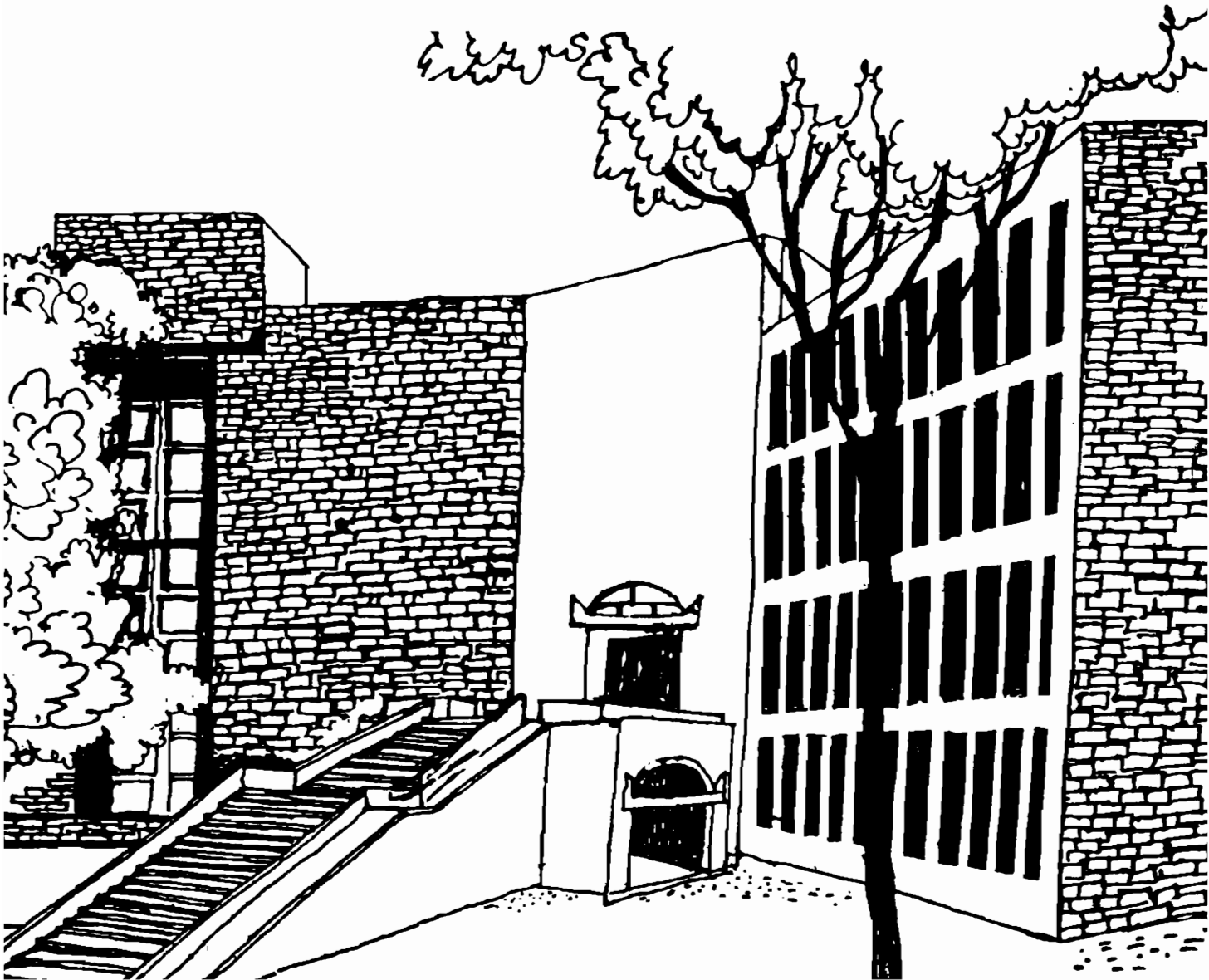




Working Paper



**SYNERGY IN GOVERNMENT POLICIES AND GLOBAL
COMPETITIVENESS OF TWO INDIAN INDUSTRIES:
AN EMPIRICAL STUDY**

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INTRODUCTION TO THE STUDY

This study by the Indian Institute of Management, Ahmedabad, India addresses itself to the question of how government policies have affected the global competitiveness of two industries (automobile components and leather) with a view to identify policy prescriptions that could enhance global competitiveness. Rather than looking at individual policies and assessing their impact, this study looks at sets of policies so as to identify the synergy or lack of thereof, among the various policies. This is a part of a study of four Indian and 2 Canadian industries undertaken by the Indian Institute of Management, Ahmedabad (IIMA) on the research question posed at the beginning of this paper, and the IIMA study itself is a part of a larger study on "Trade, Innovation and Performance" undertaken by four institutions in India and Canada¹. The study was sponsored and funded by the Canadian International Development Agency (CIDA) as a part of its Canada India Linkage Program.

The papers pertaining to the other two Indian industries and the two Canadian industries are given separately.

The Context of the Study

The study is undertaken in the context of India liberalizing its policies and attempting to integrate itself into the world market and Canada being not able to gain ground in its competitiveness with regard to relatively more sophisticated industries. A better understanding of the Government's role in enhancing the competitiveness of its industries may be very useful in arriving at workable policy prescriptions.

The Conceptual Framework

We have used Michael Porter's "Diamond" framework for our analysis². In this framework, four factors, acting together, are seen as determining the global competitiveness of an industry: the factor conditions, home demand conditions, the state of development of related and supporting industries, and the strategy, structure and rivalry of the domestic firms. The role of government policies, as Porter sees it, is in influencing and shaping the above factors rather than Government policies themselves being a factor. When underlying competitive advantage in one or more factors are present, government policies can reinforce them and help the build up of the diamond, but cannot, by themselves create advantages. The government's role is not to support uncompetitive industries through subsidies, protection through tariff barriers etc., but as a pusher and challenger who creates conditions in which the "diamond" can be strengthened. Rather than identifying and promoting industries, the government's role is to create more general signals and create conditions under which winners can emerge.

Which industries will actually gain competitiveness will depend upon their possessing certain factors that give them competitive advantage over their global competitors and their ability to innovate rather than on the support they receive from the government directly through such measures like tariff advantages, subsidies etc. The central concept in this framework is productivity enhancement through innovation.

1. The other Institutions are: The Institute of Economic Growth, New Delhi; Centre for International Studies, University of Toronto; and the Centre for Trade Policy and Law, Carlton University, Ottawa.

2. Michael Porter (1990), Competitive Advantage of Nations. London: Macmillan.

More specifically, the government's role in each of the above factors of the "diamond" are as follows:

Factor conditions. The government upgrades the general factor conditions like the country's education system, basic infrastructure, and research. It encourages training through devices like tax breaks and frame labour laws that do not stand in the way of skill upgradation.

Demand Conditions. Porter has argued that domestic demand forms a very important determinant of the global competitiveness of industries. The volume of domestic demand is important to give the needed scale advantages to the firms, but much more important is the quality and sophistication of the domestic demand that forces the domestic firms to innovate and adapt themselves to international standards for their products. Here the government's role is to stimulate the quality and quality of the domestic demand and to adopt regulatory measures that encourage industries to adopt world standards.

Related and supporting industries. Highly competitive industries in the world tend to occur not in isolation, but in clusters of related and supporting industries. Thus the policies should not be to support some industries in these clusters and provide negative support to others.

Firms' strategy, structure and rivalry. Here the policies should essentially aim at promoting a healthy competition among, and improve the productivity of, the domestic firms.

For our study, we have merely adopted Porter's diamond framework for analysis rather than testing it for validation. We, however, note some important areas where the diamond framework requires some critical examination, both in the context of India and Canada. These are:

(i) Porter has recommended a catalytic and stimulator role for the government. However, in developing countries many of which are in the "factor driven" stage of development³, it is not entirely clear that governments could rest content with such roles, and not play a more direct role at least in the case of some industries. Even in a free market economy like Canada which is also, to a considerable extent, a resource based economy, the role of the government seems to need a close look.

(ii) The role of direct foreign investment. This factor is given a low weightage by Porter, but this view has been challenged by Rugman, D'Cruz and others⁴.

(iii) The role of the home demand. The export based industries in some countries, especially South East Asian Countries, leads one to doubt whether development of a large and sophisticated home demand is vital to the development of competitiveness of industries.

Other issues that arise for formulation of public policy are:

(i) Given that some industries are likely to be more promising than others in attaining global competitiveness, should the government really be satisfied with giving "general signals" rather than giving particular support to these industries? With limited resources at its disposal, how should the government proceed?

(ii) Should the government attempt to formulate policies incrementally with regard to the diamond factors, or should it put up a bundle of coherent policies all together? The question is important because governments frequently lack the capabilities to take too many initiatives all at once.

Methodology for the Study

3. Ibid., Chapter 10.

4. Alan Rugman, "Diamond on the Rough", Business Quarterly, Winter, 1991; Alan Rugman and Joseph D'Cruz, "The Double Diamond Model of International Competitiveness: The Canadian Experience", Management Review, 33(2), (Special Issue), 1992.

For our study, we selected industries that had a good export performance in free markets and were influenced by government policies. In India, we selected the automobile component industry, leather industry, garment industry and processed food industry. In Canada, we selected software and telecommunications industries. This paper deals only with the automobile component and the leather industries.

The data for the study were collected from secondary sources, and extensive interviews were conducted with industry association representatives, executives and government officials.

The export performance of these industries were first charted on a time scale and the government policies were also charted on this time scale. The linkages were seen by juxtaposing the two series of data. By this method, it was possible to identify the periods when different policies were formulated and what bundles of policies were formulated, and what changes in export performance took place. From further discussions of these data with industry and government executives, the implications were sought to be drawn.

AN OVERVIEW OF INDIA'S POLICIES

After Independence, India followed policies that were essentially inward looking. The policies, strongly influenced by the ideology of India's first prime minister, Mr. Jawaharlal Nehru, centred around (1) a preeminent role for the State as an entrepreneur controlling the so called "commanding heights of the economy" (2) emphasis on industrialisation, especially in heavy and basic industries, with a view to develop indigenous capacity as well as capability, (3) a closed model of economy based on the Harrod - Domar model. Integration into the world economy and gaining international competitiveness were not considered so important as to "self reliant". There was also a mistrust of the private sector regarding its ability and willingness to contribute to the industrial development, which was a part of a socialist vision Nehru envisaged for the country. We present below the policies very briefly.

Licensing Policies. In 1948 and 1956 Indian government framed highly restrictive licensing policies and extensive areas of operation were reserved for the state sector enterprises. In addition, there were many areas which were reserved for the small scale sector, in which large industries were not allowed to compete. In 1970, the Monopolies and Restrictive Trade Practices Act (MRTP) was enacted, which made it difficult for large firms and business houses to expand their capacity. An Industrial Policy Statement (IPS) was issued in 1973. This statement contained a list of industries (in its Appendix I) to which new production by business houses and foreign companies would be confined, subject to licences, of course. These were industries in the so called "core" sector or those which were considered to be high priority. There were also two schedules, schedules IV and V of this Act, which specified industries in which licensing was compulsory for all firms irrespective of size. As a result of these regulations, the capacities in many industries became fragmented (except those in the state sector), and industries became progressively uncompetitive globally. Also, these policies stifled firms' rivalry and getting a licence virtually assured a firm of profits; "managing the government" became the main factor in deciding the competitive advantage of firms.

In 1973, the Foreign Exchange Regulation Act (FERA) was passed, which set severe limits to foreign investment, the scope of foreign subsidiaries in India and even on Indian firms going abroad.

Starting from 1980, certain liberalization of policies took place. Capacity expansion was made easier; technology imports were also made easier. Automatic diversification in related industries was allowed, the so called "broad banding" of industries, so that some economies of scope could be achieved. Some restrictions on expansions were removed, if the new industries were set up in backward areas. But this raised the cost of products and led to decisions being taken on considerations like the duty concessions available rather than based on long term competitive advantage.

Licensing was liberalized in 1985. The asset limit for defining business houses was raised from Rs.200 million to Rs.1000 million, and the houses could enter any industry (i.e., it was not necessary for large business houses to confine themselves to Appendix I industries under IPS, 1973), provided they went into backward areas, and produce anything not reserved for the small sector. 25 categories of industries including electrical machinery, electronic components, machine tools and industrial machinery, bulk drugs etc. were delicensed. 22 industries were opened up for MRTP/ FERA companies provided they were willing to locate such industries in backward

areas. MRTP companies were allowed to directly obtain licences for 27 industries without supported to MRTP restrictions. Liberal imports of technology and foreign collaboration were allowed. In 1988, the number of industries requiring licensing in the case of MRTP/ FERA companies was reduced from 77 to 26.

In 1991, there were major steps taken. Licensing was reduced to cover 16 industries, mostly in the nature of those using scarce materials, those which used hazardous processes, energy industries, consumer durables and strategic industries. Appendix I was abolished, and the distinction between business houses and other companies was removed. The number of industries in which state enterprises had a monopoly, was reduced to 8, and a list of certain industries in which the state would dominate was abolished, making it possible for private sector industries to operate in. Schedules IV and V of 1973 IPS, which specified licensable industries, were abolished. Although the reservation policy for small sector continued, business houses could now take equity in SSIs upto 24 percent, thus giving some opportunity for backward integration.

In 1993, the number of industries reserved for the public sector was further reduced to 6; motor car and "white goods" industries were delicensed; so were raw hides and skins leather and patent leather. The number of items in which licensing was compulsory was reduced to 15. Readymade garments were thrown open to large sector, with some conditions on export and investment. For all practical purposes, licensing came to an end.

Thus we see a progressive liberalisation in industrial policy starting from the eighties. These changes came in spurts: in 1980, 1985, 1988, 1989 and 1991.

Trade Policies. Trade policies were highly restrictive with stiff controls on imports right upto 1978. There were specifications on what could be imported, who could import them, from whom, the quantum of imports permitted etc. and these lists occupied volumes. Exporters were sought to be encouraged through allowing concessional or duty free imports against their exports, though against an import licence. Exporters were given cash compensatory support (CCS) to offset high domestic taxes, excise duty etc., duty drawback schemes, packaging credit etc.

In 1978, the so called Open General Licence (OGL) was introduced, by which importers could import items that were included in the "OGL List" without itemised import licence. The import of capital goods was made easier by putting them under OGL. There was also introduced a Phased Manufacturing Programme (PMP). For licences for new plants, conditions were laid down that they had to reduce their import content over a period, usually a few years. This helped some indigenous producers in not only reaping large profits (for the import substitution was accompanied by tariff protection) but also in upgrading their products by bringing in the latest technology. Although certain industries like the automobile component industry, which had quality buyers at home or abroad, benefited from PMP, on the whole, it would seem that the effect of PMP was to make Indian products costlier and globally less competitive, and production, more fragmented. It also produced some distortions like a new manufacturer being at an advantageous position as compared to older ones, since the way PMP worked, the newer producer could import more equipment at a cheaper price.

In 1982, imports of 100 items of raw materials and consumables, and 85 new items of machinery were put under the OGL; import of technology was made easier. The rupee was also devalued by 20 percent.

In 1985, trade barriers were further lowered to stimulate exports and updating of technology imports. A number of new items, mostly raw materials and capital goods were placed under OGL; technology itself was placed under OGL, so that technology imports became easier. Duties on capital goods for projects were slashed from 105 to 45 percent ad valorem⁵. Export duties on a number of items like iron ore, manganese ore and cotton were abolished. In this year, the so called Replenishment Licence Scheme (REP) was also introduced, by which importers could import their requirements against their exports or those of others who could sell their REP licences. Thus in a sense, market mechanisms were substituted for government control.

5. Twenty five percent for the power sector and duty free for fertilizers.

The way projects was defined, however, such that it benefitted only those going in for major capacity expansion or setting up new units. Specifically, it did not cover modernisation of existing units. This limited the attempts of firms to upgrade themselves technologically through modernisation.

In 1990, there was some more liberalisation. Customs tariffs were further reduced, and for manufacturer - exporters, import duty on all types of capital goods was reduced to 25 percent. There was one small retrograde step in this year: import of second hand plants were brought under licensing.

In 1991, major changes were introduced. The rupee was devalued in July 1991, and shortly thereafter, the Cash Compensatory Support (CCS), a subsidy to offset higher domestic prices, was withdrawn. Importers no longer needed to get replenishment (REP) licenses to get their imports, but had to get their foreign exchange through the so called eximscrips - a tradable licence for imports against exports trade by an body. Later, in 1993 these were also abolished and the rupee was made convertible on the trade account, so that imports had to purchase foreign exchange on the open market.

By 1993, the list of items permitted for imports was replaced by a "negative list" of banned/ canalised/ licensable items, and this was quite a short list. Maximum import duties was reduced to 150 percent in 1991; 110 percent in 1992; 85 percent in 1993 and 67.5 percent in 1994. Average duties have, of course, been much lower. In 1990 and thereafter, customs duties were lowered progressively, and capital goods could be imported with automatic clearance. The rupee was also devalued in 1991 to make the exports more competitive, followed by further tariff reductions.

Policies towards Foreign Investment. India's policies towards foreign direct investments was hostile for a long time. FDI was permitted only in a very limited number of industries which were considered to be in the nature of "core" high technology industries. MRTP enacted in 1970 made it very difficult for foreign firms to invest; the Foreign Exchange Regulation Act (FERA) enacted in 1973 further tightened the grip on foreign investment. Only in 1982 were some steps taken to attract foreign investment. MNCs were allowed to increase their foreign equity and collaboration with Indian firms; for export oriented units, foreign could be 100 percent. In 1991, the government allowed FDI without prior clearance so long as the equity was not over 51 percent and the products belonged to a certain list, essentially of items in modern industries and with advanced technologies.

Monetary and Fiscal Policies. In monetary and fiscal policies, the government had total control and pursued highly restrictive policies. In 1969, banks were nationalized, and lending to small sector (at highly concessional rates) was made obligatory for banks. But money supply, and hence credit was tight; thus the small scale sector industries became victims of credit squeeze. This was aggravated by the high inflation in 1973 (20.0 percent) and in 1974 (25.2 percent). Many firms, especially in the small sector, became sick; the others became progressively uncompetitive, requiring ever expanding lists of reserved items and various subsidies. Interest rates were controlled by the Government, and these were high in nominal terms, which made the cost of capital in India very high. Even though, in real terms, the interest rates were not particularly high (3 to 6 percent), the high real interest rates served as a disincentive for firms to go in for capital intensive technologies and upgrade their existing ones. Here we see a major lack of synergy between the other policies and the monetary / fiscal policies.

This lack of synergy is seen again in 1985 - '86, when so many liberal policies were being introduced in other areas. In this year, the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) were raised, reducing drastically the funds available with the banks for lending. This led to shortage of capital and increase in the cost of capital, which affected the Indian industries' competitiveness. The interest rate charged to commercial banks by RBI was about 7 percent in 1973; in 1991 it was 12 percent. The rate charged by banks to their customers usually was about 2 - 4 percent higher; the rates for short term credit was even higher; in late eighties, it was around 20 to 24 percent). This disadvantage in the cost of capital continues to today, though now Indian manufacturers can raise loans abroad, with of course, government permission. Only from 1990 we see some reductions in interest rates and reduction in the rates of corporate taxation.

The only major positive development at this time seems to be that exports earnings were made nontaxable in 1989. This made exports very attractive to manufacturers.

India's Policies: A Critical Appreciation

Till about 1973, there had been no major policy initiatives which had any drastic effect on the Indian industry's competitiveness. Due to the protected market, restrictions on imports of good and technology, a system of licensing which led to neither cost reduction, innovation nor consolidation of capacities, the inherent factor conditions deteriorated. The capital resources in the country became highly restricted, costly and dependent on government, and there was little incentive to take risks. Infrastructure did get upgraded a great deal, but no where near what was needed: indeed, the infrastructure had perpetual capacity shortages besides the quality of the products and services being very poor and the cost, high. For example, uninterrupted power supply at a specified voltage, vital for many process industries and industries using sophisticated technology, was unimaginable.

Domestic demand was small in many industries and even here demand sophistication did not get built up. The state enterprises were big and powerful buyers who could have exerted a decisive influence on the quality of demand, but did not. Partly this was because their suppliers were mostly other state enterprises over whom wielding pressure was difficult; even when they could set standards, they neither had the will, the competence, nor the incentive to do so. The ubiquitous political system interfered wherever a powerful private supplier was involved, so that it became difficult for the state enterprises to act as agents for upgradation of the quality of demand. As for the private enterprises, in the highly protected environment, they had little motivation for upgrading the quality of their products, or demand high quality from their own suppliers.

Many of the policies were industry specific, as for example, those with import and excise duties. The rates varied a great deal between different products, and the months between November and February, when the annual budget was presented, were hectic months for the industries, which lobbied hard for getting favourable rates for themselves. The policy was so much directed at particular industries that there was no possibility of bringing up related and supporting industries in any systematic manner. The prosperity of an industry depended a great deal on its duty structure, and these could be quite different for related industries. For instance, capital goods industry was always treated separately on a different footing; hence no industry tried to develop its capital goods suppliers. Rather it would try to import its capital goods whenever it got an opportunity.

The policies were also tailor made to preclude healthy domestic rivalry. Such competition as was there was on procuring licences rather than on upgrading products and technology. The economy was based on shortages, so that even when there were multiple suppliers, they were not competitors. There was plenty of profits to be made by every one.

Lastly, there were many other policies which had a significant effect on the overall competitiveness of Indian industries. For instance, the labour policies were based on the appeasement of powerful unions. Little flexibility existed in redeploying and even retraining labour; this was helped by a most obliging legal system. Consumer laws were enacted only in the eighties and even then lacked any real power.

There were some attempts to break this state of affairs, but contradictions rather than coordination was the rule in government policies (except in some periods). For instance, in 1973 - 74, we see attempts to liberalise capacity creation through automatic expansion of capacity on the one hand, and licensing, FERA and MRTP restrictions that led to fragmentation of capacity on the other. Similarly there were attempts to encourage small scale industries (SSIs), but this was accompanied by a tight monetary policy that make it difficult for SSIs to even survive, let alone become competitive. Similarly, in 1976-77, there were attempts to liberalise imports without a coherent policy to encourage expansion of industries that could utilize these imports effectively; the result was that very soon the foreign exchange reserves that had accumulated got frittered away on unproductive imports.

A more coherent set of policies can be seen in 1985 - 86, where there were simultaneous liberalisations on industrial policy and trade policy. But this period also witnessed a very tight monetary policy, with record levels of CRR and SLR, so that the engine of growth sought to be created ran short of fuel to run it.

It was after 1991 that we see a better coherence. There considerable liberalisation in licensing; the trade policy has also been liberalised with incentives for foreign investment; technology transfers and foreign collaborations have been made easier. The devaluation of the rupee has led to a short term advantage in exports; and at least the bigger firms can raise finance abroad on favourable terms of interest.

We now present the case studies of the two industries studied: the automobile component industry and the leather industry.

INDIA'S AUTOMOBILE COMPONENT INDUSTRY

An Overview of the Industry

The automobile component industry has become a highly promising industry for India. In 1992-93, the total production of the automobile components industry in India was Rs.41.6 billion, and has shown rapid growth (see Exhibit 1 for the growth of this industry). Of this production, Rs. 5.0 billion (US\$ 189 million), or 12 percent, was exported⁶. The exports from India in 1992-93 constituted about 0.2 percent of world's exports⁷. Even though this is much below India's own overall share of the world trade (0.56 percent), considering that 55 percent of the world trade in this category takes place between three countries, viz., Germany, Japan and the United States, and 85 percent between 7 countries (France, Canada, U.K., and Italy in addition to the three countries mentioned above), and that most of this trade in this category is really between subsidiaries or between subsidiaries and the parent companies, the share of India in the remaining market is in reality much stronger than what the mere numbers would suggest. The exports in dollar terms as well as exports as a percent of production have been steadily increasing (see Exhibit 2), and exports are projected to touch 25 percent of production by the year 2000 A.D. The exports are in the more sophisticated segments of production. Nearly 40 per cent of exports are in the most sophisticated segment of all, namely, engine parts; another 16 percent of exports are in transmission and steering parts; about 15 percent are in suspension and braking parts. The exports are also to more sophisticated and competitive markets. North America (almost entirely U.S.) and West Europe account for nearly 40 percent of total exports, and 14.2 percent is accounted for by South East Asian countries. Between 1983 and 1992, the highest rates of growth (37.7 percent p.a. (compounded) to America and 34.7 percent to West Europe) also was registered in these relatively sophisticated markets. These are rough indicators of the industry's competitiveness.

There were five phases in the industry's growth. In the sixties and the first half of seventies, the growth of the industry was governed by the demand from domestic vehicle manufacturers (See Exhibits 3 through 6 for the trends in production of vehicles). Exports were difficult, and so was capacity building due to licensing restrictions. After 1975-76, some liberalisation took place, and the vehicle industry raised its production. There was some insistence on Phased Manufacturing Programme (PMP) during this period, although in the absence of a liberal approach towards foreign collaborations, PMP did not make much of a difference. After 1980, vehicle production went up consequent to liberalised licensing policies; the component industry took advantage of both the increased domestic demand from vehicle manufacturers and possibilities of exports. Comparing Exhibits 1 and 2, it may be seen that the immediate reaction of the component industry to the increased demand from the domestic vehicle industry was to reduce its exports, and increase its production to meet the domestic demand. But after about 1985-86, it could be said that component manufacturers started looking at exports as a good business, and not as a default option to be resorted to only to fill up capacities in case of dip in domestic demand. There was a sharp increase in production after 1983 due to a sharp increase in domestic production of vehicles, notably cars, but this time, and particularly after 1986, the exports became an independent business for many firms, as may be seen from the increase in exports despite a steady rise in domestic demand. But after 1990, exports as a percentage of production really shot up, from 8.2 percent in 1988 to 15.3 percent in 1991-92⁸.

From 1990, the nature of exports also underwent a change. Till then the exports were largely to replacement markets abroad. But at this time, the major car/vehicle manufacturers in the West started off loading component manufacture to other countries in a bid to reduce costs. This downsizing or "sourcing" strategy of overseas

6. Automobile Components Manufacturers Association of India (ACMA), Automobile Industry of India: Facts and Figures, 1992-93 (New Delhi: ACMA, 1994), pp.25,56.

7. In 1992, the world exports in autocomponents and accessories (SIC Classification 784) was US\$ 89.6 billion. United Nations, International Trade Statistics Year Book, 1992, Vol. II, (New York: United Nations, 1993).

8. Automobile Component Manufactures Association, Facts and Figures, 1992-93. (New Delhi: ACMA, 1994).

manufacturers was taken note of by at least some of the Indian manufacturers who sought to become OEM suppliers to foreign auto manufacturers.

In a sense, it showed the maturing of the industry with a promise to hold its own in the global market place.

The Autocomponent Industry "Diamond".

Demand. Since cars were considered a luxury, the car production in India was highly stagnant, both in terms of quantity and quality. There were only two car manufacturers in the country, and the output of both these firms could not go up due to restrictions on their expansion. In 1982, a State enterprise, Maruti Udyog Limited was established with collaboration with Suzuki of Japan, Suzuki having a 20 percent equity. Maruti Udyog set up a relatively large production capacity of 100,000 cars as against 78,600 for the existing manufacturers. Maruti pursued a vigorous indigenisation programme, which enabled the Indian auto component industry to build its volume of demand and its sophistication. The component industry's production rose dramatically from 1985, from Rs.5.3 billion on 1980-81 to Rs.7 billion in 1983-84 and to Rs.9.75 billion in 1985-86. Maruti adopted the standards of quality set by Suzuki, and component manufacturers experienced what it was to supply to a highly demanding buyer.

In the commercial vehicles segment, the increases have been less dramatic but still remarkable. Unlike the car industry, the commercial vehicle industry could increase its production steadily. Tractors, in particular, were given licences freely (being an agricultural equipment) and with emphasis placed on agriculture in the period 1976 to 1980, the demand and production of tractors went up dramatically. In the period 1981-85, following broad-banding, many manufacturers entered the Light Commercial Vehicles (LCV) segment (mostly with Japanese collaborations) and there was a steep increase in LCV production during these years. There was a temporary slackening of growth after 1985 due to recession, but following a general industrial revival and enhanced demand from the farm sector for tractors, the production of commercial vehicles rose sharply from 1987, as may be seen from Exhibit 4.

Exhibit 6 gives the production of two wheelers. There was a steep increase in the production in this segment, but their components have little export market, and the knowhow involved in their manufacture is not readily transferrable to the four wheeler segment. In view of their low impact on the global competitiveness of the component industry as a whole, the two wheeler segment is not considered any further.

On the whole, it appears that till about 1982 when the domestic demand for automobiles was very limited and was kept down by Government through its licensing policies, the component industry could not gain volume through catering to the domestic demand. Due to its low volumes and restrictions on capacity expansion, the industry could not get into exports also, since it was not competitive. But when the domestic demand got stimulated through the advent of Maruti and expansion of capacities for commercial vehicles, the component industry registered a sharp rise in production. It could attain at least some increase in production volumes.

The three upward kinks in production of components in 1979-80, in 1983-84 and 1986-87 correspond roughly to the sharp increases in vehicle production in 1977-78, 1980-81 and 1982-83. The lag is due to the time it took for the component industry to adjust itself to the enhanced demand and also because the replacement market develops only 2 to 3 years after the new vehicles are put on the road.

The sophistication of demand in the automobile sector provided by Maruti was reflected in the capability of the component industry. The Indian component manufacturers upgraded their quality through a series of foreign collaborations. Government policies towards collaborations also helped. In 1985, technology imports were put on OGL, making it much easier to enter into collaborations. A study of the number of collaborations in the component industry shows that before 1980, there were very few collaborations, and of the present number of collaborations, more than two thirds (418 till 1991) were concluded after 1985. After 1989-90, import of technology became virtually free of all restrictions, and Indian component industry took full advantage of these policies.

The results of the upgradations could be seen in the exports. Exports, both in terms of dollars and in terms of Rupee value shot up from 1986-87, analysis of the exports as a percentage of production shows that the increased

production did not merely go to satisfy increased domestic demand; the firms simultaneously started exporting also. In fact, when, in 1990-91 and in two subsequent years, domestic vehicle production dipped substantially due to increased excise duty on cars, and the domestic demand for vehicles fell, the component industry looked outwards and simply increased their exports, made possible by the increased competitiveness and confidence gained by many of the companies.

The increasing sophistication of domestic demand also led many components to perform quality audits and get the ISO-9000 certification. As on 1993, 13 companies had acquired ISO-9000 certification and many others were at different levels of preparation for getting the certification. It is expected that by 1996 almost all the large and medium scale manufacturers (almost all of whom are members of ACMA) will be accredited with the ISO 9000 certificate⁹. In this process, however, the Automobile Component Manufacturers' Association (ACMA), rather than the government played an important role. ACMA organised campaigns to motivate the companies to get ISO 9000 certification, and its executives went around the companies persuading the managements to start the process. According to the Chief of ACMA, this is one of their top priority objectives¹⁰.

But the government policies also ensured that the demand at home did not even follow, let alone anticipate developments abroad. Even Maruti's contribution in this area seems to have been small.

Effect of government policies on demand. The restrictive government policies on car and even commercial vehicle production limited the domestic market for automobile components. The initiative of the government in setting up Maruti gave the industry the much needed volume, and the Suzuki collaboration, the sophistication. This seems to have increased the confidence of the component manufacturers, who no longer considered exports as a default option, to be resorted to only in times of low domestic demand. The sophistication needed in the components required improved technology, which it became possible to import thanks to the government's liberalizations of the import of technology and the import of capital goods.

Factor Conditions. The labour available in India is relatively cheap, and fairly skilled but not so productive. The automobile component industry has tried to reduce the labour content in its products progressively making this factor advantage less important. M/s Wheels India, a company manufacturing wheel rims, reduced its wages as a percent of total costs from 9.8 percent in 1975 to 5.9 percent in 1990. Another company, M/s Sundaram Fasteners manufacturing fasteners, cold extruded components, radiator caps etc. reduced its wage component from 21 percent in 1975 to 7.1 percent in 1990¹¹.

Component industry, however, functions in the general milieu of Indian industry, and the quality of its labour is still important. In an international comparison of human resource development across countries, the World Competitiveness Report, 1990 gives some figures that cannot be flattering for India¹². In terms of worker motivation and labour flexibility, India compares poorly with other countries, especially competitors like Brazil, Thailand and South Korea; somewhat comparable in terms of managerial initiative; but quite favourably in terms of skilled labour availability and managerial education. The industry has done little to upgrade the quality of its manpower.

Government labour policies have generally been pro-labour, making it difficult for managements to restructure or even improve processes. Exit policy has been (and continues to be) nonexistent. The result has been a tendency on the part of management to opt for more capital intensive projects so that they could employ less people. In a convoluted way, this has led perhaps to an enhancement of competitiveness of this industry.

9 Interview with Mr. Srinivasan, Executive Director, ACMA.

10 Interview with Mr. Srinivasan

11. The figures are taken from the firms' Annual Reports.

12. For details, the reader is referred to the original report, or to extracts in Pankaj Chandra and P.R. Shukla, "Manufacturing Excellence and Global Competitiveness", Economic and Political Weekly, February 26, 1994, pp. M-3.

Raw material availability, especially steel (even ordinary steel) had been a problem especially in the seventies, both regarding availability and cost. Domestic prices in all categories of steel were much higher than international prices, and in some categories two to three times higher. This hurt component industry badly. Many special materials needed could not be imported unless they were used in components meant for export; this was very difficult with the small volumes that were possible at that time. The local excise duties and import duties were high, so that inherently local manufacturers started with a cost disadvantage. The situation turned around to some extent only in the mid eighties but even now Indian steel is costlier than steel abroad. But in 1990, the liberalization of imports led to the possibility of the manufacturers importing steel if they chose to, at international prices. At least the larger firms could also borrow abroad, thus reducing their cost of capital.

It is difficult to say how the rupee exchange helped the industry. It would seem that the latest devaluation in July 1991 helped the exporters a great deal although this advantage due to devaluation may turn out short lived.

Effect of government policies on factor conditions. The general policies of the government discussed earlier led to the creation of a high cost economy, in which the inputs were very expensive, as for example, steel which we noted above. Even these were not available due to restrictions on imports. These factors, along with the tight credit policy in the seventies (particularly to the medium and large sized undertakings) prevented these firms from taking advantage of such liberalisations as were done, as for example, in 1973-74, and 1975-76 (automatic expansion of capacity, introduction of OGL and increase of items in IPS from 180 to 504). But when, as in 1985-86, a more consistent set of policies were in place (liberalisation of capacity expansion, broad banding, OGL imports of REP licences for capital goods, raw materials and technology, increase of the limit for classifying an industry as small scale etc.), the effect was much more pronounced. The largest "leap forward" came in 1990-92 when liberalisation was effected on a multitude of areas. The two major effects were on the cost of materials and cost of capital. Even though freely importable, raw materials could now be imported quite easily against export earnings, and manufacturers could now get materials at international prices, if they choose to. Earlier, the cost of capital in India being very high (18-20 percent and even higher for short term requirements), this put Indian manufacturers at a disadvantage. But now Indian companies can raise funds overseas (although not freely: Government approval is needed), and they can get capital at international rate (of course, they have to bear the exchange risks!).

Government can play a major role in creating more favourable factor conditions by enabling firms to upgrade their technology. This is usually an area where firms, on their own, are either unable or unwilling to invest three devices commonly employed by governments are (i) setting up facilities for research, quality improvement and testing; (ii) setting up facilities training for manpower and (iii) setting up institutes to acquaint the industries with overseas developments. But there have not been any major initiatives from the government.

The Government followed labour policies that, in retrospect, seem to have benefitted neither the labour nor the industry. Exit was made virtually impossible by making it incumbent upon companies to seek government permission for closure of any unit; this permission was usually not given. Also, the protection to labour was so high that the resultant labour force was extremely militant and unreceptive to changes, including skill upgradation. This is a factor that seems to have bothered the component industry representatives a great deal (as no doubt it must have bothered many other industries, too) as may be seen from the annual speeches of many Presidents of ACMA¹³. Such labour upgradation was vital for the component industry.

Thus on the whole, the government policies seem to have resulted in the progressive deterioration of the factor conditions. While the government directed its energies to help one industry or another through means such as preferential duty structure, more liberal licences, easier availability of credit etc., the industry as a whole was declining due to the deteriorating factor conditions. Creation of certain general incentives like the tax free status for export earnings seem to have been by far the most effective mechanisms.

Related and Supporting Industries. The capital goods industry in India was protected, but a number of manufacturers came up who could manufacture quite sophisticated machines. But these were not globally

13. See, for instance, the Presidential addresses of the ACMA at the General Meetings for the years 1979, 1980 and 1982.

competitive in terms of cost. The auto component industry seems to present little evidence of any positive interaction with the machine tool industry.

Effect of government policies on related and supporting industries. Due to the extremely complex set of rules for customs, excise etc., it has never been possible for the government to view an industry in terms of its upstream, downstream and related industries. One constant problem, for instance, has been the conflict between the interests of the capital goods industry and the manufacturing industry. Importing capital goods at lower rates of duty is obviously in the manufacturer's interest, while the capital goods industry protests against such imports, on the grounds of threat to indigenous capital goods industry. For the automobile component industry, which usually has a sizeable component of machines in its set up, this issue has always been of importance. The government has tried to balance these two conflicting interests by keeping a fairly high duty on capital goods, with periodic relaxations. But numerous anomalies cropped up, as for example when in 1985 the Government reduced the customs duty on project imports from 65 to 45 percent, but denied this benefit for machines imported for modernisation.

But the Government policies failed to develop a vibrant, globally competitive machine tools industry, which affected the other industries too. The one major initiative was setting up of Hindustan Machine Tools (HMT) in the fifties. This firm became known for its high quality machines over a fairly wide range (but not price competitive), but after seventies got into serious problems. The fact was that with relatively lower duties on machine tools, consuming industries often found it better to import these machine tools than purchase them locally; frequently collaboration agreements had supply of machine tools as a desirable or mandatory clause (with financing given as an attraction). On the other hand, the machine tool industry found itself in an environment of costly inputs so that the industry could never become globally competitive and export led. Thus government policies, in trying to balance between the interests of consuming industries and machine tool manufacturers fell between two stools as far as this industry is concerned. Instead of creating a mutually complementing and symbiotic cluster, the government made the machine tool and component industries competitors for government incentives.

Firms' Strategy, Structure and Rivalry. The component industry in India developed along two lines: one a large number of small component manufacturers, and the second, a relatively small number of medium sized firms (by Indian standards) tending to specialise in a narrow range of products. The industry consists of 200 units in the large and medium sectors and about 5000 units in the small sector¹⁴. The industry has an extremely low degree of concentration. The top 10 manufacturers account for nearly 2 percentage of the industry's turnover; the top 20 nearly 3 percent; and the top 50, nearly 4 percent¹⁵. There has been a strong incentive for small firms to stay small, thanks to the government's incentives to small scale industry. These incentives were such that the larger competitors were at a considerable cost disadvantage, although the small units could not compete on quality. But the policies of the government regarding the automobile sector ensured that even the large automanufacturers had no great incentive to be conscious of quality, and most were absolutely devoid of any such consciousness. Thus the stage was set for evolution of a component industry that could neither produce materials in large quantity nor of good quality. Rivalry among the small firms did exist, but the market essentially being a sellers' market, not much upgradation of quality took place. Nor does R&D seem to have been an objective of any priority among the Indian component firms.

One kind of rivalry that did not do any good to the competitiveness of the component industry was the rivalry between small and medium/ large firms. The government had a policy of reserving items for production solely by SSIs and from time to time this list was enlarged. In the period 1976-78, a large number of items were added to this list by the then Government which believed ardently in SSIs. But not all the items so reserved were suitable for manufacture by SSIs; many were quite sophisticated and needed close quality control. Since these

14. M.R. Dixit, "India Auto Component Industry: Learning to Export and Grow" (Ahmedabad: Indian Institute of Management, 1994) (Working Paper No.1189). The figures given are as on 1992.

15. Data compiled from ACMA, Buyers' Guide, 1992-95, from the turnover of the various manufacturers given therein. The book gives only the data for the firms who are members of ACMA, but since practically all the firms of even medium size are members of ACMA, this is hardly likely to make any difference.

components went into subassemblies and final vehicles, a problem of lack of reliability of the eventual product arose, which greatly bothered the industry¹⁶. The situation also led to lobbying by SSIs for getting more and more items reserved for themselves, and by larger firms seeking more items to be taken out of the list.

On the whole, therefore, the strategies of most of the firms were inward looking and aimed at staying small. The rivalry was limited, and there were no incentives to upgrade quality of the products or skills of their manpower until the government policies changed, making it profitable and desirable (in some cases essential) to do so. Profitability could be ensured due to the nature of the domestic market; exports were neither very profitable (until 1989) nor necessary. This was, of course, not true of some of the firms who developed a global outlook and tried to produce world class components. And it was these firms that led the pack in global competitiveness.

Effect of government policies on firms' strategy, structure and rivalry. As noted earlier, the government policies did not foster any great rivalry between units. In the licensing era, firms were more than content to produce the materials as per their licences and reap the profits. The incentives for small scale industries ensured that many firms stayed small and uncompetitive.

Small firms could not take full advantage of even the special facilities offered by government, as for example, in imports. These firms did not generally have the needed resources to import materials, and in any case their requirements were too small. The government did set up some agencies to bulk the SSIs' requirements of materials (both domestic and imported), but these were usually inefficient, incompetent and, quite often, corrupt. As pointed out by one of the Presidents of ACMA in 1971, "perhaps the most annoying hurdles that hamper the growth of small scale industries are the nonavailability of finance and raw material in time, apart from the delays in obtaining permits and licences"¹⁷. Similarly, the tight monetary policy followed in 1973-78 largely negated the benefits of other liberalisations, for medium and large firms found it very difficult to get bank credit, and despite all the "priority sector lending" requirements, small firms also found it difficult to get the needed credit from the Banks. In fact, most of these firms were permanently in a state of cash crunch, and quite often depended on the cash realisations from one order in order to finance the next. For this reason, they could not even take advantage of the incentives offered for export, for most of these incentives were in the nature of reimbursements, which took a long time to materialise. More, they demanded the keeping of documents of such detail and variety that were beyond the reach of small firms.

Some of these lack of synergies in government policies affected even the medium and large firms. The credit squeeze of the seventies and early eighties, especially severe for large firms, meant that these firms had to borrow from the open markets at very high rates of interest, affecting their competitiveness. Similarly, the import duty structure has always been a bone of contention, especially the "anomalies" between duties of finished components or assemblies and components. For instance, even in 1994, vehicle manufacturers are permitted to import finished components at 50 percent duty, while component manufacturers are to import their inputs at 85 percent duty, thus putting the component manufacturers at a competitive disadvantage.

The policies of the government to encourage setting up of industries in backward areas resulted in location of industries in such areas, driving up their cost. The government did little to improve the infrastructure in such areas (except in some particular townships) so that many which located their facilities in such areas discovered that their high costs due to higher expenditures on communications, power etc. outweighed the incentives offered by the government. Strategies of firms were unduly influenced by these incentives, and eventually turned out to be counterproductive.

It was only in the post 1990 period that a more synergistic set of government policies began to emerge, addressing simultaneously to different areas like trade, licensing, credit, industry structure etc. Allowing larger

16. See for instance, the Presidential addresses by Mr. S. Muthukrishnan in 1978, Mr. V. Chidambaram in 1981 and Mr. Abhay Firodia in 1982 at the annual meetings of ACMA. Some items reserved for SSIs included filters, radiators, leaf springs and some rubber parts.

17. Presidential address by P.V. Shah, President, ACMA, March, 1971.

firms to take equity in SSIs (in 1992-93), for instance, is expected to change the de facto structure of the industry, though evidence on this is not yet available. The liberalisation of licensing has reduced entry barriers and has led to a keener rivalry among domestic firms. The removal of restrictions on locating industries means industries can now locate in places more economically viable.

The various government policies were not even taken advantage of by many firms. In a study, Dixit found that fiscal incentives and export incentives were made use of by firms quite frequently (by about 20 out of 34 firms surveyed), and standards testing and certification services to moderate extent (12 firms). Other incentives including (surprisingly) special technology loans and grants training incentives, government procurement etc. were used only by a very small number of firms¹⁸. Also, it was the larger and medium scale firms rather than small firms that in fact made use of these policies. Thus despite intentions small industries did not or could not take advantage of the incentives provided by the Government.

The government has generally been indifferent to and ineffective regarding the problem of low quality and spurious spares. It also has not taken any steps to certify garage shops, which have proliferated, and are a ready market for cheap and spurious spares. Though Indian standards specifications exist for certain components, they do not cover the majority of the automotive components. In any case the efficacy of enforcement of these norms has been very doubtful.

Automobile Component Industry and Government Policies: A Critical Appreciation.

The policies of the government have, by and large been fragmented and lacked synergy. The component industry was targeted by the government as a promising industry, but the policies in regard to small industries prevented the industry from taking advantage of the economies of scale and become globally competitive. Similarly, while on the one side the government tried to promote the small industry through various incentives, the credit policy made it difficult for these industries to take advantage of these facilities.

In 1980-81 and 1985-86, there were some synergistic policies, but the sheer increase in demand and the sophistication brought about by Maruti seem to have been the main factors responsible for the improved production performance in components. However, these got translated into export performance partly due to the industry developing a broader vision and treating exports as a part of their strategy, and partly due to the exports becoming attractive after the exemption of export earnings from taxes.

It was only in the post 1990 period that a set of synergistic policies began to emerge, addressing simultaneously to different areas like trade, licensing, credit, industry structure etc. After these bundles of policies, the export performance of the component industry showed a remarkable increase.

On the whole, then, it seems from a study of the auto component industry, that rather than a particular policy, a set of consistent policies can lead to rapid increase in competitiveness. These policies must be addressed simultaneously to all the four factors of the "diamond" - perhaps rectifying lacunae in one area if they exist, but trying to enhance the factors simultaneously. The effect of such a coordinated set of policies is quite dramatic, as may be seen from the post-1990 experience, and to some extent, from the liberalizations in 1985 - 86.

The study of component industry also highlights the highly beneficial role of government intervention in terms of (i) stimulating demand, and (ii) providing the sophistication of demand, if necessary, through State enterprises. There seems to be little doubt that the advent of Maruti changed the face of not only the car industry, but the automobile component industry as well. It altered the quantity as well as the quality of the home demand.

INDIA'S LEATHER INDUSTRY

An Overview of the Industry

18 Dixit, Op.Cit., pp.6.

The leather industry is one in which India has a good competitive position globally. India's exports in world exports varies a great deal among different segments of this industry. India does not export raw or semiprocessed hides and skins as per government policy, since these are retained for conversion to finished leather and leather goods. In finished leather, its exports constitute about 3 percent of world exports; in leather manufactured articles (including leather garments), its share is as high as 16 percent; in foot wear components its share is probably around 8 percent, and in footwear, around 0.6 percent. Since the share of India's overall exports in the total world exports is 0.56 percent, leather industry as a whole very well qualifies for being considered as an industry in which India is globally competitive¹⁹.

The composition of India's leather exports is as follows: the highest share of 25.5 percent is claimed by leather garments and leather goods have a share of 20.4 percent. Footwear and components together constitute 32.2 percent of leather exports, and finished leather, 22.0 percent.

Most of India's leather exports (about 60 percent) are to West Europe; in this region, Germany, Italy, U.K. and France are the principal countries that import Indian leather and leather products. North America accounts for about 18 percent of Indian exports; all other areas together account for 22 percent. Competition in these markets is intense from Newly Industrialised Countries like China, Korea, Taiwan etc.

The leather industry has been a major foreign exchange earner for India. As on 1992-93, leather (including footwear and foot wear components, leather garments and leather goods) was the fifth largest item of export for India. Exports of leather and leather products amounted to Rs.36.92 billion in 1992-93 constituting 6.92 percent of India's exports. Since most of the leather production units in India are in the cottage and small sectors, reliable statistics on production and employment are hard to come by, but according to one estimate, the exports in this industry constitute about 66 percent of the total production in the country, making it one of the most highly export oriented industries of the country.²⁰ It employs about 1.4 million people, of whom about 0.6 million are engaged in the most labour intensive component of the industry, namely, flaying. Leather industry, in most of the segments, is labour intensive and this, in view of India's low cost of labour, contributes to competitive advantage on this industry, at least in the short run.²¹ The capital investment required per job created in this industry ranges between Rs.20,000 to Rs.35,000,²² as compared to an average of about Rs.100,000 for all industries. Thus for a capital scarce economy, this industry is attractive from the point of view of employment and output generation. It has therefore been an industry that has engaged considerable attention from the government with a view to enhancing its export potential.

Leather industry is one of the earliest industries of India, and even before Independence, Indian leather and, to a very small extent, leather goods were exported, mainly to U.K. After 1960s, due the closing down of tanneries in the Western countries, tanning capacity in India increased. In 1972, the Government, in order to increase the exports of finished leather and leather goods, restricted the exports of semifinished leather and banned those of raw hides and skins. The result was a dramatic increase in the exports of finished leather.

Exhibit 7 shows India's leather exports²³ over the years from 1972-73 till 1992-93 (both in rupee terms and dollar terms). The rate of growth in rupee terms, in the first half of 1970s seems to be uneven, with an overall growth rate of 6.1 percent p.a. (compounded) between 1972-73 and 1975-76. After 1975-76, the rate of growth has been much steeper: an overall growth rate of 12.7 percent p.a. was achieved between 1975-76 and 1980-81. This growth rate slowed down slightly to 10.6 percent p.a. over the next five years, with not much variation from

19. As per Michael Porter's measure of the global competitiveness of an industry. See his Competitive Advantage of Nations, pp.287.

20. "Leather Report", Economic Times, 3 November, 1995, pp.20 (special supplement on Andhra Pradesh).

21. We would argue later that overreliance on this factor has led to the industry not realizing its full competitive potential vis-a-vis its South East Asian competitors.

22. "Leather Report", op. cit.

23. Unless otherwise mentioned, when we use the terms "leather exports", it would mean exports of leather in different forms and all leather products.

year to year. However, after 1985-86, there has been a remarkable growth in exports; it has been 31.0 percent p.a. between 1985-86 and 1990-91; the growth has also been much steadier. In the last two years (1991-92 and 1992-93), there seems to have been a decline in the growth rate to around 20 percent p.a.

In dollar terms, however, the picture is somewhat different, notably over the five years from 1981-82 to 1985-86. Between 1972-73 and 1975-76, there was hardly any growth in dollar terms. From 1975-76 till 1980-81, the dollar rate of growth of exports followed the rupee rate of growth. Between 1981-82 and 1983-84, the rupee fell sharply; thus the rate of growth in dollar terms between 1981-82 and 1985-86 was only 2.8 percent p.a. But after 1985-86, despite a continuous fall in the value of the rupee, the exports in dollar terms continued to rise till 1991-92. In 1991-92, there was a heavy devaluation of the rupee, and the growth of exports, though impressive in rupee terms, became much less so when viewed in dollar terms; in fact the dollar exports in 1992-93 was marginally less than those in 1990-91.

Exhibits 8 through 13 give a breakdown of India's exports over the same time period in terms of different kinds of leather export: semifinished/ finished leather, footwear and footwear components and leather garments and goods. In 1972-73, semifinished leather constituted practically the entire leather exports. The export of semifinished leather was more or less steady at around Rs.1500 million till 1976-77, after which it fell to about Rs.1000 million in 1977-78. It remained steady there till 1980-81, when it fell drastically to about Rs.500 million, at which level it continued till about 1988-89, after which it declined, reaching zero by 1990-91.

Finished leather export increases, however, more than compensated the drop in exports in semifinished leather. From a low level of Rs.171.84 million in 1972-73, finished leather exports increased to Rs.2267.88 million in 1980-81 and further to Rs.8180.50 million by 1992-93. After 1980-81, most of the exports in this category came from finished leather. But by and large, it was after 1983-84 that exports of finished leather seem to have taken off.

But in dollar terms, the increases of semifinished/ finished leather exports have not been impressive. Between 1972-73 and 1992-93, the increases have been only about 50 percent, and even in the best years (1986-87 to 1990-91) the increase has never been much more than 100 percent²⁴. Thus the main increase in exports of leather and related items in dollar terms did not come from the semifinished/ finished segment.

Footwear and components, however, present a different story (Exhibits 10 and 11). The growth in footwear exports (in rupee terms) from 1985-86 is noticeable. Component exports have steadily increased till 1990-91, after which year they have registered a very sharp rise in the growth rate. Even in dollar terms, the increase in exports of footwear and footwear components has been steady and increasing after 1985-86.

In leather garments/ leather goods sector (see Exhibit 12 and 13), exports were negligible till 1986-87 at which point they registered a very sharp increase, especially leather garments. Between 1985-86 and 1990-91, the exports of leather garments and goods, in rupee terms, increased at the compounded rate of 54.35 percent per annum, a truly impressive performance. Even in dollar terms, the increase was 45 percent per annum in this period.

The overall picture which emerges is that India's leather exports have shown a steady increase which became much higher after about 1985-86. The trends in exports of different segments shows that over the years the share of value added items like footwear and leather garments has been steadily increasing, while lower value added segments like finished or semifinished leather have been registering a drop in their shares. Exhibit 14 shows the changes in the composition of India's leather exports in the different segments.

From 1985-86 onwards, consequent to certain other policy initiatives, the composition of exports shifted to value added items like footwear and leather goods / garments. From a situation in 1972 when 83 percent of leather exports consisted of unfinished/ semi finished leather, by 1985, semifinished leather accounted for only 10 percent and finished leather accounted for about 50 percent. By 1990, finished leather contributed only 25

24. Except for one single outlying year of 1979-80.

percent of exports; the rest being from value added items (footwear, garments and goods). Between 1987 and 1992, India increased its exports relative to the world imports by a factor of 3 in the case of leather garments.

Exhibit 15 gives the share of India's exports as a percentage of world exports over the years 1980 through 1992. It may be seen that in all value added segments, India has been able to improve its share over the years. The largest increase has been in the field of leather manufactured articles.

Leather Industry Diamond

Demand. The absence of domestic demand in leather garments, due to India's climate, has led to this segment to be almost entirely export oriented. This seems to have cut both ways. On the one hand, the industry has been producing world class materials right from the beginning and had no choice but to be internationally competitive. Even though relying almost entirely on factor conditions (lower labour costs and cheaper indigenous skins), the industry has been aggressive in importing high quality capital goods and accessories and fittings for garments. This helped the industry in producing fairly good quality garments. On the other hand, the different firms in the industry could neither cooperate to gather information about fashion trends in the world market nor could they do so individually. Indian manufacturers therefore have depended on foreign buyers for designs and even patterns. Since foreign buyers do not necessarily have experience in designing garments the patterns given by them have created problems, including rejection of garments. Also, competence in training of technicians, designers and patterns did not develop in India, either in the form of trainers or training institutions. Lastly, absence of domestic demand made it unviable for quality supporting industries manufacturing accessories like zips, buttons, linings etc. or related industries like leather sewing machine industry of international standards. Even with liberal imports, Indian manufactures often find it easier to make do with on indigenous materials, and this has often led to problems of quality.

In the case of footwear, although about 450 million pairs are consumed in the country, these are open shoes (*chappals*), which cannot be exported to the main customer countries. Ladies' shoes and sandals have some potential for export.

Hence the domestic demand in footwear and uppers is fundamentally distinct from export demand. There is a cleavage, in terms of quantity as well as sophistication, between demand for domestic consumption and export. This situation is unlikely to change in the near future because of the general level of poverty in the country. Incidentally, in most of the major footwear exporting countries, the domestic market is not very large (e.g., Italy, Taiwan and Thailand).

The domestic demand for leather is, of course, tied up with the demand for end products. Due to the increase in the quantity and quality of leather products, the demand for better quality finished leather has been steadily increasing. However, due to various constraints in factors and government policies, the supply has not always matched the demand both in terms of quality and quantity.

Effect of government policies on demand. Government policies have affected mainly the pattern of demand for leather in its various stages, rather than end products like garments and shoes. The domestic demand for garments is governed more by the climate than on government policies. As for shoes, perhaps there is emerging an affluent class which can afford to buy shoes at the upper range (Rs. 1500 or \$ 50-60). The excise duty on shoes has perhaps depressed the demand to some extent, though to what extent the price has been the determining factor in determining the habits on wearing of footwear is not clear.

The demand for finished/semifinished/ raw leather, of course, depends on the composition of demand for final products. But the demand for leather at different stages of finishing has been influenced by the government policies. In pursuance of the recommendations of a committee set up in 1972 (the Seetharamiah Committee), the government banned the exports of raw hides/skins and imposed quota restrictions and an export duty of 25 percent on the export of semifinished leather. These measures increased the domestic availability of leather, and the result has been a sharp rise in the increase of value added exports at the expense of export of leather at the lower end of value chain (see Exhibit 14).

Still, there were no restrictions in export of finished leather, and industries using finished leather found domestic availability of finished leather a problem. In pursuance of the recommendations of another committee (the Pande Committee) set up in 1985²⁵, the government sought to improve the availability of finished leather through three steps: (i) encouragement of investment in finishing capacity; (ii) allowing duty free imports of finished (bovine) leather; and (iii) doing away with the then prevailing 40 percent export obligation on the part of finishing units. These measures did stimulate the demand for domestic leather by improving both the quantity and quality of supply. This committee also recommended that footwear be made the main item of export in the leather sector, and the government accepted this recommendation. As a consequence, after 1985-86, exports of footwear shot up, and the demand for better quality finished leather emerged. Easier availability of finished leather stimulated movement of the product industry to higher quality products, and this, in turn stimulated domestic leather finishers to supply better quality leather. For even though imports could be resorted to, this was not easy for smaller units, and even for bigger units, the time delays and uncertainties associated with imports made imports a definitely inferior option, if domestic leather of comparable quality were available. Many manufacturers in fact set up their own tanneries and finishing capacity capable of producing leather of high quality. This helped in some upgradation of facilities of some tanneries²⁶.

Factor Conditions. India has a large stock of cattle. It is estimated that as on 1994, India's livestock population was 207.5 million cattle, 96.3 million buffaloes, 137.7 million goats and 42 million sheep²⁷. India accounts for 15.9 percent of world's cattle population; 56.5 percent of buffaloes; 20.1 percent of goats and 4.2 percent of sheep²⁸. These holdings are the highest in the world for cattle, buffaloes and goats, and the sixth highest for sheep²⁹. But the recovery rate of skins is very low due to a variety of reasons. Cattle are not raised in concentrated ranches, but as individual holdings across the length and breadth of the country. Hence most of the skins have to be recovered from fallen animals. Cow slaughter being taboo in some states, the leather arisings are solely from fallen animals in these state. There is also a general lack of awareness on how to carry the fallen animals to the flaying posts and on flaying the skins so that even from the fallen animals, the recovery rate is low and recovery is of poor quality.

It is estimated that flaying is not done at all in 37 percent of the cases in cattle, 25 percent on buffaloes, 43 percent in goats and 50 percent in sheep³⁰. The loss from this non recovery in 1986 was estimated at Rs.330 million³¹. Also, due to the non slaughtering of bovine animals, their average life is long and hence the availability rate of leather (i.e., number of hides available as a percentage of population) low: about 11 percent for cattle and 21 percent for buffaloes.

How much difference these practices, which are firmly based on the cultural beliefs of people, their ignorance on how to get good value for the leather of their fallen animals, and the relative economics of rearing to slaughtering cattle make to leather availability can be seen by comparing it with sheep/goats where neither such taboos operate nor are any great economic benefits derived by keeping them. In the case of sheep/goats, only about 7 percent of skins are lost due to faulty recovery methods³², largely because most of the skins are

25. India, Ministry of Commerce. Report of the Review Committee on Leather and Leather Manufacturers for Exports. (New Delhi, Ministry of Commerce, 1985).

26. Interviews with industry executives.

27. Thyagarajan, et.al, op.cit., pp.II-163. The authors' figures for 1994-95 are extrapolations data from 1951 to 1987.

28. Central Leather Research Institute, Report on All India Survey on Raw Hides and Skins (Madras: Central Leather Research Institute, 1987).

29. Sinha and Sinha, op.cit., pp.43.

30. CLRI, op.cit., quoted in Council for Leather Exports, Indian Leather Industry: Problems and Prospects, pp.2

31. Ibid.

32. Ibid.

byproducts of animals slaughtered for meat. The availability rate for goats/sheep is about 65 percent³³. Although availability figures have a lot to do with the much shorter lives of goats/ sheep, the differences between the availability rates of bovine animals and goats/ sheep arise also because sheep slaughter is much more organized and skin recovery and meat production are better integrated as compared to cattle. If organized slaughter were possible for cattle, availability of bovine leather would surely increase. There will be also less incidence of dragging the fallen animals and damaging the hide³⁴.

The generally low level of education of the workers working in this industry and the fact that most of the tanneries are in the small sector makes the tanning process of undependable quality.

However, a number of Institutions have come about in the field of leather technology, which have produced a pool of knowledgeable technicians and scientists in the field of leather technology. These institutions have also contributed to the training of the workers and supervisors in the industry. Thanks to the establishment of Central Leather Research Institute (CLRI) in Madras in 1953, which has been headed by distinguished and committed scientists, a formidable knowledge base in leather technology, especially suited for Indian conditions has been built up. Many Indian engineering colleges turn out high quality graduates in leather technology and most of them get absorbed in the leather industry. Government policies and the orientation of these institutes - especially CLRI - has ensured that these technologists work closely with the industry and have contributed to many technical improvements.

For training in leather, a number of institutions exist in India. The Central Leather Research Institute (CLRI), Madras conducts training programmes for the leather industry. It has extension centres at Bombay, Kanpur, Ahmedabad, Calcutta and Jalandhur (Punjab) where it conducts local training programmes, testing and quality assurance support. Two Central Foot Wear Training Centres, one at Agra and one at Madras conduct training programmes for supervisory technical personnel for the leather sector; Footwear Design and Development Institute (FDDI) Delhi trains people in footwear design; the National Institute of Fashion Technology, Delhi trains manpower for the leather garment sector and the Indian Institute of Leather Products, Madras conducts training of technical manpower for footwear, leather garments and accessories. The last is managed entirely but he private sector. In addition, there are State level leather training centres catering to the training requirements of artisans in that State, and training centres run by the Khadi³⁵ & Village Industries Commission (KVIC) for village level artisans.

While these institutions do provide good training support, many of them are unable to produce the trained manpower either in terms of quantity nor quality. Also, in the crucial area of design, both of footwear and garments, India seems to be almost dependent on the Western buyers for their designs and as for trained artisans, except for areas like Madras, Bombay and Delhi where there are a number of export oriented units on a relatively larger scale, the other units still have a long way to go.

CLRI has an advanced centre for education and training in leather technology and footwear science and engineering. It works with Anna University, Madras and provides education at Bachelors, Masters and Ph.D levels in leather technology. It also offers a number of refresher courses to professionals in the leather sector. Human resource development in leather products design and fabrication has been a hall mark of CLRI. It also provides training courses in byproduct utilization, safety management, production planning and management. It also conducts some international courses.

Testing

33. Ibid.

34. But it is unlikely that this will happen in the near future. One firm in Hyderabad, which was set up in 1992 for export of cattle meat (and which can produce high quality leather) has been facing continuous problems from religious and semi religious groups.

35. Khadi means handloom spun/ worn garments.

CLRI has set up a quality testing services in collaboration with SATRA, U.K. International class testing facilities. Material testing, finished product evaluation, on line testing, failure rate analysis feasible.

In the area of footwear design, India has failed to build up good factor conditions. Until 1980, there were neither good design facilities nor trained designers. After Pande Committee's recommendations³⁶, the Government set up the Footwear Design and Development Institute and the CLRI also set up computer aided design facilities. These have together produced some strength in designs in the country, but still only to a limited extent. India still depends on foreign designers for a large part of its footwear and garment designs.

India's factor conditions with respect to leather industry seem to be mostly based on what Porter calls basic factors rather than advanced factors: cheap but uneducated and unproductive labour, availability of a large population of cattle which do not yield particularly good quality of leather³⁷ and cheap but inefficient facilities for production. But this dependence on cheap labour has led to Indian leather industry not being able to exploit its full potential to improve its world competitiveness position. For example, in the footwear sector, according to a study, about 50 percent of costs of footwear are accounted for materials, and the cost advantage of LDCs over Newly Industrialised Countries (NICs) is only about 4 percentage points. This is more than offset by better inventory management, and less scrap generation³⁸. Similarly, for garments, only about 10 percent of the total costs are accounted for by labour while 75 percent as accounted by raw materials alone. Thus labour, as such, is losing its importance as a determinant of competitiveness. Only recently has India started building on some advanced factors like design capabilities and trained workers in footwear, leather goods and garment industries. No wonder that even though the industry has been a good exporter, it has been an exporter in the lower segments. The main redeeming feature seems to be the stock of technologists built up over a period, and the role played by them in upgrading the industry.

Dependence on cheap labour has led to Indian leather industry not being able to exploit its full potential to improve its world competitiveness position. For example, in the footwear sector, about 50 percent of costs of footwear are accounted for materials, and the cost advantage of LDCs over Newly Industrialised Countries (NICs) is only about 4 percent points. This is more than offset by better inventory management, and less scrap generation. Similarly, for garments, only about 10 percent of the total costs are accounted for by labour while 75 percent are accounted by raw materials alone. Thus labour, as such, is losing its importance as a determinant of competitiveness. Only recently has India started building on some advanced factors like design capabilities and trained workers in footwear, leather goods and garment industries.

Effect of government policies on factor conditions. The steps taken by the government in 1973 led to the establishment of tannery capacity. A survey of tanneries undertaken in 1988 revealed that about 60 percent of tanneries in the unorganized sector and 50 percent in the organized sector were set up after 1972. Of these, about 40 percent of the tanneries in the unorganised sector and 81 percent in the organized sector were set up between 1973 and 1980. Without these new units, increased exports of finished leather would have been impossible.

Another committee (the Kaul Committee), which gave its report in 1979, saw lack of modern machinery and availability of inputs like chemicals as the main impediments to development of leather industry in general and its exports in particular. Possibly influenced by the extremely comfortable foreign exchange reserves position at that time, the Committee recommended liberalisation of import of capital goods for the leather industry. In pursuance of the recommendation of this committee, the government reduced import duty to 25 percent on all tanning, finishing, footwear and other leather goods machinery, which were placed on OGL.

36. India, Ministry of Commerce, Report of the Review Committee on Leather and Leather Manufacture for Exports (New Delhi: Ministry of Commerce, 1985).

37. Goat/sheep skins produced in India are considered to be of very good quality.

38. Ashoka Mody, Rajan Suri, Jerry Sanders and David Van Zoest, International Competition in the Footwear Industry: Keeping Pace with Technological Change (Washington D.C.: World Bank, 1991), pp.24.

As a result, considerable imports of machinery took place, but this was done by the firms without looking at the matching inputs needed. Often the machinery imported were obsolete, substandard, or unsuitable for Indian needs. Unspent cash assistance received in the previous year was made taxable, and this led to the manufacturers to import their machines quickly, without any systematic assessment on how they would be put to use. Many of these machines turned out to be unnecessary and unusable³⁹. Little modernisation, in the real sense of the term, took place. By seeing the problem of nonmodern machinery as merely a factor condition rather than integrating it with capital goods industry (in other words, by failing to develop a capital goods industry for leather machinery), its impacts could, at the best have been only short term. Even this limited impact did not take place, for the Government failed to evolve matching measures to capitalize on the improvement in factor conditions resulting from modernization or upgradation of the machinery - like export incentives, marketing assistance, making available increased and improved supply of leather, and upgrading the quality of manpower. Thus the Kaul Committee's recommendations failed to have any major impact, and perhaps might even have decreased the competitiveness of Indian industry by leading to excessive capitalization and low capacity utilization.

The next committee set up by the government in 1985 (The Pande Committee) gave a more comprehensive set of recommendations. It looked at the availability of the proper quality of leather, training facilities, related industries like those producing lasts and components like soles, testing facilities for quality control, development of a packaging industry and enhancement of design capability. It also recognized the need for better nexus between development and research. It thought that there is a need to focus on one segment and develop this segment vigorously; thus it recommended making footwear as the most promising segment and taking initiatives for promoting the footwear industry.

As a result of these recommendations, the government took the following steps to enhance the factor conditions:

- i) To improve the availability of good quality leather, import of finished bovine leather and raw hides and skins were made duty free for export oriented units.
- ii) The import duty on all tanning, finishing, footwear and other goods machinery were brought down to a uniform 25 percent. This enabled rapid upgradation of machinery especially footwear manufacturing machines. Several units imported the latest machines and acquired capability to produce high quality footwear.
- iii) A Footwear Design and Development Institute (FDDI) was set up in Delhi which concentrated on evolving the latest designs and training designers and artisans.
- iv) A number of training centres were set up in the country, especially in states like Tamil Nadu, where there was already an established footwear industry.
- v) The Council for Leather Exports was asked to take up technical training as an important activity and this body actively liaised with the newly set up training centres.
- vi) The Central Leather Research Institute at Madras took up training of artisans as an important activity. In a clear departure from the practice in other CSIR laboratories,⁴⁰ training was made an activity run on commercial lines, meaning that they were offered to industries on a full cost basis. These training programmes turned out to be well organized and were well received by the industry, and by 1994, the training had become an activity with its own niche in CLRI, claiming about 2 percent of the time.

39. Sinha and Sinha, *op.cit.*, pp.20-21.

40. Council for Scientific and Industrial Research. Under this body, a large number of these laboratories were set up in the fifties with the hope most of these laboratories will enable the Indian industries to upgrade their products. In reality, then laboratories failed to deliver and have been the subject of much criticism.

The contrast in the approach of these initiatives, as against those earlier, may be noted. There was a more synergistic approach to the different policy initiatives needed in different areas. It was the synergistic nature of these policy changes, attacking the different crucial areas at one time and bringing about the needed policy changes, that improved the factor conditions in the leather industry in general and in the footwear industry in particular.

The net result of these policy changes has been to give a boost to the export of leather garments, goods and footwear/ components of footwear, at the expense of leather itself, whether finished or semifinished. Even though in monetary terms, the export of finished leather has kept on increasing, its share as a percent of total exports has kept decreasing, while that of finished goods has increased, as may be seen from Exhibit 14.

There were further policy changes, especially in 1988⁴¹. Until 1988, the location of new units was subject to the rule that they should be in backward areas. In 1988, this restriction was removed and locational policy for leather industry was made the same as for any other industry. This step, besides altering the strategies of firms, also led to their locating their industries in areas where infrastructure was better; this enhanced their competitiveness. In this year, the import of components, consumables and raw materials required for the leather industry were put under OGL with very low or nil duties, and this removed a major irritant for the exporters.

Another committee set up to look at the leather industry in 1992 (Murthy Committee) took a look at the industry in all its aspects⁴². Its approach was even more comprehensive than that of the Pande Committee. It recognized the backward state of infrastructure and other factor conditions in the leather industry, and the important of training to upgrade the quality of manpower. In pursuance of its recommendations, the government took some steps which did improve the factor conditions, although it did not accept one crucial recommendation, viz., dereservation of the entire leather industry for the small sector. Some of the important policy initiatives were:

1. Foreign collaborations were liberalised and were made available to the industry in the normal course.
2. A training and modernisation assistance fund, funded jointly by the industry and the government, was set up.
3. Greater stress was placed on training centres upgrading their facilities and improving their training. The institutions like CLRI were encouraged to involve the private sector in their programmes.

The net effect of these measures is difficult to quantify at least for the present. They were not so much in the nature of specific measures to improve specific aspects of the industry performance; rather they were aimed at improving the general factor conditions.

Related and Supporting Industries. There are a number of related and supporting industries for the leather industry like leather working machinery, injection moulding machinery, specialized machine tools, chemicals, and design services including designs developed on computer. None of these are well developed in India. For capital goods, imports have always been preferred, and unlike, for instance in the garment industry, where textile machinery industry did develop in the country, no leather machinery industry developed to any significant extent in India. Chemicals are available till the finishing stage, but the chemicals for the finished stage and speciality chemicals are to be imported since their low volumes of consumption do not justify the development of an indigenous industry. The design industry also, as we have seen, is a recent development and has not progressed very far.

41. For details of these policy changes, see India, Ministry of Industry (Department of Industrial Development), Report of the Working Group on Leather and Leather Goods Industries for the Eighth Five Year Plan (1990-95). (Delhi: Ministry of Industry, 1990).

42. India, Ministry of Industry, Department of Industrial Development. Report of Committee on Measures for strengthening Leather Industry in India (Delhi: Ministry of Industry, 1992).

Effect of government policies on related and supporting industries. Government policy initiatives in this field have been weak. Until 1985, no committee appointed by the government even looked at the supporting industries like the capital goods industry and the design industry. Only in the field of chemicals has there been some initiatives through the Central laboratories like CLRI to develop new chemicals needed for the industry and liaison with the firms to produce them. The result has been a very weak corner of the diamond for the leather industry, in stark contrast to the conditions prevailing in, for instance in Italy, where a strong cluster of related and supporting industries emerged⁴³.

Firms' Strategy, Structure and Rivalry. The leather industry is dominated by small and medium scale units. Especially in tanning, more than 75 percent of the production is from this sector. Leather footwear production for domestic consumption is reserved for small scale sector; hence large units can be set up only for export. Cottage / small scale industries account for 70 percent of the production of closed shoes and 90 percent of open footwear. Shoe uppers are produced almost entirely in the large scale units and meant solely for export. However, it is not only the large units that export; in fact, about 60 percent of footwear exports (in terms of value) comes from the cottage / tiny sector. In garments, due to the climate of India, there is hardly any demand for leather garments, and the production is mainly for exports, produced by different scale units: from medium to large units that are well mechanized and producing 5000 garments and above per month, to relatively small units producing 20 to 100 garments per day⁴⁴.

The reservation rules for the small sector had a drastic effect on the structure of this industry. They meant that a firm had only two options: either stay small and cater to the domestic market, or become larger in size and become export oriented. Most of the units have opted for the former. Because of their small size, their being scattered and the absence of any effective body to bring them together, the firms have not been able to come together and chalk out a coherent strategy for themselves. Nor could they undertake R&D, even collectively. They could not innovate and bring up their products and capabilities to world standards.

Effect of government policies on firms' strategy, structure and rivalry. Even more than in the case of the automobile component industry, the motivation of firms in the leather industry to stay small was great. The entire leather industry was reserved for small scale industry except for processing semifinished leather to finished leather. In the case of manufacture of footwear and other leather products, if a firm from organized sector wanted to enter, it was subject to an export obligation of 75 percent. The minimum capacity of the machines is about 1000 pairs per day, and the investment required about Rs. 20 to 30 million. This is beyond the limit of investment if a firm did not want to lose its "small scale industry status". This meant that if a firm wanted to manufacture machine made shoes, it had to become export based. This prevented effective rivalry among the firms for the quality domestic market. There was no incentive for firms to attain bigger sizes and adopt modern machinery.

This must be contrasted with what was happening in Taiwan, Korea and China. From the early eighties, sensing a move of footwear manufacture away from the Western countries, these countries began to build their capacity, building up-to-date modern plants and investing heavily in R&D, design and computer aided manufacture⁴⁵. Even though after a certain scale, the economies of scale tend to flatten out in the footwear industry, the Indian manufacturers approached nowhere near this size.

Added to this was the excise duty limits which applied for firms exceeding production value of Rs.2 million. The levy of excise duty makes a substantial difference to the price, and hence firms competing in the domestic market that were also near the threshold size had a very strong incentive not to go beyond the limit for excise duty free production.

43. Michael Porter, Op.Cit., pp. 100-103.

44. Central Leather Research Institute (CLRI), Indian Leather Industry: Problems and Prospects. (Madras: CLRI, 1990), pp.30.

45. Mody et.al., op.cit.

Another distortion introduced by the government policies was that there was no excise for shoe uppers; but the moment a sole was attached, it was subject to excise duty. This made the firms to avoid manufacturing soles or adding value to a shoe upper by making it into a complete shoe. Even though this problem did not apply to exported products, there was no incentive for firms manufacturing uppers and with an interest in the domestic market to become shoe manufacturers.

The policy changes of 1973 with the intention of stimulating exports, introduced some incentives. But these failed to reward the manufacturers. The export incentives were such that traders, rather than manufacturers, benefited from these incentives. Even though the Seetharamiah Committee recommended to give cash subsidy against exports to set up new capacity and to modernise the existing capacity, this recommendation was not accepted; instead a cash compensatory support was given which benefitted only the traders. Thus even though new capacity did get created, the old units did not get a chance to modernize.

The tight monetary policy at this time made it difficult for village leather units to get credit from banks even if they took the initiative to modernize, despite the fact that they belonged to the small scale sector. This was because of their difficulty to prove their viability (in fact many units became nonviable). With all the ostensible support to SSIs, these firms also had their own problems which made them not only globally uncompetitive in many areas, but also dependent entirely upon government support in the form of incentives, excise duty rebates, etc. As in the case of component industry, small firms always found it difficult to get finance from banks, despite their being in the "priority sector" for lending. Similarly, while materials could be imported at low duty or no duty at all, importing them involved so much of paper work that the small firms could not really take advantage of them. Thus their strategy was not one of continuous upgradation, but to use the available indigenous components and stay in the lower value ends of the export market. Due to the vast number and reach of these firms, the efforts of the government to bulk the motivated requirements were not very effective.

The policies of the government to compel locations of the new leather industry units in backward areas resulted in many firms setting up their firms in such areas that had no proper infrastructure. They were inherently competitive and depended entirely on government incentives even for survival. They suffered so many disadvantages in terms of availability of infrastructure facilities, logistics support etc. required for effectively competing in the world market that it would now indeed be difficult for these firms to become competitive.

Even after 1990 when there was much liberalisation all around, leather industry was still subject to licensing and SSI reservations. Commented the Murthy Committee (1992):

"The policy frame work has been shaped in the following premises:

- (1) This is a traditional rural industry providing employment to a large number of people in rural India; that modernization/ mechanization of this industry would result in large scale displacement of artisans and people belonging to weaker sections of society engaged in this industry.
- (2) That production of various leather articles for domestic consumption should therefore continue to be produced in artisanal (sic) production units.
- (3) That modernisation/ improved/ technology may be allowed only for production exclusively meant for export".⁴⁶

The result was also a bifurcation of firms pursuing an "export based strategy" and a "domestic based strategy". There was little mingling between these two markets. Thus neither the firms based on the domestic strategy could upgrade their products to international standards nor could the export based firms take advantage of the domestic market. The main recommendations of this Committee, to dereserve the entire leather industry was not accepted by the government.

46. India, Ministry of Industry (Department of Industrial Development, Report of Committee on Measures for Strengthening Leather Industry in India (Delhi 1992) (Murthy Committee).

Lastly, such incentives as there are for leather industry will be lost for a firm which upgrades itself to using substitute materials for goods including footwear. Thus despite a worldwide trend to move away from leather to substitutes, an early shift into these substitutes seems unlikely by Indian firms. The result would be that after a decade, the Indian firms would be left behind by their competitors who are switching over to the latest materials.

Leather Industry and Government Policies: A Critical Appreciation

Placing the different government policies in juxta position over the years, we see the government's policies till 1985 being addressed to only portions of the diamond: availability of leather, state of the machinery etc. Even though the limited concerns addressed to by these policy measures were tackled to some degree of success, rapidly other factors became limiting, and the overall impact on the industry was limited: they succeeded only in shifting the exports from raw or semifinished to finished leather. There was no major improvement in the competitiveness of the value added segments of the industries. It was only after 1985 when a number of issues were addressed to simultaneously that some success was achieved. In fact, even though certain important problems like those posed by reservation for small scale industries have not been solved, the effects on the export performance has been quite dramatic.

There have been many contradictions in government policies which have prevented the Indian leather industry from taking advantage of its full potential. The major increases in exports in 1985-86 occurred when there was an attempt to implement a more coherent set of policies which aimed at attacking all the points of the diamond. Subsequent efforts have been piecemeal, removing a constraint here and an impediment there, which have resulted in accelerating the rate of increase in exports slightly, but not achieving any break through.

The case of leather industry highlights the need for direct and industry specific government intervention, if some of the industries are to become competitive. With government initiatives like improving the factor conditions through setting up of supporting institutes, improving training etc., giving appropriate incentives and removing bottlenecks, the government has been able to bring up this industry from a low level industry to one with a high promise for global competitiveness. On the other hand, the nondevelopment of related and supporting industries for the leather industry shows that these conditions do not develop on their own; intervention is needed.

The case also highlights the dangers in the government not creating conditions in which the industry keeps up with the latest global trends. Increasingly, labour as a component of cost is becoming less important, and scale factors becoming critical. Yet the government has devised a structure of incentives that leave little enthusiasm with the firms to become big or upgrade and innovate. Even with clear signs of leather being likely to be substituted by other materials, the Indian firms have not made any move to follow these trends, and government policies provide a strong disincentive for them to do so.

The case of the leather industry also questions the need for a large and sophisticated domestic demand as a requirement for global competitiveness. In most of the countries that are large players in this industry (China, Italy, Taiwan and Thailand) is the domestic demand large or sophisticated. They all treat this industry as "export oriented", and domestic demand is incidental.

This is, of course, not to say that domestic demand does not help; it only questions the need to develop domestic demand as a prerequisite for global competitiveness.

Conclusions

Role of the Government. From our studies of the automobile components and leather industries, it seems a passive and indirect role for the government may not bring about any major changes in the competitiveness in the industries; a more direct and industry specific role seems called for. For example, in the automobile component industry, the creation of Maruti stimulated the quality as well as the sophistication of the domestic demand; in the case of the leather industry the upgradation of infrastructure and factor conditions were a direct outcome of government intervention. On the other hand, the nondevelopment of related and supporting

industries, in both the cases studied shows that these factors do not develop on their own. Some targeted and purposeful intervention seems beneficial.

At the same time, a broader set of policies, that go to provide incentives for firms to upgrade and innovate seem to be very important. The reduction of tariff barriers for raw materials and components and exemption of export earnings from corporate taxation seem to have stimulated exports at the firm level.

Role of the Home Demand. While a large and sophisticated home demand may be useful in enhancing an industry's competitiveness, this seems by no means essential. As noted, industries that are highly export dependent seem to do well not only in India, but in other countries like Taiwan.

It may therefore be a wrong policy to look at the industries from the point of view of whether the domestic demand is large and sophisticated before predicting whether they are likely to become globally competitive. For many industries in which LDCs hope to become major players in the world market, other factors governing competitiveness may be more important than domestic demand.

Targeting of Industries. Whether the government should be content with evolving broad policies and letting the winners emerge or whether it should discriminate in favour of promising industries is an important policy question. It would seem that to bring up an industry to be globally competitive, there is need to take a number of measures that are industry specific and promote agencies that have as their mission promotion of the competitiveness of their industries. What seems more important is the way these institutions (like the Council for Leather Exports and Automobile Components Manufacturers Association) work with the industries and are responsive to their needs. There seems no need to presume that such associations may not be effective in bringing about substantial changes in the concerned industries' competitiveness.

The case studies indicate that well directed and coherent sets of policies for specific industries that have some inherent elements of competitiveness can help in the enhancement of the competitiveness of these industries. Since governments have limited capacity to undertake such industry specific measures, it seems inevitable that some targeting is done.

Policies: Incremental vs. "Bundles". It seems from our studies that fragmented policies that are addressed to only portions of the diamond do not give much result; the bottlenecks are merely shifted to another area. Sets of coherent policies, all executed together, seem to be vital to give a big push to the selected industries. Even though such bundling of policies call for considerable energies on the part of the government, this seems necessary and with careful selection of industries, the strain on the government in developing such packages of policies can be reduced.

EXHIBIT 1 AUTOMOBILE COMPONENTS INDUSTRY

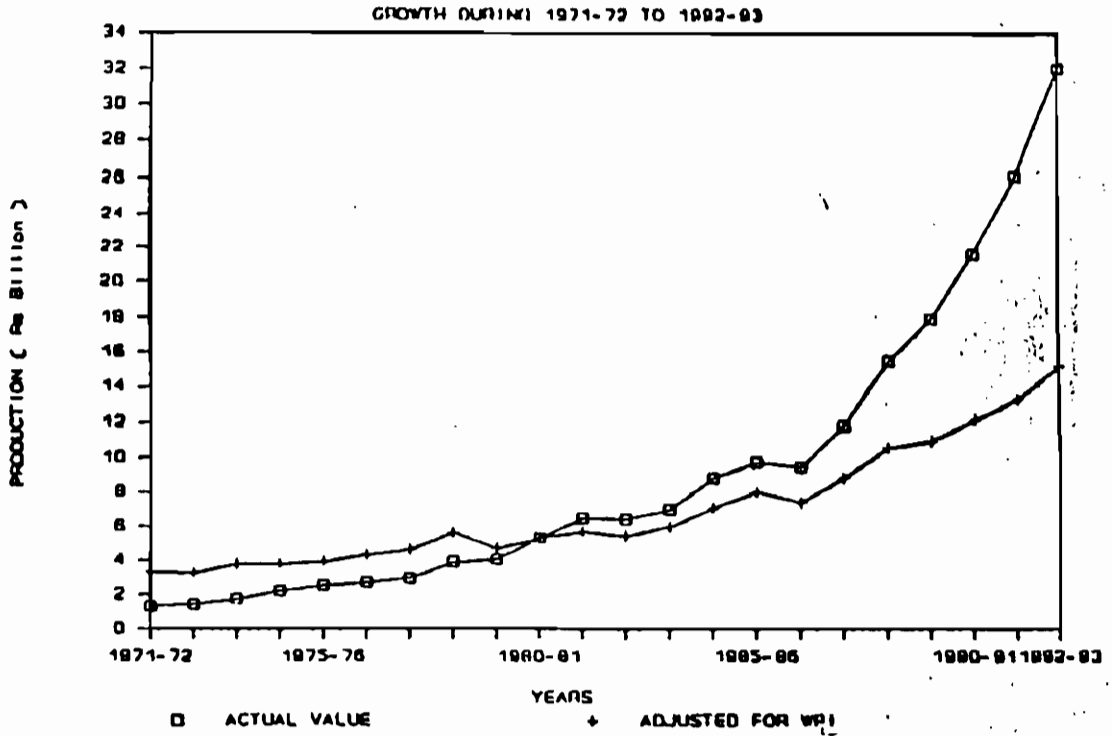


EXHIBIT 2 AUTOMOBILE COMPONENTS EXPORTS

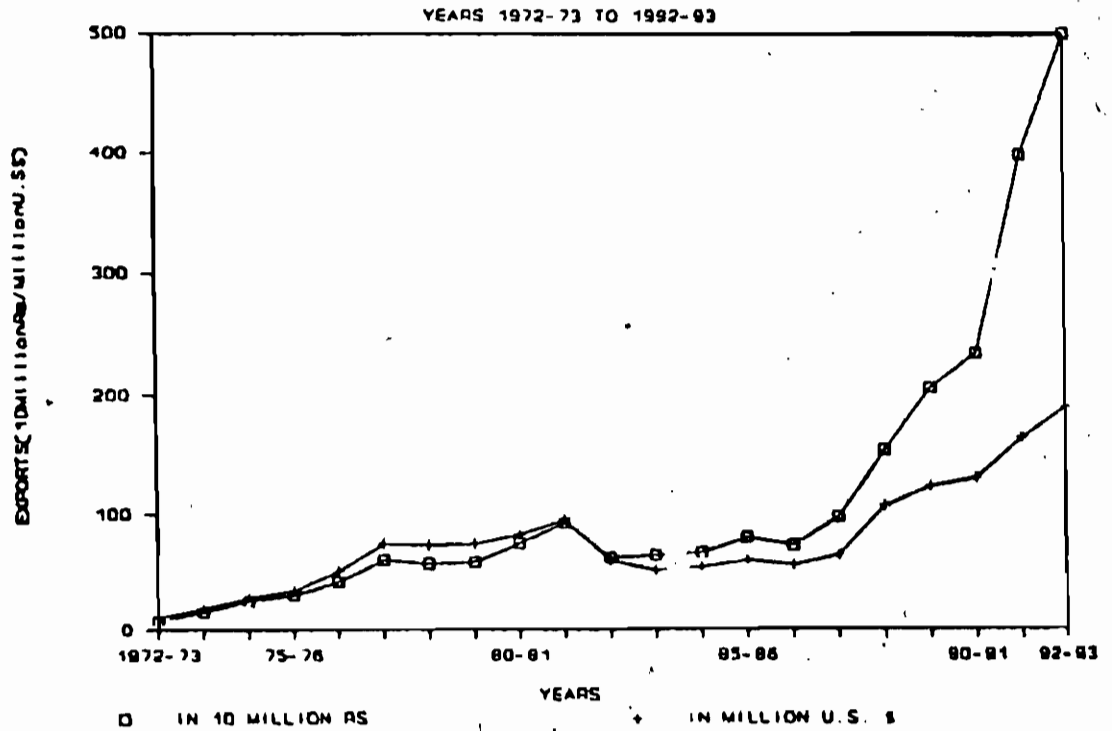


EXHIBIT 3

PRODUCTION OF PASSENGER VEHICLES

CARS AND JEEPS

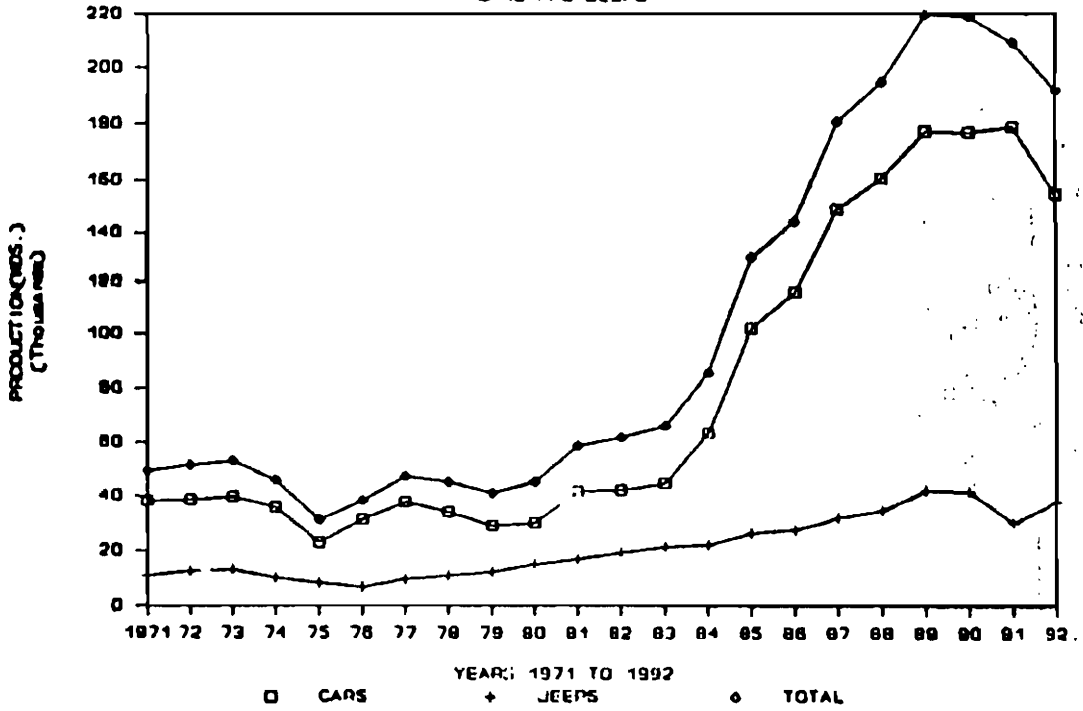


EXHIBIT 4

GROWTH OF COMMERCIAL VEHICLES

BUSES, TRUCKS, LCVs & TRACTORS

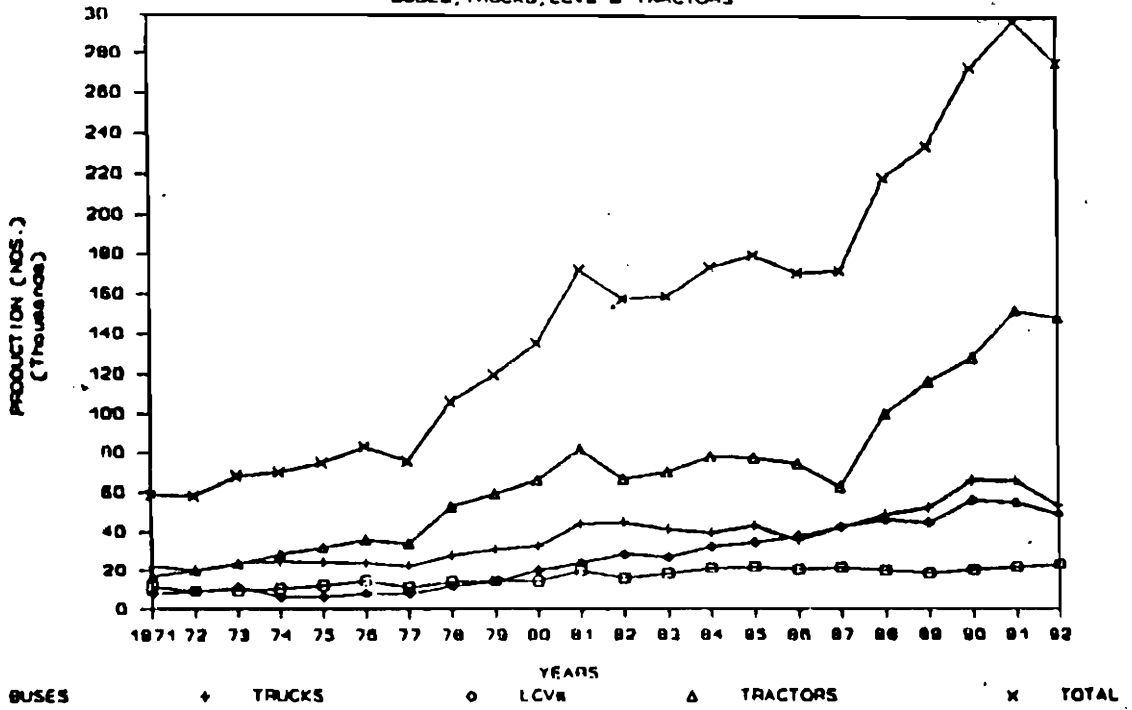


EXHIBIT 5

TOTAL FOUR WHEELERS PRODUCTION

1971-92

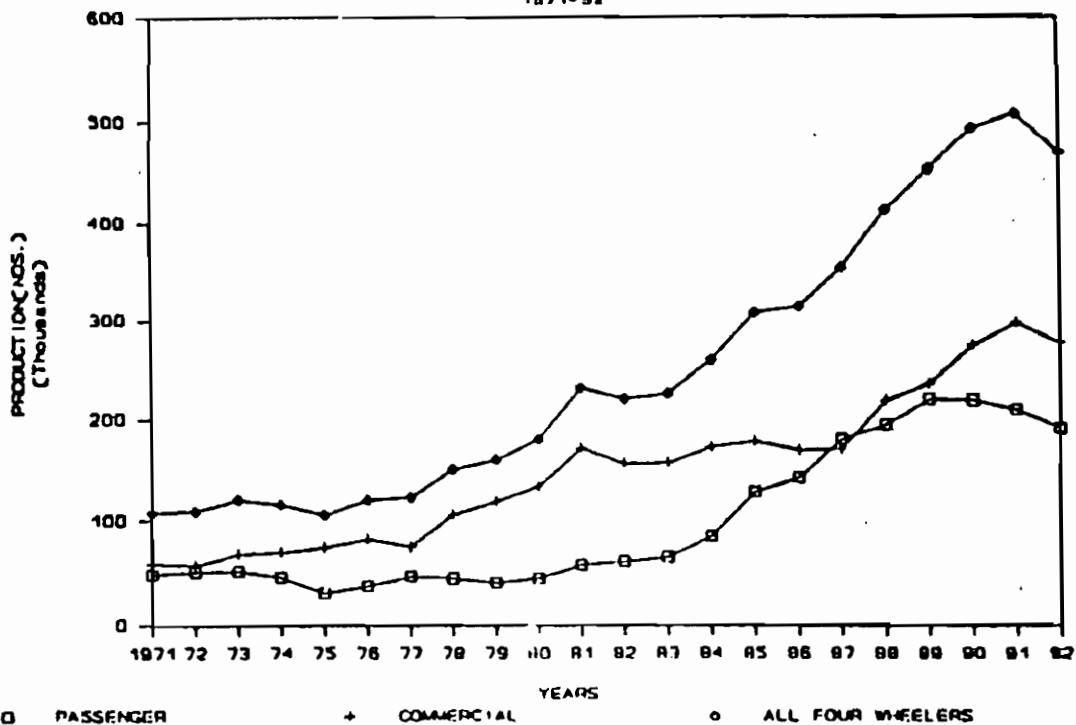


EXHIBIT 6

PRODUCTION OF TWO/THREE WHEELERS

YEARS 1971-1992

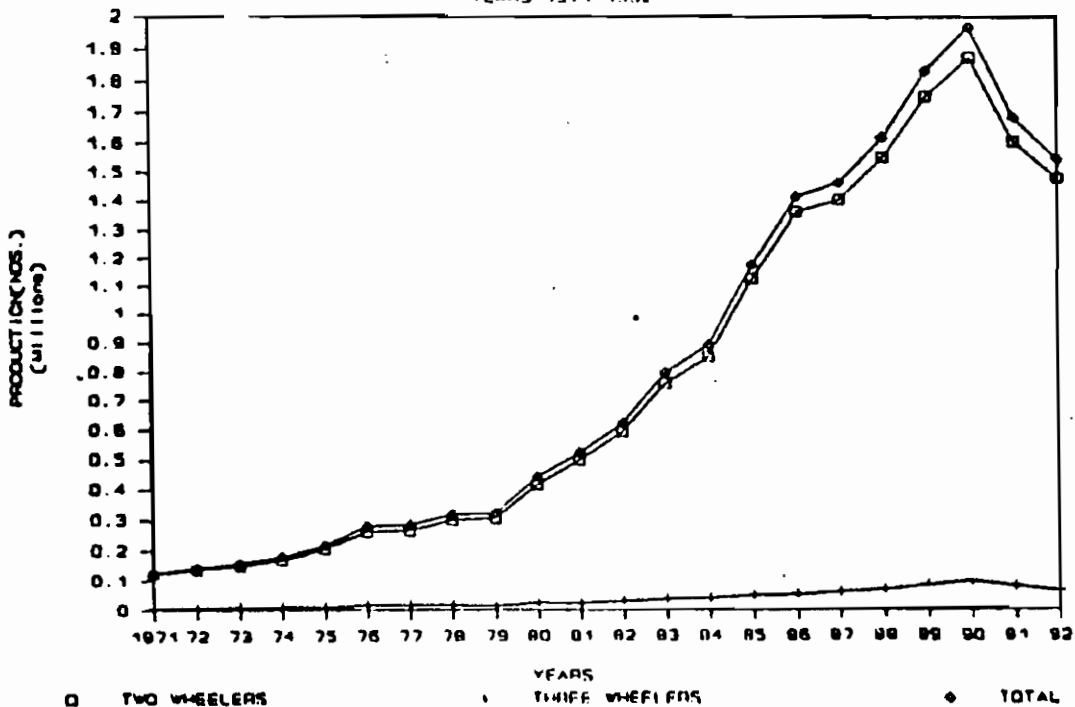


EXHIBIT 7

GROWTH OF LEATHER EXPORTS

RUPEES VIS A VIS U.S. \$

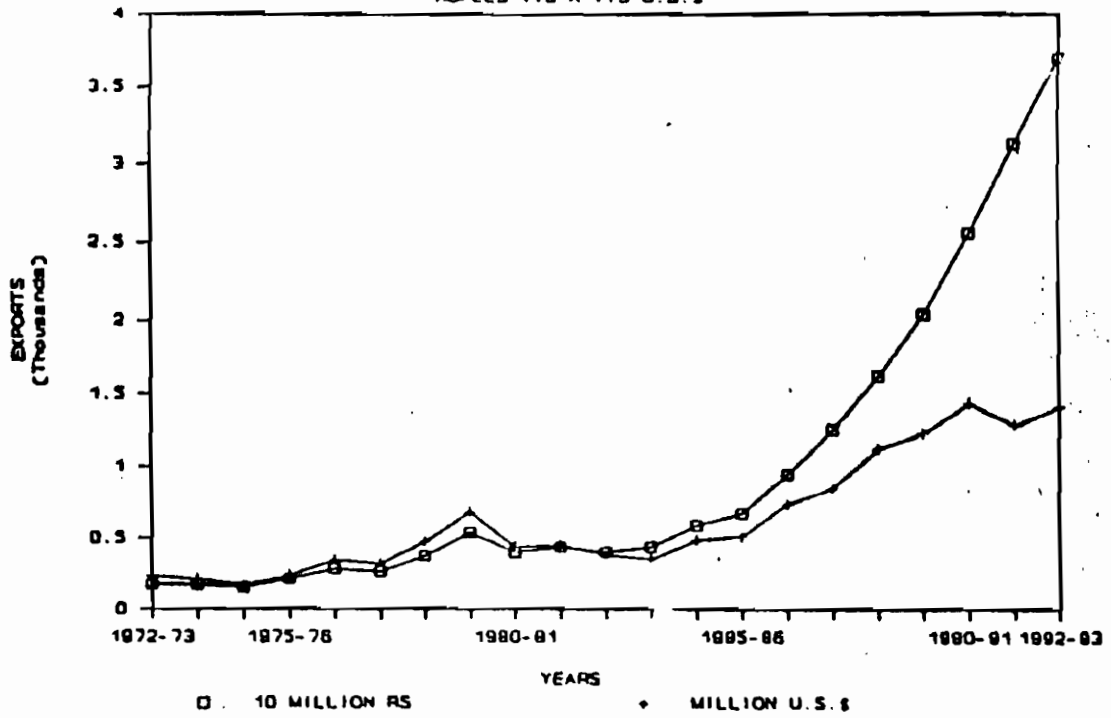


EXHIBIT 8

EXPORT OF SEMIFINISHED/FINISHED LEATHER

YEARS 1972-73 TO 1992-93

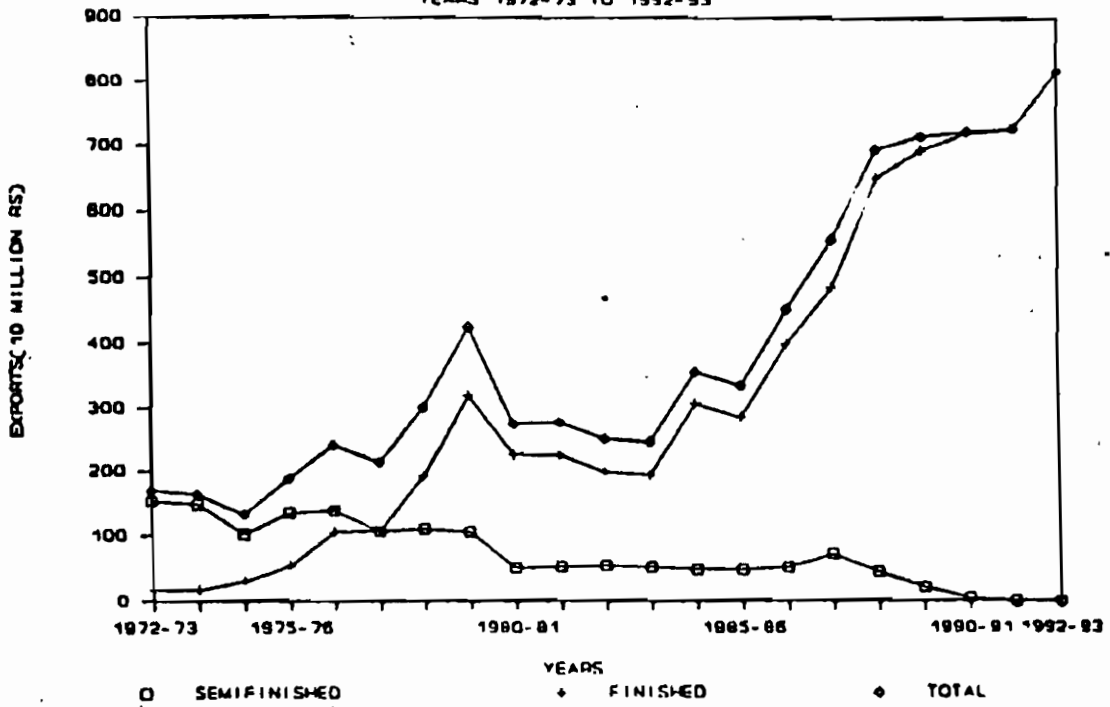


EXHIBIT 9

EXPORT OF SEMIFINISHED/FINISHED LEATHER

RUPEES VIS A VIS U.S. DOLLARS

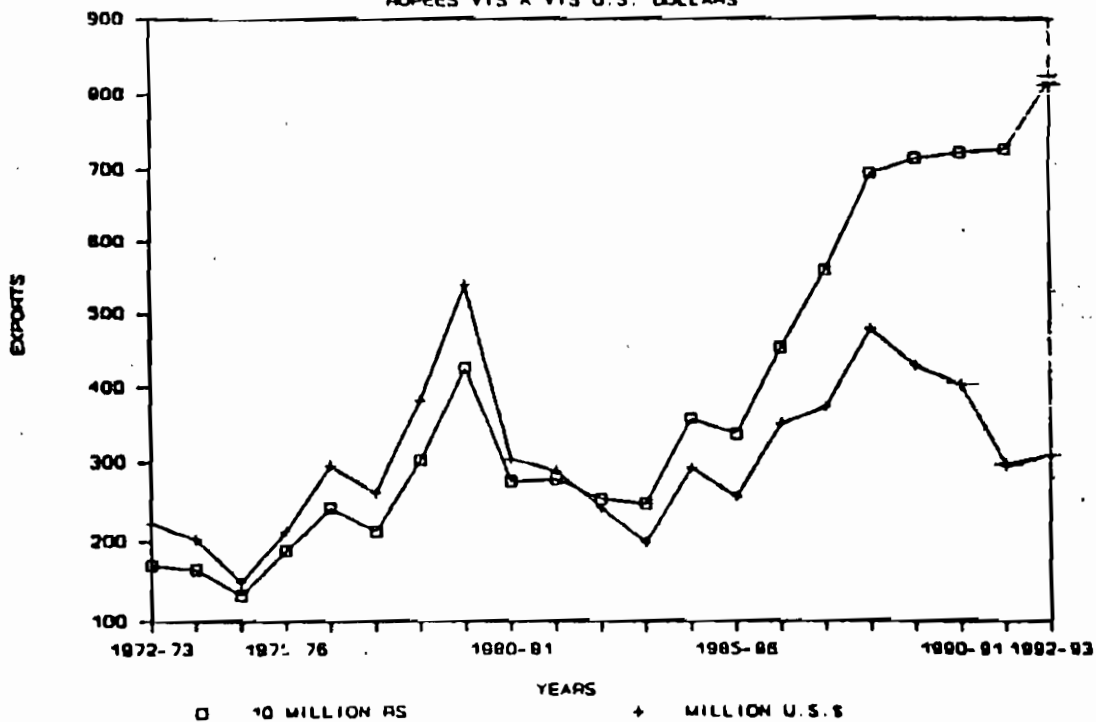


EXHIBIT 10
EXPORT OF FOOTWEAR/COMPONENTS

YEARS 1972-73 TO 1992-93

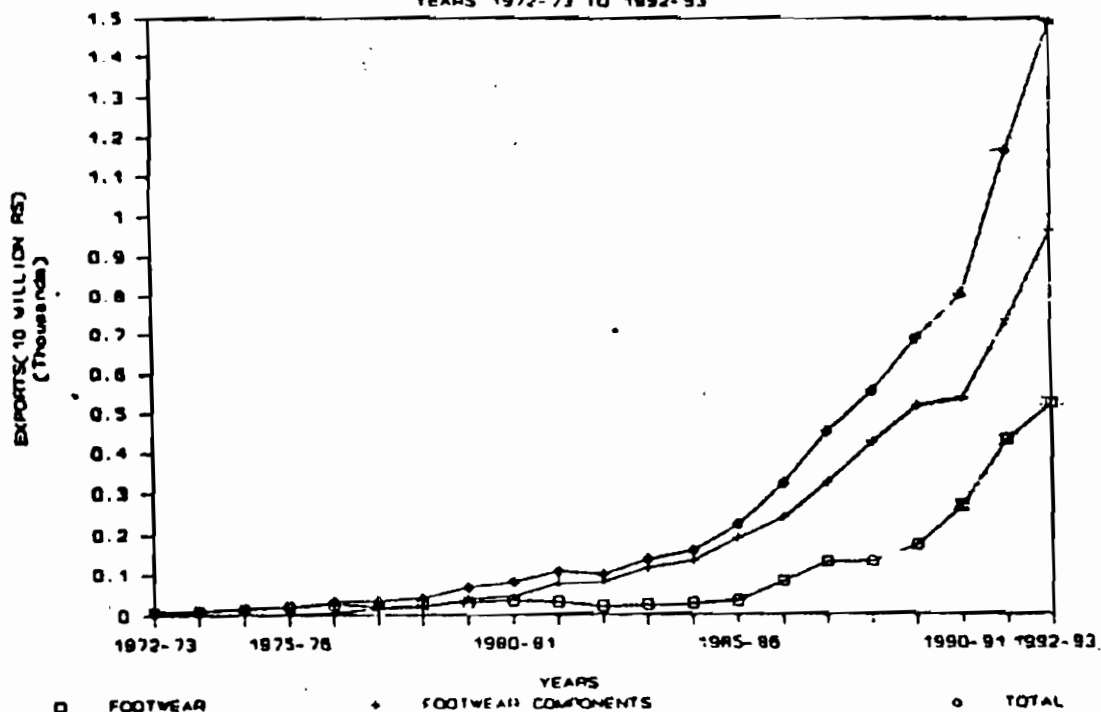


EXHIBIT 11
EXPORT OF FOOTWEAR/COMPONENTS

RUPEE VIS A VIS U.S. \$

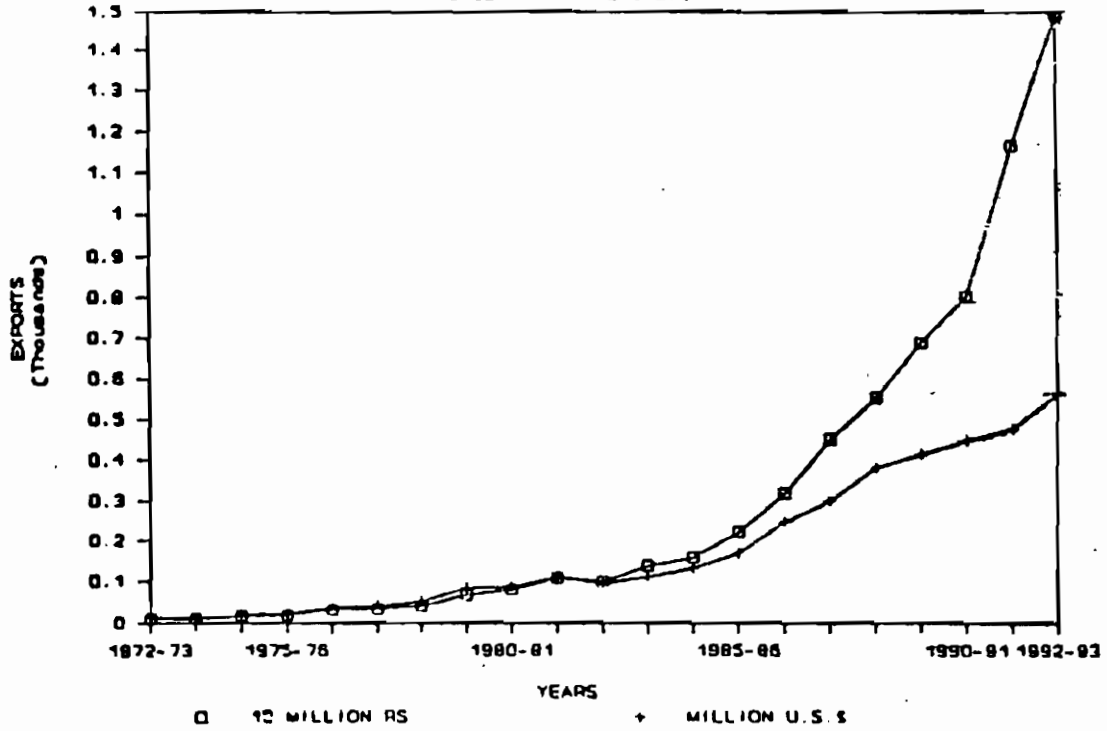


EXHIBIT 12
EXPORT OF LEATHER GARMENTS/GOODS

1972-73 TO 1992-93

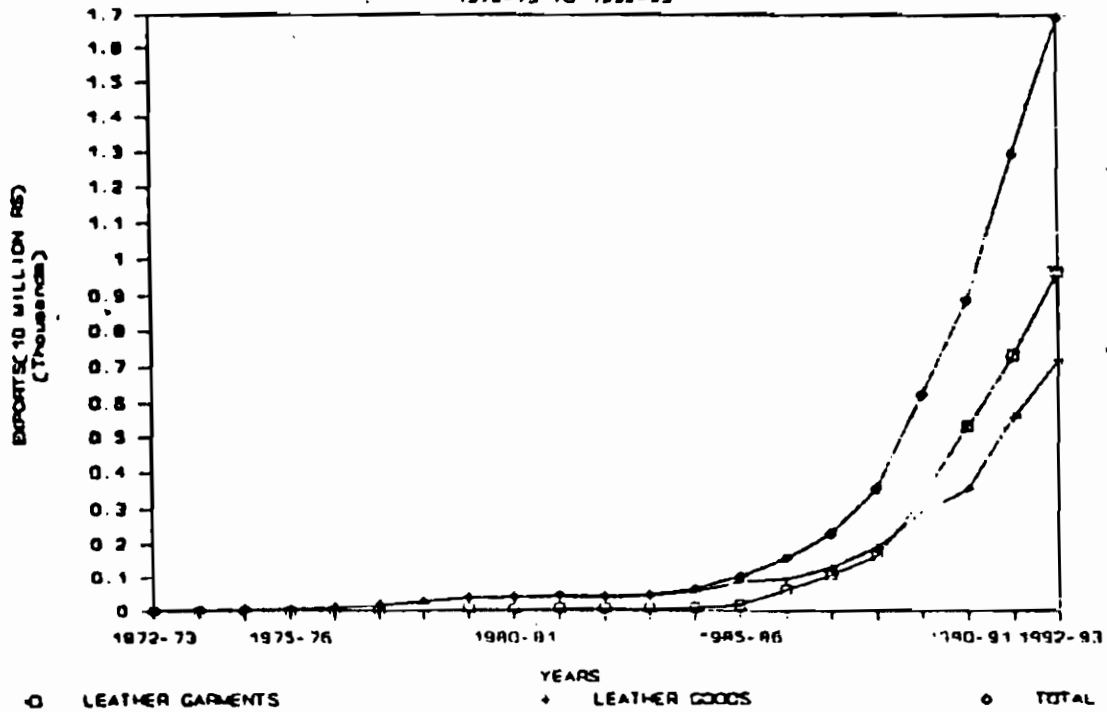


EXHIBIT 13 EXPORT OF LEATHER GARMENTS/GOODS

RUPEE VIS A VIS U.S. DOLLAR

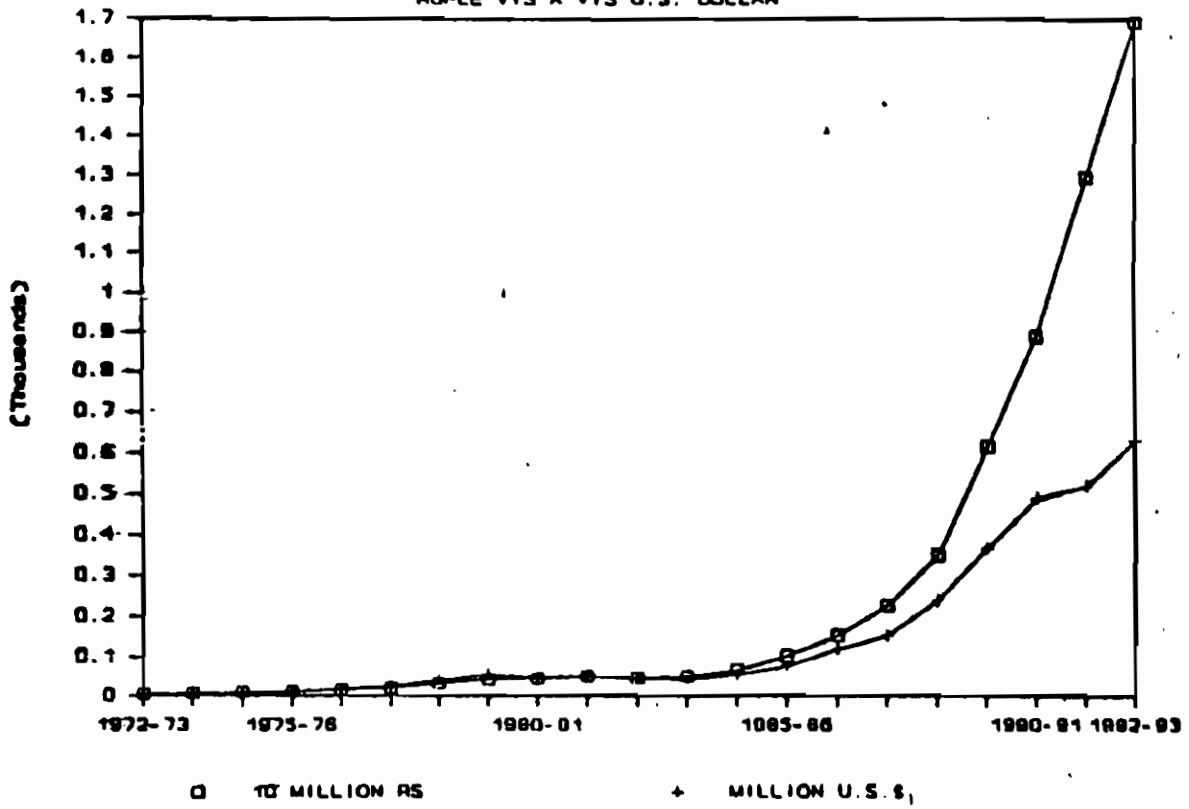


EXHIBIT 14 INDIA'S LEATHER EXPORTS

CHANGES IN COMPOSITION (1972-73-1992-93)

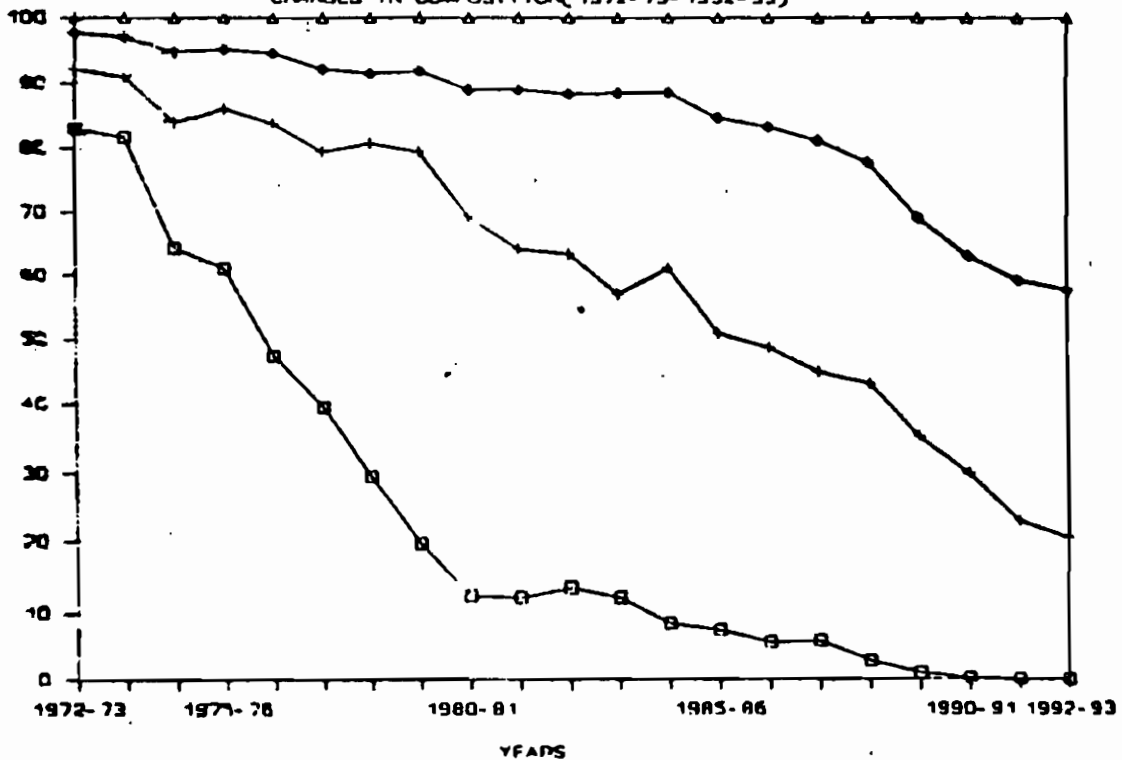


Exhibit 15

Leather Industry: India's Share of World Exports

	1980	1985	1990	1992
Leather (611)	10.0	7.9	4.8	3.4
Manufactured Articles (612)	6.3	16.4	13.5	x6.7
Prepared Parts of Footwear (6123)	6.2	19.0	14.1	x7.5
Footwear (855)	0.5	0.4	0.71	x0.61

Notes: 1. The figures in brackets are the SIC classifications.

2. x denote that the concerned figures are estimates.

3. Under footwear, Indian statistics show only leather footwear, while world trade statistics are for all footwear including synthetic.

Source: United Nations, International Trade Statistics Year Book, 1992, Vol. II (New York: United Nations, 1993).

FIG 5.1a INDIA'S SHARE OF WORLD EXPORTS

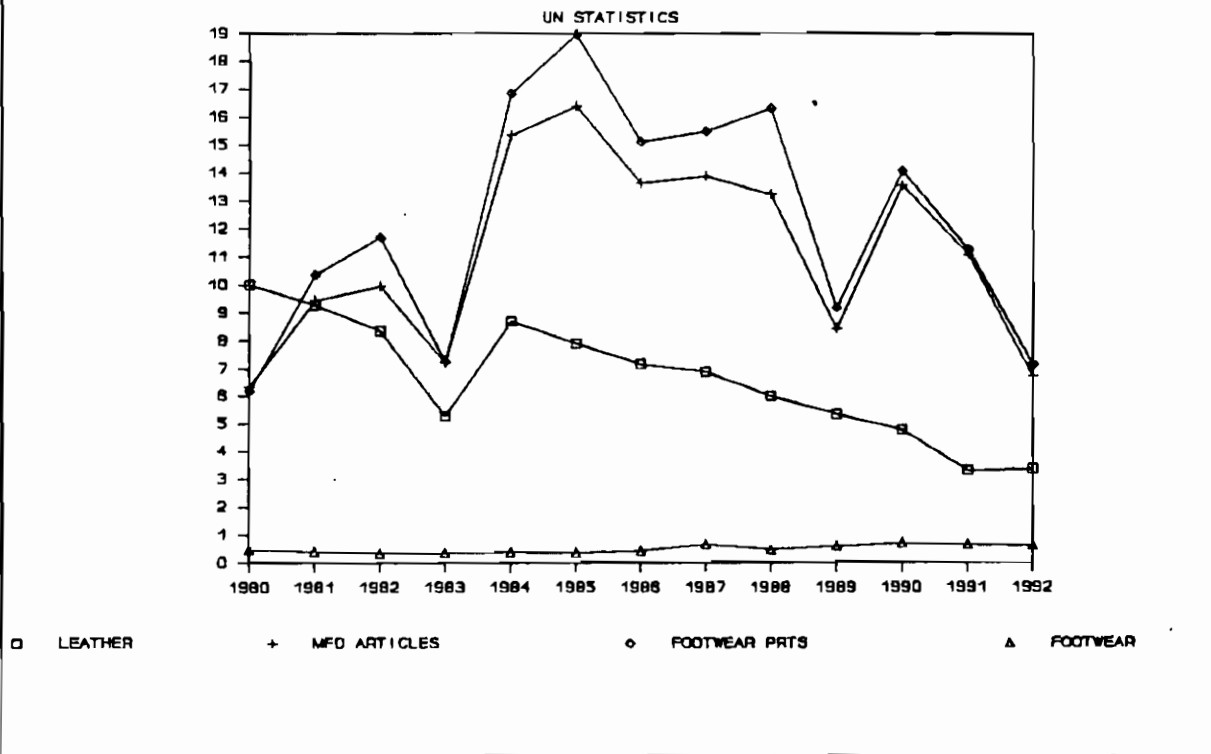


FIG 5.1b INDIA'S SHARE OF WORLD EXPORTS

