OUTSOURCING BROWN GOODS TO INDIA

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An inquiry into the trade position of Chinese SMEs between 2000 and 2006

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ABSTRACT

The People's Republic of China has been flirting with the concept of free trade ever since the debacle at Tiananmen Square in the late 1980s. However, State control of macro economy and free movement of both labour and capital within PRC remain questionable. The last decade has witnessed phenomenal changes in the Indian industry after the declaration of the liberalization, privatization and globalization policy of the government. On one hand the government has welcomed the foreign companies to enter the Indian market and compete with the local players. On the other hand our tax structures and reservation policies make them uncompetitive. Several researchers have conducted many studies in the past with respect to the small-scale sector. But the 'brown goods manufacturing sector' has not been studied exclusively in the past. This study is an attempt in exploring the problems faced by the 'Brown goods sector' in particular. The author has in the process evaluated the impact of Indo-China Trade from the perspective of macro management of international outsourcing of brown goods.

This paper is basically concerned with evaluating the impact of Globalization on the Small-Scale sector of the Indian Economy in respect of outsourcing of Brown goods from China. It is essentially based on secondary and tertiary research. Despite occasional manifestations of disappointment and distrust, the globalization of economic life is now almost taken for granted. Scholars like Meghnad Desai and Sorab Sadri beg to disagree. Nevertheless, many feel that globalization is a phenomenon whose time has come. For almost a century it has continued its long march through communities, civilizations and nations often leaving behind a trail of disputed benefits. Historically it has been called many a name with economic dominance leading to political subjugation in a world divided vertically and horizontally. One has witnessed its journey through periods of free movement, interrupted by barriers of legislation and statute - only to continue its onward march, linking scarcity with plenty, poverty with affluence and ignorance with knowledge, sharing and caring the stakeholders along.

Now with a networked global economy working relentlessly on real time basis across the globe, the barriers have been breached by free flow of information and technology. Despite nations and institutions indulging in erecting safety nets and barriers to suit their ends, e-convergence and globalization have now become inseparable building blocks of the world economy. It was in 2000, that a total of 73% of countries in the world that were open to international trade, according to the definition of Sachs and Warner (1995). These countries represent 47% of world population. Until 2000, China and India world's largest countries remained essentially closed to trade (Sachs and Warner 1995). External reforms began in mid-70's in China and in the aftermath of BOP crisis for India resulting in reduction in trading barriers and rise in volume of trade. The decade long process of economic liberalization has extended an open invitation to global players to enrich the market place.

It is after four decades of socialist ideologies and many disappointments later, we now espouse the free market system as a means to a better life for our people. This ideology came up to us more by default than by design. We have drifted towards liberalization, privatization and globalizations with their own hampers of promises prosperity and stability. The Indian corporate sector for four decades prior to 1991 operated in a protectionist environment. "The result was an insufficient and flabby industrial structure of agglomerative firms under family control, with fragmented capacities and without economies of scale, largely stagnant technology, dependent on the State for finance and protected market, hemmed in by the straitjacket of controls in literally every aspect of the economy, with little experience of real competition, and with a vested interest in an economy of scarcity and shortages which the system of controls had provided." (c.f. Baldev R Nayar, *Globalization and Nationalism*, 2001).

In the early euphoria of liberalization, the private sector welcomed the measures of the government but it soon came to realize that opening up the Indian economy to foreign competition meant more and cheaper imports, more foreign investment, opportunities to the MNCs to raid and takeover their enterprises. According to Baldev Raj Nayyar, "the Indian businessmen are facing unequal competition". The Indian firms not only suffer from 'size disadvantages' and lack of financial power but also suffer from high, multiple cascading indirect taxes-especially at the local level, where they are not applicable to foreign imports- that results in making Indian goods uncompetitive. And FICCI president, K. K. Modi called this aspect the 'subsidization of imports'.

Baldev Raj Nayar also points out that the tariff structure has at times contained some serious anomalies, such as when finished goods attract lower tariffs than raw materials and components. Then, again, State has allowed imports from MNCs in areas that are reserved for the small-scale sector whereas Indian business is not allowed to produce in those areas. "From the prospective of domestic manufacturers", concludes Nayar," the State has thus not been sufficiently vigilant about their interests, for it has allowed profit margins of domestic firms to be squeezed by cheaper imports."

In some areas, the State has pursued policies that have clearly discriminated in favour of MNCs. For example, in the power sector the State has offered counter-guarantees only to MNCs for fast-track projects without providing similar concessions to Indian firms. Then, the taxation of capital gains has favoured foreign firms with far lower rates, which could further be avoided tally if foreign firms come through Mauritius. Not only this, MNCs are allowed 100% subsidiaries whereas the takeover code allows only restricted share buy back options to the

Indian promoters. What Samuelson would say in view of the factor price equalization hypothesis is any economist's guess.

On account of all these reasons, the process of globalization at the behest of the World Bank and unleashed in 1991 has 'created' a new world - a world in which not only there has been an inflow of substantial foreign capital, but also the domestic corporate sector for the first time saw itself as the 'target' rather than the 'beneficiary' of the heightened activities of foreign investors. The swiftness, vigour and aggressiveness with which the foreign investors sought to penetrate and capture the domestic market have caused serious worry to the Indian corporate sector.

Small-scale and cottage industries have an important role in India's industrial and economic development of India. Their development has been given a lot of emphasis because of a number of avowed objectives such as promotion of entrepreneurship, generation of employment opportunities, development of decentralized development, prevention of concentration of economic development, utilization of local resources, protection of interests of artisans, preservation of craftsmanship and heritage of the country etc. The criterion for differentiating small-scale enterprises from the large-scale is generally based on the size, capital resources, and labour force of the individual unit.

According to the *Government Of India; Economic Survey 2000-01* the number of small-scale units stood at 32.25 lakh in 1999-2000 and their output produced was Rs.5, 78,470 crore in 19 92-2000 (at current prices). According to a study conducted by SIDBI Team in association with NCAER in 1999 the share of the small-scale sector in employment in the total industrial sector was around 40%. Today, they account for nearly 45% of gross value of output, 30% of gross value of exports and over 50% of industrial employment in India.

The 'Brown goods' manufacturing sector belongs to the small-scale units producing mixers, grinders, juicers, food processors, irons, room coolers, water heaters, ovens, toasters, etc. They constitute a market size of Rs. 2600 crores approx. It is divided mainly into two segments: the organized and the unorganized sector. The organized sector has just about 10 to 12 players only on all-India basis. This covers 55% of the entire market and consists of almost Rs.1450 crores market. The rising middle-class segment in India is of more than 300 millions. With their high marginal propensity to consume, they offer a rising and growing market opportunity to this industry. The Indian domestic demand as in case of a single product like dry irons itself is approx. 6.5 billion units. The gap between demand and supply is today being filed with the import of Chinese products that are cheaper and of better quality. These products today threaten to wipe out the Indian manufacturers who face an 'imperfect competition' because of globalization and faulty government policies.

To support the development of the VSI sector, an elaborate institutional network has been established and several schemes have been introduced to provide infrastructure, financial, technical operational and marketing assistance. To guard against competition from the large firms, manufacture of a large number of items were exclusively reserved for the SSI sector and SSI units were given preferences in Govt. purchases.

However, the SSI units suffer from a number of problems that include technological, marketing, financial and operational problems. They are not able to supply branded goods in large quantities with consistent quality to large buyers like trading houses and department stores. An additional consideration that has a bearing on exports is speedy delivery especially where the exporters need to use computer-aided machines to be able to match the delivery schedules of their competitors. Consequently large-scale investments are required. The poor quality of inputs manufactured in the small-scale sector has its deleterious influence on the end products. The final products suffers because low quality components over the final quality of the assembled product. The result is that for export of such items many components have to be imported. It is therefore imperative for future export growth that adequate new investment and technology up gradation take place in these industries and that existing units are allowed to upgrade.

With liberalized global dimension these units have come to face increasing competition. A large number of these units are today sick/ weak, many of which are unviable. Small-scale units do not need protection by reservation and can survive in free markets. Existence of product differentiation means that many SSI firms co-exists with large firms and cater to different consumption needs. As the markets grow, small companies also grow in size and retain their dominant position. Large industries would become more competitive if they had more demanding buyers. They would then upgrade in quality as well. The removal of reservation will also pave the way for greater equity participation from large Indian companies and foreign investors along with greater sub-contracting. It would then be much easier to establish interdependent relationships between large, medium and small industries as subcontractors, ancillaries and suppliers of parts and components.

It has been found that in the case of many items currently reserved for small-scale industries the manufacture of these items at appropriate quality and efficiency levels required investments in plant and machinery at a level much higher than the existing investment limits. The existing investment limit on these items, therefore, precludes the quality production of such items in India.

Changed economic circumstances suggest that the obsolete policies of small-scale reservations should now be abolished. The policy of reservation prevents the successful units from growing. It therefore acts as a dampener on entrepreneurship. The policy of reservation has crippled the growth of several industrial sectors, restricted exports and has done little for the promotion of small-scale industries.

The Indian market has received statutory support and the regulatory institutions and processes have been universally acclaimed as market friendly. Since the changes in the trade policy instituted since 1991 almost all items are now freely importable. A careful examination of the import policy has shown that QR restrictions were almost completely done away with by April 2001, making almost all the reserved items freely importable. This means that, whereas foreign companies, which produce these products, could sell them freely in India, large domestic companies are not free to manufacture such items. Some protection however, is provided by the applicable customs tariff. These facts give credence to the view that the government has allowed free competition between the India small-scale sector and the multinationals but not with the large Indian companies.

According to the *Expert Committee on Small Enterprises*, appointed by the Government of India in 1997, reservation may have played only a limited role in promoting small-scale industries while restricting the entry of large companies into these industries. The issue of investment limit is also of greater relevance for the items that are reserved for small-scale industries. In the case of industrial units manufacturing reserved items they are not permitted to cross the small scale investments limits and are therefore not able to grow. Instead it is often found that such units merely clone themselves and set up parallel separate units rather than expanding the original unit as would have happened if the items were not reserved. Thus the reservation policy acts as a powerful barrier to growth.

There is a strong feeling that the policy of exclusive reservation has not contributed to the healthy development of the SSU sector. The Abid Hussain Committee, for instance, observed: ".... instead of focusing on areas that should be the province of the small scale sector by economic rationale, the SSI policy has traditionally concentrated on exclusive activities for this sector. In this process it has lost sight of the simple by determining logic of market system that it can make business sense for a large company to do anything that can be done more competitively by a small unit. A policy of exclusive reservation for the small-scale industry, therefore, is at best unnecessary and at worst inefficient."

According to Baldev Raj Nayyar, "the Indian businessmen are facing unequal competition". The Indian firms not only suffer from 'size disadvantages' and lack of financial power but also suffer from high, multiple cascading indirect taxes- especially at the local level, where they are not applicable to foreign imports- that results in making Indian goods uncompetitive.

According to J.C. Sandesara, the measures undertaken in the 1991 policy were based on a proper understanding of the problems faced by the small-sector and were well directed to mitigate the handicaps faced by this sector. But In a study released in 1992, Bhavani finds that policies intended to favor small industries (reservations, financial incentives, etc.) are neither promoting employment nor improving the competitive base of small firms as quoted in Ira N. Gang, "Small Firms in India: A Discussion of Some Issues" Dilip Mookherjee (ed.), *Indian Industry: Policies and Performances* New Delhi 1997. "Rather they are working as strong disincentives for growth of small firms" as, argued by Ira N. Gang. He says, "The support measures give protected enterprises an incentive not to grow out of the small-scale sector".

According to Samir Amin, 'Implementing protectionist policies can involve "creative" non-formal barriers, such as phyosanitary measures, export marketing boards or small-scale reservations, all of which are used and abused in India. Secondly, there are strong interactions between trade policy and other domestic policies, so that trade liberalization should not be viewed in isolation from domestic reforms. Small-scale reservations, which reserve production of certain products to the small-scale sector, interfere in obvious ways with India's imports. Thirdly, a comparison with China is useful because both countries are of comparable sizes and both have a history of inward looking trade policies'.

Globalization has definitely impacted the structure and working of our small-scale units and the ripples of the repercussions can be seen on manufacturing units as well as employment of labour. According to Nayyar in *Globalization: What Does it Mean for Development?* In Bibek Debroy (ed.) *Challenges of Globalization*, "The emerging flexible production system, shaped by the nature of technical progress, the changing output mix and the organizational characteristics is forcing firms to constantly choose between trade and investment in their drive to expand activities across borders. The declining share of wages in production costs, the increasing importance of proximity between producers and consumers and the growing externalization of services are exercising a strong influence on the strategies and the behaviour of firms in the process of globalization."

"To compete successfully in an increasingly independent multipolar world, industry has to move to fast in innovation, manufacturing, marketing, distribution and services. In addition to changes in the government policies and programmes, a new commitment to quality has to be ensured to meet competitive challenges in the changing world markets." As stated by S. K. Bose in 'Achieving and retaining global competitiveness' *New Dimensions In Global Business: Perspective* 2001 (ed.) B. Bhatacharya and Amit Gupta.

In his 'Great Indian Dream', Arindham Chaudhri towing the cloney capitalist line states, "It makes for little economic wisdom to sacrifice a country's manufacturing sector to the idea of open market. It is the manufacturing sector, which has traditionally been instrumental in raising standards of living through higher work productivity in any given economy. The bottom line in a country has to do all it can to protect its manufacturing sector."

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