002 while during 2002-03, 10 industry groups (notably 'food products', 'beverages and tobacco', 'transport equipment and parts' and 'textile products', etc.) witnessed an increased growth over 2001-02.

A broad analysis of industrial growth during the nineties as per the use-based classification reveals that while the consumer goods industries sustained growth momentum to some extent during the latter part of the reform period, substantial decline in growth was witnessed in basic and intermediate goods segments. The demand for these goods in the face of sustained consumption demand during 1996-97 to 2001-02 implies that industry may be undertaking inventory adjustment created by the initial phase of capacity creation and overproduction. Although production of capital goods witnessed an improved average growth during the latter phase of the reform period, a rapid decline was observed during 2000-02 onwards, indicating the impact of weakening investment demand in the economy. However, a sharp recovery in capital goods sector during 2002-03 and its sustenance during 2003-04, indicates positive investment sentiment among the producers.

Quality Aspects

The subdued industrial growth of the 1990s, however, camouflages the qualitative transformation of the industry in the wake of India's participation in the global economy. Indeed, the post-globalisation phase has witnessed increasing resilience and immunity to shocks (RBI *Annual Report 2002-03*, art no. 7.2, p. 118). More recently in 2002-03, the overall growth performance was not only sustained but also turned out as one of the highest in the world despite a confluence of several shocks such as border tension, severe drought, increase in international crude oil prices, SARS scare and continuing slowdown in global economic activity. In the past, a single such shock had derailed and destabilized the growth process. The contrarian recent experience, however, motivates me to move on to the qualitative aspects of industrial performance, which were attained through an assiduous process of restructuring and reengineering undertaken in the 1990s. For this purpose, I would mostly focus on the largest constituent of industrial activities, viz., manufacturing, which accounts for around 17 per cent of GDP, 12 per cent of total workforce, and 80 per cent of merchandise exports. Besides, unlike the East Asian countries, where the manufacturing-GDP ratio declined sharply over the last decade, the same has largely sustained in India.

Globalisation transforms the industrial scenario by affecting the behaviour of the incumbent firms as also the potential entrants while providing a larger menu of choices with consumer. Therefore, the impact analysis of the qualitative aspects of industry has been attempted under the following heads: profitability, productivity, market/cost structure, corporate size/spread, and diversification.

A. Profitability

The opening up of the economy could impact upon the industrial profitability not necessarily in a predictable fashion. As competition intensifies with globalisation, profitability takes a beating. However, competition could have a spurring effect on productivity at least in the growing sectors, which might, in turn, push up profitability. On the whole, the Indian evidence in the 1990s indicates higher profits for the factory sector, growing at 21.6 per cent per annum as against 19.4 per cent in the 1980s. Such trends appear to have been reinforced in the more recent period. As per a recent RBI survey, profits after tax (PAT) of the private corporate business grew by over 49 per cent in the first half of 2003-04 on top of 22.9 per cent in the corresponding period of the previous year.

B. Productivity

Similar to the impact on profitability, globalisation entails productivity losses in the contracting sectors and productivity gains in the expanding sectors. Generally, outward orientation performs a valuable role in developing the labour skills, technology, market experience and expertise, which can produce a sustained increase in productivity. The evidence for most Asian countries points towards a significant effect of trade liberalisation on productivity (Das, 2002). Empirical studies have been equivocal on the trends in productivity in India during 1990s. This is because estimates of productivity are susceptible to the underlying assumptions about the structure of the production function and the methodology of estimation. The RBI ***Report on Currency and Finance 2002-03*** has thrown up some preliminary evidence on the decline in total factor productivity growth (TFPG) of the manufacturing sector in the 1990s. Such a decline in TFPG could be a reflection of the underlying structural and cyclical factors (Das, 2003). Among the structural factors, exit restrictions for labour and cumbersome bankruptcy procedures could have led to higher incidence of industrial sickness, adversely impacting upon the manufacturing TFPG. Furthermore, the cyclical downturn from the mid-1990s may have resulted in higher excess capacity and concomitantly, lower TFPG. At the sectoral level, however, there are evidences of improved TFPG for the exporting sectors vis-à-vis the non-exporting ones (Dholakia and Kapur, 2001; Unel, 2003).

Apart from TFPG, the role of factor (capital and labour) accumulation and the corresponding productivity in the growth of manufacturing needs to be placed in perspective. While capital intensity has increased during the 1990s, growth in capital productivity in the manufacturing sector has declined vis-à-vis the previous decade. During the 1990s, growth in fixed capital outweighed the growth in value added in most of the 17 two-digit industry groups. This has possibly led to a lower or negative capital productivity growth for the majority barring two groups, viz., wood and furniture, and chemicals. On the other hand, growth in labour productivity increased during the 1990s. Industry-wise, however, the increase was limited to a handful of six industry groups, notably, wood and furniture, chemicals, metal products and transport equipment. On the whole, labour seems to have responded flexibly vis-à-vis capital to the challenges of globalisation.

C. Cost Accounting

In the past protected environment, Indian enterprises were not sufficiently induced to improve cost efficiency. Opening up of the economy in the 1990s has led to the adoption of new techniques, technologies and processes to ensure that costs are continually reduced (Rao, 1998). The reduction in customs duty and decontrol of many industrial goods have also facilitated easy import of cheaper raw materials and capital goods and, thereby, contributed to cost reduction.

Until recently, interest payments used to have a major bearing on the cost structure of the industry. With the opening up of the economy, the industry has now access to alternative and cheaper sources of funds. The sustained policy initiatives for macro stability and structural reforms have led to a softening the domestic interest rates has been felt all the more in an integrated world. In the process, interest payments by the factory sector have decelerated to 14.5 per cent during the 1990s from 18.4 per cent during the 1980s. During the first half of 2003-04, interest payments by the corporate business sector have, indeed, declined by 16.8 per cent over and above a decline of 10.6 per cent in the corresponding period of 2002-03.

D. Exports and Industry

Although India's exports account for less than one per cent of global exports, it ranks among the top 15 countries in terms of export gains during 1985-2000 (World Investment Report, 2002). Significantly, exports-GDP ratio increased to 10 per cent in 2002 from a low of 4.5 per cent in the 1980s. The latest DGCIS data have placed the exports growth at 42.7 per cent for December 2003. With this, the exports growth turned out to be 13.5 per cent during the current financial year so far and remained above the target of 12 per cent for 2003-04. The resounding achievement on the exports front even in the face of persisting appreciation of Rupee testifies that India's exports have come of age and have attained the competitive edge in the global market place.

The destination pattern of India's exports has undergone remarkable changes in the recent period whereby the importance of developing countries as an export market has considerably increased. Besides, the importance of primary products in the export basket has witnessed a steady decline and especially since the 1990s. In contrast, the technology-intensive products, in general, and engineering and petro products, in particular, have displayed dramatic improvement in the recent period.

E. Imports and Industry

Imports, especially those of capital goods, are often taken as a leading indicator for industrial production as also of the near-term investment climate in the economy. A definite relationship between imports and industrial production, however, may be difficult to establish as imports could be either complements or substitutes to domestic industry. In the Indian case, non-oil imports, thus far, have been mostly in the form of capital goods, raw materials, and intermediate goods, which complement the industrial production. A number of recent studies have found a positive relation between industry-related imports and industrial growth

(Nambiar, Mungekar and Tadas, 1999; Neogi and Ghosh, 1998). The RBI ***Report on Currency and Finance 2002-03*** has also indicated that during April 1996 to March 2003, (i) imports had a unidirectional impact on industrial output; and (ii) both total imports and the 'select imports' positively affect industrial output as also manufacturing output with an approximate lag of four quarters. The significant growth in the net fixed capital formation and gross capital formation of the factory sector during the 1990s reflects improved absorption capacity of the industry in the post-globalisation phase.

Contrary to the perceived fear in the wake of removal of quota from April 1, 2001, there has been no flood of imports so far. Indeed, 2001-02 had been the first year in more than 20 years to record a current account surplus. During the current financial year so far, non-oil imports have grown at close to 30 per cent in the context of continuing industrial resurgence.

F. Market Structure

The concentration within an industry is measured by the dominance of firms in terms of market share. The Hirschman-Herfindhal Index (HHI) is a popular measure for such purpose. The analysis of HHI for a sample of 231 four-digit level industries indicates that only 76 industries have shown an increase in concentration between 1992-93 and 2000-01.[4] In contrast, 150 industries witnessed decline in concentration during this period. When the 231 industries are regrouped on the basis of identical broad categories, only four industry groups show a significant decrease in HHI. Out of 10 other broad industry groups, which did not record a significant change in their respective HHI, 8 have witnessed a decrease while two have recorded an increase. This shows that market structure in most of the industries has become more competitive possibly with the entry of new players and the monopoly power of the top firms has somewhat eroded.

G. Market Concentration of Top Ten Companies

Market concentration can also be examined by looking at the added up shares of the top companies in the total. Accordingly, the market share of top ten

[4] Data on market size and shares from the publications of the Centre for Monitoring Indian Economy (CMIE) are used.

companies[5] in terms of sales was calculated across industries. Interestingly, the market share of the top ten companies increased in industries like wholesale and retail trade, paper and paper products, jute textile, tea plantation, sugar and engineering during the 1990s as compared to the 1980s. On the other hand, the market share of the top ten companies decreased in respect of the following industries over the same period: rubber & plastic industries, cement & cement products, construction and chemical & chemical products. On the whole, the picture turned out to be mixed.

H. Corporate Size and Spread

It is quite clear that the private corporate sector as a whole responded well to the on-going reforms. As per an NCAER study (2001), the share of smaller factories declined during the 1990s, and that of larger factories increased, which may be the result of the on-going process of mergers and acquisitions under liberalisation. When compared to UK, US, Japan, South Korea and China, the share of large size industrial enterprises was found to be much higher in India (World Bank, 1989).

Due to speedier urbanisation during the 1990s, the spread of industries moved gradually from urban to rural areas in pursuance of economies of scale with respect to land, labour and infrastructural developments. This is reflected in enhanced invested capital in the factory sector of the rural areas at 41.0 per cent in 1997-98 as against 26.2 per cent in 1990-91.

I. Industrial Diversification

The diversification of the industrial structure is generally measured by the Berry's index in the literature.[6] As per some preliminary evidence based on the Berry's Index, the industrial diversification has not undergone much change during the 1990s.

Another aspect of industrial structure is the diversification of output across the States. In a liberalised and more open economy framework, new industries are

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[5] Based on the data collected for the articles on finance of select non-Government non-financial public limited companies, Reserve Bank of India; published in various issues of RBI Bulletin between 1980-81 and 2002-03.

expected to be set up in States with smaller industrial base. However, during the 1990s, skewness of industrial output across the States appears to have increased. This implies that the industrial output is getting concentrated in a few States.

J. Takeover - Domestic and Abroad

At the time of opening up in 1991, there were apprehensions that the foreign companies would buy out the Indian ones. In reality, however, foreign companies turned out not so active in mergers and they accounted for about a third of the acquisitions between 1990-91 and 1998-99 (Basant, 1999).[7] In contrast, globalisation has now made it possible for Indian multinationals to take over foreign companies. For example, it is reported that Essel Packaging has taken over Propack of Switzerland to form Essel Propack, now the biggest producer of laminated tubes in the world. During the current financial year, such Indian takeovers have accelerated so much as to constitute a new trend. Not only the biggest Indian companies but also the mid-sized companies are increasingly becoming multinationals through foreign acquisitions. Thus, the brick and mortar economy, which is otherwise felt to be not so competitive, has finally caught up with the new economy in terms of acquisitions of foreign companies.

K. Impact on SSI

SSI production decelerated to 8.2 per cent during the 1990s from 11.1 per cent during the 1980s. Nevertheless, the decelerated SSI growth has been in tandem with the overall manufacturing slowdown over the same period. During 2000-03, the SSI sector has reported an average growth of 7.3 per cent, surpassing the overall manufacturing performance. The lifting of quantitative restrictions on imports from April 2001 does not seem to have affected the sector much as reflected in resurgence in growth in the recent period. In this regard, an ICRIER study indicates that instead of quality competition the SSI sector is faced with price competition from imports on account of inflow of certain goods through informal

[6] The Berry's Index is a measure of diversification, which varies between 0 and 1. The value of Berry's index near 1 implies less diversification and the value approaching 0 means highly diversified firm/industrial sector.'

[7] Basant, Rakesh (1999), 'Corporate Response to Economic Reforms in India', Working Paper No. 99-06-04, Indian Institute of Management, Ahmedabad.

channels, avoiding customs duties.[8] Nonetheless, the import competition seems to have caught on the larger SSI units. On the other hand, the small ones, being inherently flexible have promptly switched over into newer activities.

Having presented a somewhat detailed overview of the impact of globalisation on Indian industry, I shall next highlight a few emerging issues.

[8] Krishna, S. (2000), 'The Impact of Phasing Out of Import Licensing on Small Scale Industries', ICRIER Working Paper No. 60, December.

III. Impact of Globalisation on Industry: Some Issues

The globalisation of the Indian industry has brought to the fore some challenges and opportunities:

1) The high exports growth in the Asian countries has been possible on the back of a strong domestic industrial sector, which created a base for sustainable exports growth. The industrial GDP during the high growth phase exceeded 10 per cent (per annum) in these economies. In contrast, India's industrial GDP underwent a phase of deceleration in the 1990s. Besides, her share in global trade did not improve much over the same period. Furthermore, the commodity structure of India's exports remained almost unchanged until the mid-1990s. Such developments could perhaps be attributable to small-scale industry reservations, high transaction costs and inflexible labour laws besides other structural bottlenecks. Therefore, strident efforts need to be put in place in relaxing such supply side constraints on India's exports growth.

2) The linkages between trade and foreign investment in India indicate that FDI has been much less important in driving India's export growth, except in information technology. In this context, perhaps, the SEZ (special economic zone) policy needs a relook in the light of the Chinese experience. Given India's exports structure and low labour cost, the potential for higher manufacturing exports, especially to the developed countries, is pretty high.

3) Of late, BPO by foreign firms has emerged as an important source of demand for select Indian manufacturing products. Particularly, there has been a spurt of activities, using India as the global hub of sourcing in the auto industry. This has been made possible on the back of manufacturing excellence in auto components. Indeed, in 2003, four Indian firms in the auto-parts industry won the prestigious Deming award in total quality management.

Nonetheless, the majority of the manufacturing activities is yet to benefit out of the on-going BPO boom. Indeed, what is necessary is the provision of world-class physical infrastructure, which would, in turn, create an enabling environment for pursuit of excellence in the manufacturing activities in general. This could open the floodgate of BPO to a diversified basket of India's manufacturing as also sustaining the sector-specific BPO boom.

4) While the globalisation process has undoubtedly posed challenges to the SSI sector, a new vista of opportunities has been simultaneously thrown open for the sector. Now, the SSIs could overcome their long-felt problems like limited marketing opportunities and access to raw materials and modern technology. Today, the sector could gain easy marketing access through Internet. Besides, the trade liberalization measures have made access to imported technology and intermediates relatively easy. This is expected to improve the competitiveness of SSI items. Furthermore, with focus on core competency by bigger companies, the SSI could gain immensely out of ancilliarisation/outsourcing by larger units.

Let me now sum up what I have presented so far.

IV. Summing Up

The new industrial policy of 1991 un-caged the competitive spirit of industry by abolishing industrial licensing in almost all industrial sectors, abolishing restrictions on MRTP companies, terminating the phased manufacturing programmes, substantially freeing foreign direct investment and import of foreign technology, and freeing areas hitherto reserved for the public sector. This policy reform removed almost all restrictions on new entry into the industrial sector. Over the years, the trade regime has also been modified substantially so that there are now no quantitative restrictions on the import of industrial goods. At the same time the tariff structure has been brought down considerably thereby reducing the protection available to Indian industry.

India's participation in the globalisation process has been fruitful on a number of counts. There has been a turnaround in growth shortly after the balance of payments crisis of 1991, followed by a high growth phase during 1993-94 through 1996-97. While the economy subsequently entered into a long-drawn downturn in the second half of the 1990s, the recent performance has thrown up increasing signs of resilience and robustness of the growth process.

The absorptive capacity of the industrial sector increased after the initiation of liberalisation process, which has impacted on its size and spread. The globalisation process also brought about changes in the expenditure pattern of the industries. The costs of production, including interest payments declined which resulted in increased profitability of the factory sector. The integration of the markets enabled the firms to expand their markets beyond their traditional destinations. Increased M&As is the direct outcome of globalisation, which led to increase in R&D activities in many of the sunrise industries.

The industrial performance has been broadly in tandem with the trends at the aggregate level. The globalisation process, at the end of the arduous restructuring, has given rise to a competitive industry ready to take on the mighty world. However, there are a few areas of concerns, which need to be addressed expeditiously. The first and foremost is to facilitate the restructuring process in the SSI sector ensuring its smooth transition and subsequent resurgence. Incidentally, to a great extent, India's exports performance is predicated upon the successful restructuring of the SSI sector. The exercise could be buttressed by relaxing the other structural constraints impinging on India's exports drive. Particularly, the SEZ policy could be refurbished in the light of the Chinese experience. Infrastructure seems to hold the key not only in sustaining the BPO boom for the Indian manufacturing but also in providing a durable basis to India's exports competitiveness.

The package of reforms that has been carried out over the past 12 years was also expected to lead to significant industrial restructuring. The reduction in import protection and the introduction of new competition were expected to lead to a reallocation of resources more in line with India's comparative advantage in the international industrial economy. Resources should have moved from the more capital-intensive sectors to the more labour using ones, leading to both higher output and employment growth. The shift of resources to more labour using industries will, however, not take place unless this is accompanied by labour reform. It is felt that much more flexibility is required for industrial restructuring in terms of more rapid bankruptcy procedures, easier reallocation of capital, faster transformation of urban land use, and flexibility in labour use (Mohan, 2002).

Industrial restructuring has also been made difficult by the Urban Land Ceiling Act, which made changes in land use very difficult. Accomplishment of the envisaged legislative changes will provide for much greater flexibility. Putting in place a social security mechanism for workers displaced due to industrial restructuring is important. The other main rigidity inhibiting investment in labour using industries is the obsolete policy of small scale industry reservation. The attainment of both higher volume growth and of higher unit value realisation will require both larger scales of operation and higher quality. It is therefore essential to loosen constraints in these sectors so that they can grow freely in volume, utilise better machinery, graduate up to higher technology levels, and utilise better international marketing channels (Mohan, 2002). Moreover, the Indian industry needs to invest much more actively in skill building, in product quality upgradation, and in R&D.

The experience of the most successful developing countries in the recent period suggests that globalisation transforms market structure through behavioral responses of incumbent firms and entrants to enhanced freedom of choice. The globalisation process leads to, *inter alia*, changes in the expenditure pattern of the industries, reduction in cost, increased M&As. Unlike East Asia, where the manufacturing sector's share in GDP declined sharply over the last decades, in India, the share in the 1990s has remained broadly the same. The increasing investment impulses in the Indian industries, particularly in attracting more FDI may change the industrial structure further to cope with the international competition.

This learned audience may recall the recent Goldman Sachs Study, which has prognosticated India to be among the top four economies of the world over the next fifty years. In this context, the Study has highlighted, *inter-alia*, the role of increasing openness in the pursuit of higher and sustained growth. It is perhaps apposite that the areas of policy action suggested above are expeditiously addressed which would facilitate an early launch of the country in the leading league of nations.