

Draft

**Current Policies of Reserve Bank of India Regarding
Agriculture and Industry**

Dr. Narendra Jadhav

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I. Indian Agriculture : An Assessment and Policy Imperatives

At the time of Independence, agriculture contributed to more than 50 per cent of India's gross domestic product (GDP). Today, it accounts for less than one-fourth of GDP. Experience from elsewhere in the world shows that this pattern is not uncommon. When a developing country matures and evolves in terms of economic development, the share of agriculture in GDP does tend to decline. What makes the Indian case uncommon is on account of two factors: First, the agricultural productivity has distinctly decelerated in the recent period. Indeed, there it is widely believed that the reform process in India initiated in 1991 has, by and large, bypassed the agriculture sector. Secondly, the proportion of population dependent on agricultural income has remained virtually unchanged at exceptionally high level of around 60 per cent. This is certainly a cause for concern since the paucity of gainful employment opportunities has, arguably, been disturbing the social cohesion – manifest at times in terms of increased occurrence of suicides by farmers.

Against this backdrop, this paper aims at highlighting and articulating a host of major issues and suggesting some policy prescriptions.

Indian Agriculture: Issues and Prospects

While there are a number of factors responsible for the present state of agriculture in India, the following seven issues merit attention on priority:

- (i) Declining productivity and increased variability in agricultural production;
- (ii) Decline in capital formation;

- (iii) Inadequate credit delivery;
- (iv) Sub-optimal use of inputs and technology;
- (v) Distortionary pricing and subsidies;
- (vi) Untapped export potential;
- (vii) Inadequate employment generation.

These are discussed below, in that orders.

1. Declining Productivity and Increased Variability

Indian agricultural production, of late, has been characterised by sharp variations due to unpredictable nature of monsoon. For instance, foodgrains production in the country varied between 174.19 million tonnes in 2002-03 (the lowest in the last 12 years) and 212.20 million tonnes in 2003-04, (the peak production attained so far). Similar variations can be observed in the production of non-foodgrains as well. Oilseeds production in 2002-03 stood at 15.06 million tonnes, the lowest after 1987-88; this increased subsequently to 24.98 million tonnes in the next year which was the highest oilseeds production the country witnessed so far. It turns out that the variability of agricultural production in the 1980s was as much as five times the average variability recorded in the overall GDP during 1992-93 to 2002-03.

Such wide variations in agricultural production underline the rain dependence of the Indian agriculture, thereby underscoring the need for improving the irrigation facilities. In 1998-99 only 39.2 per cent of the gross cropped area in the country was under irrigation. Moreover, the irrigation coverage across various crops and states remains highly skewed.

The high degree of variability in production also stems from the problem of declining yields for few crops. The yields of agricultural products reveal an unstable trend in recent years. The yield of foodgrains, which showed significant gains from 710 kg/ha in 1960-61 to 1704 kg/ha in 1999-2000, has stagnated in the recent past largely on account of rice and wheat. The yields of pulses have been low during the entire period since the 1960s. In the case of commercial crops, the yields of oilseeds improved significantly during the 1980s and 1990s, but fluctuated sharply during the recent period. Sugarcane yields improved during the four decades since the 1960s, but have been declining steadily during the last few years. Yield of cotton crop, which declined during the 1960s and increased during the 1980s and 1990s have stagnated since then between 190 kg/ha and 265 kg/ha.

2. Decline in Capital Formation

During the 1990s, a steady downturn in investment rates was experienced by the agricultural sector, mainly in public investment. The ratio of public sector capital formation in agriculture to Gross Public Sector Capital Formation declined from 17.7 per cent in 1980-81 to only 4.1 per cent in 2000-01. At the same time, capital formation in agriculture as a ratio of GDP originating from agriculture also declined from 8.5 per cent in 1980-81 to 6.1 per cent in 2000-01. In this context it may be noted that around 90 per cent of public capital formation in agriculture is invested in major and medium irrigation facilities, while most of the private sector capital formation goes towards minor irrigation projects. With the declining trend in public sector capital formation, the onus lies now on the private sector capital formation. Although the private sector capital formation in agriculture has been on the rise during the past decade, it has not been

able to meet the shortfall on account of the corresponding decline in public investment. The inadequacy of new capital formation has slowed the pace and pattern of technological change in agriculture with adverse effects on productivity. To rejuvenate agricultural growth, the declining trend in public investment needs to be corrected.

3. Inadequate Credit Delivery

Lower deployment of credit in agriculture : Despite a well developed credit delivery structure, the outreach of banks to the rural areas has remained restricted. In tune with the recommendations of the Narsimham Committee on banking reforms, after the expiry of the five-year branch expansion programme of 1990-95, the subject of opening rural branches was left to the commercial judgement of banks. Driven by profitability and prudential regulation considerations and concepts of para banking, the scheduled commercial banks seem to have preferred to limit the rural expansion and shifted their expansion focus to the urban areas instead. As a consequence, the banks' reach for the rural population suffered and stagnated. This has resulted in lower deployment of credit to agriculture. Although the ratio of agricultural credit to agricultural GDP has increased from 5.4 percent in 1970s to 8.7 per cent in 2001-02, it may be noted that agricultural credit as a proportion to total credit has declined from 20.5 per cent to 10.5 per cent during the same period indicating lower deployment of credit in agriculture. Moreover, the extent of credit deployed from out of deposits mobilised in rural areas has fallen rapidly as reflected in the Credit-Deposit ratio which declined from 65 per cent in mid-1980s to around 42 per cent now.

Lower growth in Long-term Credit : It has been observed that short-term credit disbursements to agriculture have outpaced long-term credit disbursements. For instance, disbursements of direct short-term agricultural finance grew at a rate of 15.6 per cent during 1990-91 to 2000-01, whereas the long-term finance grew at a lower rate of 12.2 per cent during the same period. A major part of the priority sector lending norm in agriculture is now being met through short-term loans to agriculture, *i.e.*, Kisan Credit Cards.

The lower growth in long-term credit to agriculture is a matter of concern as it severely hampers capital formation in agriculture. The lower growth of long-term credit to agriculture also severely restricts the credit absorptive capacity of the rural population. The long-term credit is needed for capital formation, and therefore, increasing the productivity and incomes of the rural population, thereby raising their credit absorptive capabilities. Moreover, it is also needed for creation of rural agri-business infrastructure like warehouses, cold-storages, transportation facilities, *etc.*, for increasing business potential and better realisation of market prices by the farmers. In the absence of adequate long-term credit flow to agriculture in particular, and rural sector in general, the business potential and therefore, the credit absorptive capacity of rural population is severely hampered.

Decline in credit to small borrowers : Besides the overall decline in agricultural credit, what is even more worrisome is the decline in the number of small loans (of up to Rupees 25,000). These are essentially informal sector loans which slipped from a peak of 62.55 million in March 1992 to 37.22 million in March 2002. Their share in total bank credit also declined from 25 per cent to only 6 per cent during the same period. Thus,

it seems that brunt of credit squeeze in agriculture is being faced by small farmers.

4. Sub-Optimal Use of Inputs and Adoption of Technology

The imperative of stabilising and augmenting agricultural yields is also evident from the fact that there is less scope for increasing area under cultivation of various crops. Further, apart from the decline in land-holding size, there is increasing cost of production and depletion of ground water. Increase in agricultural production would therefore have to emanate from improvements in productivity from the existing cultivated area through use of location-specific high yielding varieties, balanced fertiliser doses, effective transfer of technology and timely supply of all inputs. There is also an urgent need to increase the availability of farm electricity power to boost productivity.

Unsatisfactory Spread of New Technology : One of the main reasons for the low levels of yield in Indian agriculture has been the unsatisfactory spread of new technological practices, including the adoption of High Yielding Varieties (HYV) of seeds and usage of fertilisers, inadequate spread of farm management techniques and other practices such as soil conservation and crop rotation. The adoption of the HYV seeds require intensive use of fertilisers and pesticides under adequate and assured water supply. In the absence of proper irrigation facilities, the use of HYV seeds would entail higher yield risk as compared to traditional seed varieties. This increased risk is one of the elements obstructing the speedy adoption of HYV seed cultivation across regions and crops.

Low availability of farm electricity power : The availability of farm electricity power in the country continues to be low. During 2000-01, it was as low as 1.35 kilowatt/hectare in India as compared with some of the developed nations, such as Japan (8.75 kw/ha), Italy (3.01 kw/ha), France (2.65 kw/ha), the United Kingdom (2.5 kw/ha), and Germany (2.35 kw/ha). Furthermore, there is a wide disparity among the States in India regarding the availability of farm power.

5. Distortionary Pricing and Subsidies

The Minimum Support Price (MSP) mechanism was put in place to provide assured incomes to producers. However, during the 1990s, substantial increases in MSPs of rice and wheat have significantly distorted the incentives provided to these crops at the cost of other crops. At the same time, power subsidy provided for irrigation has further tilted the incentives against rain dependent crops like pulses and oilseeds. These distortions have obstructed efforts aimed at diversification of crops.

Higher Remunerative Prices for Rice and Wheat Obstructing Diversification :

Substantial increases in MSPs of rice and wheat during the 1990s, in conjunction with unattractive MSPs for other crops, have resulted in increasing cultivation of rice and wheat, especially in irrigated areas. This situation arose due to the fact that assured income (income per hectare obtained by multiplying MSP with yield per hectare of a given crop) from rice and wheat cultivation had been consistently higher than their respective costs of cultivation, while the assured incomes in case of other crops like oilseeds and pulses fell short of their costs. The adverse

incentives provided by MSP constraining crop diversification require correction.

Excessive drawing of water due to power subsidy in irrigation : The disincentive problem has been further accentuated by the provision of subsidies on electricity and diesel which have encouraged cultivation of water intensive crops such as rice and wheat. Subsidisation of electricity for irrigation has also led to excessive drawing of ground water and resulted in soil degradation leading to depletion of water table and increased soil salinity, especially mainly in the agriculturally developed regions like Punjab, Haryana and West Uttar Pradesh. In fact, in these areas, rice is cultivated as a cash crop, since the staple cereal of the region is wheat. Moreover, since farmers with larger capacity pumps can draw water away from the water table adjoining their farms at a faster rate than those with smaller farms, this has had an adverse impact on the small and marginal farmers. There is an urgent need to correct this problem by increasing the assured income from crops other than rice and wheat on one hand and reducing subsidies on electricity for irrigation by imposing adequate user charges.

Notwithstanding the recent increase in the MSPs of oilseeds and pulses by a larger quantum than those of paddy and wheat, the assured incomes from these crops still continues to be low, especially since the low yield rates obtained in these crops. Therefore, there is an urgent need for crop diversification, specifically, growing oilseeds and pulses in irrigated areas, so that assured incomes from these crops will increase, apart from addressing the soil sustainability issues. Furthermore, crop diversification to other crops is also necessary since Indian rice and wheat do not enjoy comparative advantage in international markets. While the increased

cultivation of oilseeds and pulses in irrigated areas may address the soil sustainability issues, growth of fruits and vegetables in less irrigated areas, along with watershed creation and proper management water resources, may address the issue of rain dependence and the consequent volatility of farm incomes, as the water requirement for orchards is generally lesser than other crops. However, increased cultivation of fruits and vegetables necessitates better storage, transportation and food processing facilities in rural areas for enabling farmers to realise higher incomes. It also requires that Indian food products be compliant with at least *codex alimentarius* norms, for them to be internationally competitive.

6. Untapped Exports Potential

In recent period India has emerged as a leading producer of many agricultural products in the world. India is now the largest producer of coconut, arecanut, cashew nut, ginger, turmeric, black pepper, and the second largest producer of fruits and vegetables. This progress on the domestic front has, however, not been translated into enhanced exports of these commodities. Exports of agricultural products generally displayed a relatively lower rate of growth except for a brief period in mid-1990s. While exports of traditional commodities such as tea, coffee, rice, spices and oil meal have decelerated, sharp expansion was observed in exports of high value and processed agricultural products such as fruits and vegetables, processed fruits, juices, and meat and meat preparation. In order to realise the huge potential of exports which has so far been untapped, particularly in respect of processed foods, it is imperative that domestic controls are removed expeditiously and adequate rural infrastructure is in place which would ensure efficient warehousing, processing, packaging, storage and related research.

It is now agreed that Indian agriculture has vast business potential, especially in the food processing sector, in view of the substantial production of fruits and vegetables and milk and other animal food products in the country. However, tapping this business potential in food processing industry requires that Indian food exports should comply the *codex alimentarius* norms.

7. Employment Absorptive Capacity

Nearly 60 per cent of the population in India is dependant on agricultural income. This is clearly symptomatic of the failure of other sectors *i.e.*, industry and services in absorbing the surplus labour from agriculture. This problem is likely to be even more important in future. The demographic profile of India is currently under a transition. It is expected that the working age population as a proportion of total population would double during the next three decades. This, in turn, would imply a growing proportion of population dependant on agricultural income which would have to be absorbed through creation of adequate employment opportunities within the agricultural sector.

II. Extracts from the Common Minimum Programme (CMP)

A. Policy Intentions Relating to Agriculture

1. **Enhanced Public Investment** : The UPA government will ensure that public investment in agricultural research and extension, rural infrastructure and irrigation is stepped up in a significant manner at the very earliest. Irrigation will receive the highest investment priority and all ongoing projects will be completed according to a strict time schedule.
2. **Step up in Rural Credit** : The rural cooperative credit system will be nursed back to health. The UPA government will ensure that the flow of rural credit is doubled in the next three years and that the coverage of small and marginal farmers by institutional lending is expanded substantially. The delivery system for rural credit will be reviewed.
3. **Lower debt burden on farm loans** : Immediate steps will be taken to ease the burden of debt and high interest rates on farm loans.
4. **Expansion of insurance** : Crop and livestock insurance schemes will be made more effective.
5. **Dryland farming, watershed and wasteland development** : The UPA government will introduce a special programme for dryland farming in the arid and semi-arid regions of the country. Watershed and wasteland development programmes will be taken up on a massive scale. Water management in all its aspects, both for irrigation and drinking purposes, will receive urgent attention.

6. **Minimum wage laws for farm labour** : The UPA administration will ensure the fullest implementation of minimum wage laws for farm labour. Comprehensive protective legislation will be enacted for all agricultural workers.
7. **Clear land titles** : Revenue administration will be thoroughly modernised and clear land titles will be established.
8. **Professionalisation of Cooperatives** : The UPA government will bring forward a Constitutional Amendment to ensure the democratic, autonomous and professional functioning of cooperatives.
9. **Removal of Controls** : Controls that depress the incomes of farmers will be systematically removed. Farmers will be given greater say in the organisations that supply inputs to them.
10. **Protection from Imports** : The UPA government will ensure that adequate protection is provided to all farmers from imports, particularly when international prices fall sharply.
11. **Focused Procurement and Marketing** : The UPA government will ensure that government agencies entrusted with the responsibility for procurement and marketing will pay special attention to farmers in poor and backward states and districts.
12. **Remunerative Prices** : Farmers all over the country will receive fair and remunerative prices. The terms of trade will be maintained in favour of agriculture. The UPA government will take steps to ensure that dues to all farmers including sugarcane farmers will be cleared at the earliest.

B. Policy Intentions Relating to Food and Nutrition Security

1. **Medium-term strategy for food and nutrition security** : The UPA will work out, in the next three months, a comprehensive medium-term strategy for food and nutrition security. The objective will be to move towards universal food security over time, if found feasible.
2. **Targeted PDS** : The UPA government will strengthen the public distribution system (PDS) particularly in the poorest and backward blocks of the country and also involve women's and ex-servicemen's cooperatives in its management. Special schemes to reach foodgrains to the most destitute and infirm will be launched. Grain banks in chronically food-scarce areas will be established.
3. **Antyodaya cards** : Antyodaya cards for all households at risk of hunger will be introduced.
4. **Improving efficiency of FCI** : The UPA government will bring about major improvements in the functioning of the Food Corporation of India (FCI) to control inefficiencies that increase the food subsidy burden.
5. **Nutrition programmes** : Nutrition programmes, particularly for the girl child will be expanded on a significant scale.

III. Medium-Term Priorities

(i) **Comprehensive Perspective Plan (CPP)**

There is, at present, no comprehensive agricultural plan in India and various policy measures are announced in an *ad hoc* manner. With a view to giving a medium-term perspective to agricultural development, it is suggested that a **Comprehensive Perspective Plan** (covering 3-5 years), akin to the Exim Policy, should to be formulated for the agricultural sector covering various aspects like production, marketing, external trade, *etc.* Besides, proper sequencing of reforms in the related areas, the CPP should spell out attainable targets in these areas. The CPP should be a rolling plan with **annual announcements** of relevant policy changes besides taking stock of the progress achieved with regard to targets. The National Action Plan being prepared by the Ministry of Agriculture for Increasing Agricultural Productivity and Doubling Food Production by 2011-12 could be reconciled with the CPP.

In order to take advantage of the liberalisation in the global markets and India's competitive advantage in several agricultural commodities, the CPP would have to be dovetailed with WTO's Agreement on Agriculture (AoA).

(ii) **Steeping up of Public Investment**

Investment in agriculture should be raised from the present level of around 1.3 per cent of GDP to at least a minimum of 2-3 per cent of GDP in the medium-term. In order to improve and further encourage private sector investment in agriculture appropriate fiscal incentives may be provided. A regular monitoring of on-going investment projects is necessary so as to facilitate identification/ rectification of gaps in

implementation. Emphasis needs to be placed on successful completion of on-going projects in time-bound manner, rather than starting new projects.

iii) Marketing Reforms

All barriers to free movement of commodities (inter-State) need to be removed. While the Essential Commodities Act (1955) has been amended, in practice, restrictions still continue to exist in certain areas, which hamper free movement of commodities. All States/UTs need to modify their Agricultural Produce Marketing Committee Acts so as to create a lawful role for private and co-operative sector in market development, which could go a long way in encouraging activities like contract farming.

iv) Agricultural Inputs

With a view to facilitating distribution of seeds/fertilisers and other inputs to small farmers in remote areas, it is suggested that the services of PACS (as done in some States like UP), gram panchayats, etc., could be utilised, in addition to the existing arrangements.

v) Watershed Development

There is need for involving grass root panchayat level institutions, voluntary agencies and community participation in watershed development

vi) RIDF

In order to increase the utilisation of RIDF funds, which is at present hampered by the stipulation regarding contribution of matching funds by the State Governments, there is a need to have a relook/relaxation of this norm.

vii) Precision Farming

Another aspect of market determined agricultural development and crop diversification is the precision farming. Precision farming makes use of remote sensing to macro-control of Global Positioning System (GPS) to locate precisely ground position and of Geographic Information System (GIS) to store ground information. It precisely establishes various operations, such as the best tillage, application of fertiliser, sowing, irrigation, harvesting etc., and turns traditional extensive production to intensive production according to space variable data. Precision farming not only may fully utilise resources, reduce investment, decrease pollution of the environment and get the most of social and economic efficiency, but could also make farm products controllable, and hence be produced in standards and batches. However, precision farming has been confined to developed countries so far. Land tenure system and smaller farm size have limited the scope of precision farming in India. However, there is a wide scope for precision farming in irrigated/commercial/fruit and vegetable crops/high value crops. It would, of course, necessitate development of database of agriculture resources, which will act as decision support system at the farm level.

viii) Commodity Futures Trading

To create more awareness among farmers, NABARD/ State Government agencies may be encouraged to organise campaigns about the benefits of futures trading. Warehouse receipts to be made tradable, with adequate legal backing to develop commodity futures.

ix) Foodgrains Procurement Operations

Few States like Punjab and Haryana are at present the major beneficiaries of the Government's food procurement operations. The scheme needs to be extended to other States.

x) Providing insurance coverage to non-wilful defaulters

Presently, many farmers are not eligible for obtaining Kisan Credit Cards/loans from banks, mainly due to defaulting their loan commitment at some point of time. However, a major portion of the small and marginal farmers can be non-wilful defaulters. Predominantly they are rain-dependent farmers, and therefore may have suffered due to either drought/flood, which are quite common across the country. In such a scenario, making credit available to non-wilful defaulters may enhance the credit flow to agriculture, apart from increasing the capability of these farmers to improve their incomes. However, such argument is contingent on the fact that these farmers do not suffer from the vagaries of weather in future. This necessitates insulating farm incomes through appropriate insurance mechanism. Though the National Agricultural Insurance Scheme is operational, its reach has not been adequate to insulate borrowers from the vagaries of monsoon. This would have to be reviewed comprehensively and appropriate correction mechanism needs to be devised.

xi) Intensive use of information on marketing

To reap adequate benefits from crop diversification, it is mandatory that adequate marketing facilities be created. Creation of marketing facilities not only necessitates investment in warehouses, cold storages and transportation, *etc.*, but also providing adequate information to farmers regarding ruling prices and demand-supply situation in various markets across the country. The role of Information Technology in this regard could be phenomenal. Presently, National Informatics Centre provides price data on various agricultural commodities at <http://agmarknet.nic.in>. However, these prices data are available in English and moreover, it demands that

farmers/producers have internet connectivity. Provision of the same data in regional vernacular at information kiosks established at suitable places like village punchayat office or Regional Market Committees, could go a long way in improving the information flow to farmers/producers. Furthermore, creation of e-markets on the web can allow farmers/producers to sell their produce from their place of residence and then ship the merchandise to the buyers.

xii) Comprehensive Database on borrowers

Another use of the information technology could be establishment of a comprehensive data base on borrowers of various lending institutions. This will help a long way in increasing credit flow as presently, borrowers need to submit numerous No Objection Certificates to banks for availing loans, which takes substantial time in acquiring as the borrower needs to visit numerous bank branches spread across the block. The time element involved in obtaining the NOCs puts a large opportunity cost on the borrowers' time apart from hindering the timeliness of credit delivery. In presence of the comprehensive data base, the banks can verify the particulars of any loan applicant and do away with the need for excessive documentation like submission of NOCs and enhance the timeliness of credit delivery.

IV. Immediate Action Plan

The following suggestions could be considered on an immediate basis during the current financial year.

- i) **Announcement of Comprehensive Perspective Plan** : Comprehensive Perspective Plan (CPP) for Agriculture could be announced initially for a three year period from 2004-05 to 2006-07 to make it co-terminus with the Tenth Five Year Plan. Thereafter, Five Year CPP could be announced.
- ii) **Higher public investment** : The forthcoming budget 2004-05 could earmark higher outlay for public investments in agricultural research and extension, rural infrastructure and irrigation projects.
- iii) **Monitoring Project Implementation** : To ensure proper end-utilisation of funds and completion of projects on time either a separate Task Force/Group can be constituted or periodic progress reports may be obtained from the respective State Governments. This could help in identifying bottlenecks in various stages of the project implementation and help in taking immediate necessary corrective measures.
- iv) **Fiscal Incentives** : To encourage private sector participation (corporates and other such entities other than individuals) in R&D, rural infrastructure building and extension services, fiscal incentives like tax holidays could be thought of. Separate amount may be earmarked for R&D in dry land farming.
- v) **Legal Reforms in Marketing** : A mechanism needs to be instituted to monitor/speed up the reforms in States/UT's Agricultural Produce Marketing Committee Acts.

- vi) **Incentives for building rural infrastructure** : Banks/ corporates could be given incentives for building godowns/cold storages to facilitate value addition, supply chain management and prevent distress sales. (In Southern States, banks like the Canara Bank have already taken some initiatives).
- vii) **Greater participation for distribution of inputs** : Services of PACS/ Gram panchayats to be utilised, in addition to the existing arrangements, to facilitate distribution of agricultural inputs like seeds/fertilisers.
- viii) **Greater participation for in watershed development** : Grass root panchayat level institutions, voluntary agencies and community participation in watershed development could be encouraged.
- ix) **Better utilisation of RIDF funds** : The stipulation regarding matching contribution from State Governments could be modified to facilitate better utilisation of RIDF funds.
- x) **Price Protection** : Price Stabilisation Fund should be set up for other agricultural commodities similar to that for tea, coffee, rubber and tobacco so as to protect the interests of farmers from the effects of fall in international prices.
- xi) **Distress Relief Fund** : A Special Distress Relief Fund may be created to provide succour to small and poor farmers to prevent them from taking extreme measures like suicide in the event of natural calamities like droughts/floods.
- xii) **Grain Banks** : Grain banks to be established in food scarce areas. Measures to strengthen better targeting of the Public Distribution System to be initiated

- xiii) **WTO and Agriculture** : A Standing Advisory Committee on Agriculture and WTO, comprising of a cross-section of representatives drawn from the needs to be set up to both, prepare India for the challenges arising out of Agreement on Agriculture (AoA) and facilitate in taking advantage of India's competitive strengths in various agricultural commodities. The Group could undertake detailed commodity-specific studies to delineate our strengths and weaknesses.
- xiv) **Farmer Education** : Farmers have to be educated about phyto-sanitary measures to enable them to produce products complying with the WTO standards.

Section II

Impact of Global Economic Dynamics on Growth of Indian Industry

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). 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

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

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.

II.1. 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.

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

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

(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 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.2. 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 companies⁵ in terms of sales was calculated across industries.

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

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.

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

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.'

are 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

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

sector is faced with price competition from imports on account of inflow of certain goods through informal 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.

II.3. 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 ancillarisation/outsourcing by larger units.

Section III

Proposals in Union Budget 2005-06 relating to Agriculture and Industry

The Budget commits to eliminate poverty through generation of gainful employment and accordingly identifies the sectors with high potential. It also seeks to improve health conditions of citizens through better nutrition and hygienic drinking water facilities. The Budget bestows special attention to minorities, backward classes and regions and gender specific issues. It intends to provide impetus to rural India in six areas, viz., irrigation, roads, water supply, housing, rural electrification and telecom connectivity. It proposes to have a road map for agricultural diversification particularly in respect of fruits, vegetables, flowers, dairies, poultry, fisheries, pulses and oilseeds. It recognises the need for large investment from private and cooperative sectors for setting up agricultural markets, marketing infrastructure and support services. The Budget sets out a new paradigm in investment policy whereby the Government will play essentially a catalytic role in terms of a public private partnership rather than fully funding investment.

(i) Assault on Poverty and Unemployment

Policy proposals on poverty and unemployment are aimed at boosting agricultural growth, employment generation and directly address the issue of poverty. The major proposals are

National Rural Employment Guarantee Scheme: Allocation for National Food for Work programme increased from Rs.4,020 crore in 2004-05 to Rs.11,000 crore in 2005-06. The Government intends to convert this programme into the National Rural Employment Guarantee Scheme.

National Rural Health Mission : To be launched in the next fiscal with components like training of health volunteers, providing more medicines

and strengthening the primary and community health centre system; work on the six AIIMS-like institutions to start next year.

Antyodaya Anna Yojana: The Budget proposes to cover 2.5 crore Below Poverty Line (BPL) families under the Antyodaya Anna Yojana scheme in 2005-06.

Integrated Child Development Services: Scheme to be expanded with creation of 1,88,168 additional anganwadi centres; supplementary nutrition norms to be doubled; Centre to share one-half of the States' costs.

Mid-day Meal Scheme: The allocation in the Mid-day Meal Scheme has been increased to Rs.3,010 crore from Rs.1,675 crore in 2004-05.

Sarva Shiksha Abhiyan: A non-lapsable fund called "Prarambhik Shiksha Kosh" created for funding the programme; allocation to increase to Rs.7,156 crore in 2005-06.

Drinking Water and Sanitation: All drinking water schemes brought under the Rajiv Gandhi National Drinking Water Mission; emphasis to be on providing drinking water facilities in the remaining uncovered rural habitations; and on tackling water quality in about 2.16 lakh habitations; Total Sanitation Campaign to be extended to all districts;

Scheduled Castes and Scheduled Tribes: A new window to be added to scholarship schemes: any student securing admission in one of the short listed institutes of excellence, to be awarded a larger scholarship for tuition fees, living expenses, books and a computer; Rajiv Gandhi National Fellowship to be introduced for SC and ST students for pursuing M.Phil and Ph.D. courses in selected universities.

Women and Children: In course of time, Departments to be required to present gender budgets as well as make benefit-incidence analyses

Minorities: Equity support for the National Minorities Development and Finance Corporation to be increased; a certain percentage of new schools

under the Sarva Shiksha Abhiyan and the Kasturba Balika Vidyalaya Scheme and new anganwadi centres to be located in districts, blocks or villages with a substantial minority population; assistance to be provided for recruitment and posting of Urdu language teachers in primary and upper-primary schools; schemes for pre-examination coaching to include reputed private coaching institutes.

Backward Regions Grant Fund: To be established; an allocation of Rs.5,000 crore 2005-06, and an equal amount to be allocated every year in the next four years.

Jammu & Kashmir: Special plan assistance to be provided under a Reconstruction Plan in addition to the normal State Plan; Baglihar project to be provided adequate funds; Udhampur -- Baramulla rail line to be implemented as a project of national importance.

North Eastern Region: It is proposed to support Kumarghat--Agartala and Lumding--Silchar—Jiribam--Imphal projects with additional funds outside the railway budget; special package for highway development (Rs.450 crore).

Rural Infrastructure: It is proposed to provide a corpus of Rs.8,000 crore in 2005-06 to the Rural Infrastructure Development Fund which was revived last July.

(ii) Bharat Nirman

Goals: to bring an additional one crore hectares under assured irrigation; to connect all villages that have a population of 1000 (or 500 in hilly/tribal areas) with a road; to construct 60 lakh additional houses for the poor; to provide drinking water to the remaining 74,000 habitations that are uncovered; to reach electricity to the remaining 1,25,000 villages and offer electricity connection to 2.3 crore households; and to give telephone connectivity to the remaining 66,822 villages.

(iii) Investment

Equity support of Rs.14,040 crore and loans of Rs.3,554 crore to Central Public Sector Enterprises (including Railways) in 2005-06.

(iv) Agriculture

(a) *Roadmap for Agricultural Diversification*: To be prepared with focus on fruits, vegetables, flowers, dairy, poultry, fisheries, pulses and oilseeds.

(b) *National Horticulture Mission*: Rs.630 crore in 2005-06; to cover research, production, post-harvest management, processing and marketing in an integrated manner.

(c) *Agricultural Marketing Infrastructure*: A new scheme for Development/Strengthening of Agricultural Marketing Infrastructure, Grading and Standardisation to be introduced to induce large investments from the private and cooperative sectors for setting up agricultural markets, marketing infrastructure and support services such as grading, standardisation and quality certification; to be implemented through NABARD and NCDC in those States which amend their APMC Acts.

(d) *Water Resources, Flood Management and Erosion Control*: National Project for the repair, renovation and restoration of water bodies to be launched in March 2005; pilot project for 16 districts in 9 States to cover nearly 700 water bodies; 20,000 hectares of additional land to come under irrigation; outlay of Rs.180 crore in 2005-06 for flood management and erosion control in the Ganga basin and in the Brahmaputra and Barak valleys; Rs.52 crore for the Farakka Barrage Project; outlay for AIBP to increase to Rs.4,800 crore in 2005-06.

(e) *Micro Irrigation*: Coverage to increase to 3 million hectares in the Tenth Plan and to 14 million hectares in the Eleventh Plan.

(f) *Rural Credit and Indebtedness*: RBI to examine the issue of allowing banks to adopt the agency model by using the infrastructure of civil society organisations, rural kiosks and village knowledge centres to provide credit support; agricultural credit of Rs.108,500 crore to be disbursed in the current year; increase in the flow of credit by another 30 per cent in 2005-

06; public sector banks to increase the number of borrowers by another 50 lakh.

(g) Farm Insurance: National Agricultural Insurance Scheme (NAIS) to continue for *kharif* and *rabi* 2005-06.

(h) Micro Finance: Target for credit-linking to be enhanced from 2 lakh Self Help Groups (SHGs) to 2.5 lakh SHGs; Micro Finance Development Fund to be redesignated as the “Micro Finance Development and Equity Fund” with an increased corpus of Rs.200 crore; RBI to open a window to enable qualified NGOs to use the External Commercial Borrowing (ECB) window.

(i) Micro Insurance: NGOs, SHGs, cooperatives and MFIs to be invited to become micro insurance agents.

(j) A Knowledge Centre in Every Village: Government to join Mission 2007 - a national initiative launched by an alliance comprising nearly 80 organisations including civil society organisations, with the goal to set up a Knowledge Centre in every village by the 60th anniversary of Independence Day; support to be routed through NABARD; Rs.100 crore to be provided out of the RIDF.

(k) Agricultural Research: An initial provision of Rs.50 crore for the National Fund for Strategic Agricultural Research.

(v) Manufacturing

“Manufacturing Competitiveness Programme” to be launched to help small and medium enterprises; design to be worked out by the National Manufacturing Competitiveness Council in consultation with the industry.

(a) Textiles: Allocation of Rs.435 crore for the Technology Upgradation Fund (TUF); a 10 per cent capital subsidy scheme to be introduced for the textile processing sector; cluster development approach to be adopted for the production and marketing of handloom products; 20 clusters to be

taken up in the first phase at a cost of Rs.40 crore; coverage of life insurance scheme for handloom weavers to be enlarged to 20 lakh weavers in two years at a cost of Rs.30 crore per year when fully rolled out; coverage of the health insurance package for weavers to be increased to 2 lakh weavers at a recurring cost of Rs.30 crore per year.

(b) Sugar Industry: NABARD, in consultation with State Governments, RBI, banks and financial institutions to work out a scheme for providing a financial package with a moratorium for two years, on both principal and interest, and a schedule of payment having regard to the commercial viability of each unit; interest rate of 2 percentage points below the bank rate to be made applicable to outstanding loans as on October 21, 2004; Indian Banks' Association (IBA) and NABARD to work out a scheme under which factories may renegotiate their past high interest loans.

(c) Pharmaceuticals and Biotechnology: Corpus for the research and development fund to be increased in phases; stable policy environment and incentives to be provided to help the two industries become world leaders.

(d) Small and Medium Enterprises: 108 items identified for de-reservation; provision for "Promotion of SSI Schemes" enhanced to Rs.173 crore in 2005-06; units in knowledge-based industries such as pharma, biotech, and IT to be provided equity support through the SME Growth Fund.

(e) Skills Training: 100 ITIs identified for upgradation; out of them, 67 ITIs in 15 States/Union Territories linked with industry to be upgraded at a cost of Rs.1.6 crore each; Skills Development Initiative (SDI) to be introduced as Public-Private Partnership.

(f) Foreign Trade : Target of US\$ 150 billion for exports by the year 2008-09 fixed in order to double India's share in world exports to 1.5 per cent.

(vi) Infrastructure

(a) *Telecommunications*: A provision of Rs.1,200 crore for Universal Service Obligation (USO) Fund in 2005-06; 1,687 subdivisions to get support for rural household telephones; BSNL to provide public telephones in the next three years to the remaining 66,822 revenue villages.

(b) *National Highway Development Project*: NHDP III to be launched in 2005-06 to target selected high density highways not forming part of the Golden Quadrilateral or the North-South and East-West corridors; Rs.1,400 crore provided in 2005-06 to four-lane 4000 kms; a special package for the North Eastern region with allocation of Rs.450 crore.

(c) *Rural Electrification*: To cover 1.25 lakh villages in five years; focus to be on deficient States; creation of a rural electricity distribution backbone envisaged, with a 33/11 KV substation in each block and at least one distribution transformer in each village; Rs.1,100 crore provided in 2005-06

(d) *Indira Awas Yojana*: Allocation increased to Rs.2,750 crore in 2005-06; about 15 lakh houses to be constructed during the next year.

(e) *Special Purpose Vehicle*: A financial Special Purpose Vehicle (SPV) to be established to finance infrastructure projects that are financially viable; SPV to lend funds, especially debt of longer term maturity directly to eligible, appraised projects to supplement other loans; limit for 2005-06 to be fixed at Rs.10,000 crore.

(f) *Provision of Urban Amenities in Rural Areas (PURA) clusters*: The National Commission on Enterprises in the Unorganised/Informal Sector has proposed pilot projects for 'growth poles' applying the PURA principles; creation of a few growth poles, as pilot projects to be taken up in 2005-06.

(g) *National Urban Renewal Mission*: To cover the seven-mega cities, with a population of over a million and some other towns; outlay of Rs.5,500 crore in 2005-06 including a grant component of Rs.1,650 crore.

MEASURES RELATING TO RBI*(i) Rural Infrastructure*

It is proposed to provide a corpus of Rs.8,000 crore in 2005-06 to the Rural Infrastructure Development Fund which was revived last July.

(ii) Rural Credit and Indebtedness

The Reserve Bank of India (RBI) is requested to examine the issue of allowing banks to adopt the agency model, by using the infrastructure of civil society organisations, rural kiosks and village knowledge centres, to provide credit support to rural and farm sectors.

(iii) Micro Finance

The programme of linking Self Help Groups (SHGs) with the banking system has emerged as the major micro-finance programme in the country. The Budget proposes to enhance the target for credit-linking in the next fiscal from 2 lakh SHGs to 2.5 lakh SHGs.

(iv) Special Purpose Vehicle

A financial Special Purpose Vehicle (SPV) to be established to finance infrastructure projects that are financially viable; SPV to lend funds, especially debt of longer term maturity directly to eligible, appraised projects to supplement other loans; limit for 2005-06 to be fixed at Rs.10,000 crore. A provision of Rs.1500 crore for “viability gap” funding for infrastructure projects has also been made. That mechanism will be used also in conjunction with the funding mechanism through the SPV.

