

## Locational Factors For Industrialization in India –Some Myths and Realities



### Economics

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### ABSTRACT

*This paper examines India's development strategy, and to what extent it may be considered a success. It provides a brief history of why and how the strategy was adopted, as well as of its implementation, including the role of initial conditions, such as human capital, geographical location, and infrastructure. It analyses the extent and reasons for success of the strategy, including policy, political economy, timing, and linkage of the strategy to economy-wide development. Particular attention is given to the relative roles of domestic and international actors, including the part played by foreign investment, trade, and other dimensions of openness. The paper considers the extent to which the strategy remains viable for the future, the challenges still faced, and what other strategies might be required. It concludes with possible lessons for other countries and their future development strategies.*

**Introduction:** India's economy seems to invite animal metaphors, particularly those of the lumbering elephant or caged tiger. The former is consistent with a culturally or environmentally deterministic view of the country, or perhaps inspired by its size, which hinders nimbleness. The latter obviously suggests that there have been shackles placed on the economy, implicitly by policymakers. The experience of the last few years seems to have been favourable to the latter view, and invites a re-examination of India's development strategy. What has that strategy been, and to what extent can it be considered a success?

To answer that basic question, this paper proceeds as follows. It outlines the basic contours of India's initial post-independence development strategy, and provides a brief history of why and how that particular approach was adopted. The description of its implementation includes a discussion of the role of initial conditions, such as human capital, geographical location, and infrastructure. Next, the paper analyses the extent and reasons for success of the strategy, including policy, political economy, timing, and linkage of the strategy to economy-wide development. This is followed by specific attention to the relative roles of domestic and international actors, including the part played by foreign investment, trade, and other dimensions of openness. The paper then considers the extent to which the strategy remains viable for the future, the challenges still faced, and what other strategies might be required. It concludes with possible lessons for other countries and their future development strategies.

### Strategy overview

The concept of a development strategy implicitly assumes a role for government. Whereas economic development in places such as Britain, the Netherlands and the United States had been driven by relatively decentralized commercial interests (though often influencing, or aligning with government policies), later European models of development, such as Germany and France, relied more explicitly on direction from the state. Most strikingly, the Soviet Union followed a model that included not just state guidance, but intervention in almost all aspects of the daily functioning of the economy. The latter required an elaborate conceptual and administrative apparatus of economic planning. The Soviet model also diverged from previous state-led industrializations in attempting to remove, rather than co-opt or collaborate with the commercial classes.

It is natural that the experience of capitalism in its imperialist form created a deep mistrust of the market institutions that underpin the capitalist system, in former colonies as well as other countries on the periphery of the system. This attitude affected views of international and domestic trade, international and domestic finance, and domestic production in agriculture and in industry. Such attitudes are well documented among leaders

and intellectuals in India, from before independence to the current day. In the 1930s and 1940s, and even for several decades beyond, the Soviet model appeared to provide a viable and successful alternative for India.

### Cost Effects of Industry Location

Our empirical strategy in this section is to estimate a cost function to see how cost (thereby profits) are affected by the economic geography of the region where the firm is located. If specific factors related to the local economic geography have cost-reducing impacts, then firms are likely to choose regions with disproportionately higher levels of these factors. The analytic framework to examine location of manufacturing industry primarily draws on findings from the "new economic geography" (NEG) literature. Krugman (1991) and Fujita et al. (1999) have analytically modeled increasing returns, which stem from technological and pecuniary externalities. In models of technological externalities, interfirm information spillovers provide the incentives for agglomeration. Assuming that each firm produces different information, the benefits of interaction increases with the number of firms. This provides incentives for the entrepreneur to locate the firm in close proximity to other firms, leading to agglomeration

### History and implementation

The previous section has summarized the state of thinking with respect to development strategy at the time of Indian independence, and in subsequent decades. To some extent, the question posed in the introduction, of the relative roles of environmental and policy factors in shaping India's development strategy, remains. The task of shaping an answer can benefit from a brief historical excursion, and that is undertaken next, before turning to an assessment of implementation of the strategy. A key idea that runs through the historical summary is that India's initial conditions at independence were shaped by institutions that had exhibited remarkable longevity, as a result of influential environmental factors.

The Indian subcontinent is a distinct geographic region, bounded by oceans, mountains and deserts. It includes several large river basins, the most significant of these being the Indus and Ganges in the north, though several important rivers cross the southern peninsula. The monsoon rains are a central feature of Indian life, and contribute to parts of India being historically extremely fertile for rain-fed agriculture. At the same time, significant parts of the region are in rain shadows, and are characterized as semi-arid.

### Review of literature

**Baruah (2011)** in his paper put forth the statistical evidence that industrial disparities in India both during pre and post reforms period has persistently been widening. His study reveals

that North Eastern states, in spite of being rich in natural resources were placed at the bottom of the ranking in the composite index of Industrial development. According to him, it is the infrastructural bottle necks which are responsible for regional industrial disparities. He summarized in his paper that the centre should come forward in a big way in providing infrastructural facilities to enable North Eastern states, to reap the benefit of economic reforms.

**Khare and Yadav (2011)** conducted a study based on the data provided in the annual survey of industries. The variables – number of registered factories, number of workers, capital investment, value added, population, geographical area etc. Simple statistical tools of mean, standard deviation and co-efficient of variation of different ratios have been used. The study concluded that both internal and external factors determine the process of regional industrial development. Regional disparity in industrial development has widened in the process of industrial development.

**Sabyasachi and Sakthivel (2012)**, tried to measure the impact of economic reforms on regional inequality in India. They took a study period from 1980-81 to 1999- 2000. They have divided study into two phases: Pre-Reform (1980-81 to 1990) and Post-Reform (1990-91 to 2000). According to them, in pre-reform period, the regional industrial inequality existed there, but remained stagnant; this is because of the role of public sector in maintaining regional parity in India by directing resources to backward areas. While in the post reform period inequality has increased because reforms have given greater freedom to private sector, which always found attracted towards relatively more developed regions, because of relatively developed infrastructure. They concluded that in the post reform period the rise in regional inequality is due to regional industrial inequality.

**Kumnoor (2012)**, in his study analysed the pattern of industrial development in the backward region of the state of Karnataka. According to the study, a wide spread industrial disparity prevails in Karnataka state. Bangalore alone contributing 50 percent of registered factories and 60 percent of the factory employment where as Gulbarga, one of the most backward districts of Karnataka contributed only 9 percent of registered factories and 8 percent of the factory employment. However, the fiscal and financial concession led to increase in the share of backward districts in industrial units and employment over the period of time. He concluded that this fiscal and financial support given to backward region, led to reduce regional disparity.

**Gurubasappa (2013)**, in his work ,investigated how the small scale industries play an important role in reducing regional imbalance, also ensuring development in backward regions. He took Bidar and Dharwad districts of the state Karnataka as the loci case study. According to him, among the factors influencing location decisions of entrepreneurs, incentives and concession have proved to be most important factor. Since natural location factors like availability of raw materials, availability of labour, location of similar industries, transport facility etc. has a very marginal influence on the location decision of most of the industries located in Dharwad and Bidar districts. According to his work, small scale industries have developed only in these two backward district of Karnataka and generated employment therein.

#### Limitations of existing work

The studies mentioned above are robust, however, there are avenues for further research. The role of the determinants of agglomeration such as local infrastructure and policies etc, in explaining this phenomenon is still not entirely clear. In any case, industrial agglomeration cannot be solely explained in terms of sector-level variables. The empirical literature has recognized that the latter class of variables has only partial explanatory

power but the analysis was not taken forward in terms of the inclusion of additional explanatory factors.

The only study for India (Lall and Chakravorty, 2003) is in fact at a highly aggregated level (three-digit), when cluster formation is mainly at four-digit or even at five-digit level. Moreover, their study concentrates only on three cities. The clustering in India is not only at a much more disaggregated level, but also in different States. The present study takes care of all these limitations. There exists no study for India that is as extensive as this one, taking 21 States and 66 manufacturing industries at the four-digit level.

#### Domestic and international factors

India has historically been a significant trading nation, and it was the colonial experience, involving discriminatory British policies against Indian goods, that contributed to the formulation of a development strategy that emphasized self-reliance after independence. Prohibitive tariffs and extremely restrictive quotas constituted the trade dimension of the policy framework. Foreign direct and portfolio capital investment was also highly restricted, mostly through outright prohibitions. Even in areas where investment was allowed, it was on a case-by-case discretionary basis. Similarly technology transfer, which would require foreign exchange payments or associated investment, was also severely limited through a process of discretionary approval. In practice, bureaucratic controls made restrictions much tighter than they might appear to be on paper. Finally, capital flows abroad, or indeed, any flows of foreign currency out of the country were greatly restricted.

Another key set of international policies was an overvalued exchange rate, which was designed to make imports of inputs cheaper for import substituting industries, but severely inhibited exports, and created an artificial scarcity of foreign exchange. As a result, a black market in foreign exchange flourished throughout India's early decades. Even after the Bretton Woods system of fixed exchange rates was abandoned in 1971, India continued to maintain a somewhat overvalued rate. In addition to making exports expensive, this policy made imports cheap, and the ostensible goal was to restrict imports through tariffs and quotas to those inputs that would be required for import substituting industrialization. Only in the 1980s did a significant depreciation of the rupee begin, and this process of market alignment accelerated further in the 1990s, so that after a few more years, the exchange rate was market determined, albeit with heavy intervention by the Reserve Bank of India (the central bank) to control volatility, and sometimes the level as well.

#### Conclusion

Industrialisation is a key factor not only for economic development of a country but also for improving the standard of living of the people. Slower is the growth of industrialisation slower is the economic growth. Realizing this strong relationship, the developed countries of the world have attributed a dominant role to industrial sector and achieved very high rates of growth. India had realized the importance of industrialisation since the inception of planning in 1951. Therefore, India started emphasizing the process of industrialisation since the second five year plan onwards. Over a period, though India has achieved industrialisation, has become self reliant but still it has not tapped its full potential. At the same time industries in the country are not evenly distributed, rather it has concentrated in a few states creating territorial industrial disparity.

If India's development failures and successes offer some lessons for other countries on balancing the role of government and market in development strategy, perhaps its most important lesson comes from its political institutions. Democracy in India, however, imperfect, has survived and deepened over the

last six decades. It has provided an important institutional backdrop for the recent economic success of the country. If anything, it has begun to provide a vehicle for more vigorous competition among politicians to serve long-term constituent interests (Singh 2007).<sup>2</sup>Democracy has also allowed the media and civil society organizations to operate relatively freely in India, bringing greater transparency and accountability to markets and governments. The design of robust democratic institutions must be considered the greatest achievement of India's strategy of development.

If one recalls the chaos of India's partition in 1947, it is clear that achieving sustainable democracy was not a foregone conclusion. To some extent, the heterogeneity of India, and the lack of any single axis of social domination made it easier to sustain the institutions created from 1947 onward: in this regard, the contrast with Pakistan is perhaps telling. The same heterogeneity also created problems of multiple vetoes (Bardhan 1984). However, greater federalism and economic decentralization—also to some extent accidental byproducts of political fragmentation—have helped break some of those previous logjams. The final lesson from the Indian experience is that carefully designed political institutions that can manage competing interests effectively are an achievable goal, as well as a supportive backdrop for development. Yet institutions and policies are functions of ideas, and the evolution of India's recent development success is also a testimony to the power of ideas, however slowly they come to be accepted.

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