CHAPTER I
INTRODUCTION

Globalization is becoming an engine of growth–triggered by free trade and increasing role of the market economy. The recent wave of economic globalization has produced widespread interest among countries for the improvement and upgradation of national competitiveness, as globalization is continuously introducing major transformations in trading and production systems. With the changes in production, trading and financial transactions, importance of competitiveness for each nation of the world has increased and thus each country wants to achieve more and more international competitiveness. The competitive pressures, together with the rapid advances in production, information and transport technology, help in accelerating the speed and intensity of globalized manufacturing systems. For the growth of manufacturing system, it is essential for countries to develop the ability to pursue strategies for improvement in productivity and competitiveness.

Competitiveness is a hotly-debated topic among policy-makers and businessmen throughout the world. As new regions and international trade agreements spring up, nations are torn between the allurement of better access to foreign markets and the fear of new competition in existing markets. Competitiveness is equivalent to strong performance of economies relative to other countries, where strong performance means economic growth, rapid increase in exports and increased well-being. The definition of competitiveness as used by businessman and the man in the street is simply the capacity to sell one’s products profitably. To be competitive, a firm must be able to undercut the prices or offer products of better quality at the same price than its competitors. (Cockburn, et al, 1999)
A firm is considered to be competitive if it is able to sustain its earnings over time and can be viewed as a strong competitor if it is able to increase both its market share and its earnings. Competitive strength is less certain if a firm expands its market share by reducing prices and incurring losses, notwithstanding the strategic reasons that might lie behind such moves. Similarly, an economy may be regarded as competitive if it is able to grow without being constrained by balance of payments difficulties and is judged as doing particularly well if it grows faster than other countries. There are, however, some obvious and significant differences between the competitiveness of a firm and that of a country. As Krugman (1994) has stressed, competition among firms, which is usually oligopolistic, implies winners and losers, but the success of one country in the world market need not be at the expense of other countries, because higher exports can also mean higher imports. Also, countries produce and trade a wide variety of products and thus may be competitive in some areas and not in others. Strictly speaking, a firm that expands its sales also increases its purchases, while countries often behave like individual firms, in that the gains of one can imply losses for the others, only when demand is stagnant (Haque, 1995).

In international trade, competitiveness may be defined as the ability of a country to improve its sales in international and national markets at the expense of its competitors i.e. its edge over competitors in sales. International competitiveness may also be reflected in the success of a country in import substitution in the domestic market in comparison to overseas supplies (Verghese 1979). Export growth and / or the magnitude of the trade balance are popularly viewed as signs of a country’s general economic strength and competitiveness. A practical and widely used definition of competitiveness has been put forward by the U.S Commission on Industrial Competitiveness according to which “International Competitiveness is the ability of a country to produce goods and services that meet the test of international markets and simultaneously maintain and
expand the real income of its citizens” (Tyson 1992; Ostry 1991). A country’s competitiveness must be judged not only against its performance in the world market but also in terms of its capacity to sustain economic growth over a period of time. It is in this light that some countries like Germany, Japan, Korea and several other East Asian economies appear as strong competitors. Their rapid export growth has been accompanied by rising incomes and their economic performance has been maintained over a long period (Haque, 1995).

A country’s competitiveness is complicated by distinct notions of productive efficiency i.e. its relative efficiency (or comparative advantage) in producing tradable products; and the absolute level of the production costs relative to other countries. While the concept of relative efficiency helps to explain the pattern of international specialization in production; it provides no indication of the overall competitiveness of countries. While the comparisons of absolute production costs (converted into a common currency unit) may help to explain the success (or failure) of countries in world markets for individual products, such comparisons are easily distorted by exchange rate changes and are hard to aggregate economy-wide (Haque 1995).

Competitiveness is a union of four sets -:

1) Production of goods and services based on new technologies,

2) Capacity to increase market shares in the world trade which implies advantage in export market,

3) Move towards trade surplus, and

4) Increase in the level of per capita income of the country. (Diwan and Chakraborty, 1993)

In the past, competitiveness has been defined in terms of increased sales at home and abroad. Production theory as well as trade theory focuses
on sales. In international context, standard trade theory identifies causes of world trade. Traditional trade theory, given by Adam Smith (1776), stresses on the notion of absolute advantage, in which a nation exports an item if it is the world’s low-cost producer. David Ricardo (1815) redefined this notion of comparative advantage recognizing that market forces will allocate a nation’s resources to those industries where it is relatively most productive. Ricardo’s theory was based on labor productivity differences between nations. Heckscher and Ohlin (1920) theory is based on the idea that all nations have equivalent technology but differ in their endowments of so-called factors of production such as land, labor, natural resources and capital. The standard Heckscher-Ohlin theory explains competitiveness on the basis of comparative advantage that is defined in terms of factors of production. In the process, it identifies the fundamental determinants of competitiveness viz: divergences in technologies or relative factor endowments, returns to scale, price distortions, etc. However, empirical work using standard trade theory is restricted to broad attempts to evaluate which of these explanations is best for a given nation or for the world taken as a whole. In fact, all of them carry some truths and interact in complex ways which vary from industry to industry and even from firm to firm in the real world. This theory was based on certain assumptions such as identical technologies, constant returns to scale and no differentiated products. But now a days, these assumptions are, at best, unrealistic and the theory no more explains the stylized facts such as, growth in global markets in which countries trade identical goods where production involves similar factor proportions. The producer theory states that it is a firm’s drive to maximize profits, subject to the technical constraints of their production function, that determines the amount it sells and, consequently, its competitiveness. As long as profitable opportunities exist, firms and industries will increase their production and sales. Thus the existence of profits suggests a firm’s or industry’s increased competitiveness (capacity to sell profitably) while losses suggest falling competitiveness. Producers theory goes on to explain
that to make profits and thus expand sales, firms must be able to bring unit costs below market-determined prices. Costs are thus the fundamental determinants of competitiveness (Cockburn, et al 1999).

In international context, the competitiveness of a country can be influenced by various factors viz. price as well as non-price factors. Price competitiveness includes not only the contract price but also all the underlying influences such as cost, profit etc. Non-price factors include a wide range of influences such as quality, design and marketing (Verghese, 1979). Competitiveness of a country over time should be viewed in terms of ability to adapt the quality, marketing methods, composition, direction etc, of its exports in accordance with the changing requirements of the market. The share of a country in the growing sector of world trade can be taken as one of the indicators of its competitiveness. It is also generally recognized that there is a close association between the export of manufactures and the international competitiveness of a country as the world exports of manufactures is reckoned as a reflection of an improvement in its competitiveness. Export competitiveness of a country is determined by following factors:

- Resource endowment base in the economy,
- Cost consideration,
- Quality of the commodity produced,
- Remuneration of factors of production,
- Exchange rate,
- Productivity through the use of better technical skills and human resource development,
- Economies of scale, and
- Institutional and policy mechanisms (Basin, 2005)
Different methods are used to measure the competitiveness of a country. Each method gives a different measure or indication of competitiveness, it is difficult to say which measure is the most appropriate and realistic from the point of view of a given country. In view of the complex technical and statistical problems confronting the various measures, a more realistic idea of the changes in the competitiveness of a country can be had by comparing the results of the various measures. It is also possible that some methods of measuring competitiveness may be more appropriate for some countries than other methods due to the specific nature of the data or the underlying economic forces operating in those countries (Verghese, 1979).

The most commonly used measures of competitiveness are:-

- Relative unit value of export of manufactures.
- Relative consumer price index.
- Relative wholesale price index.
- Relative GDP deflator.
- Relative unit cost.
- Relative profitability
- Relative export prices
- Real effective exchange rate
- Exchange rate
- Unit labour cost
- Labour productivity
- R & D expenditure
Competition and competition policy are also important for developing countries in their own right. Although developing countries may not have needed competition policies in the past, they do so now in the wake of liberalization and globalization and the structural changes that these nations have brought about both at national (privatization and deregulation) and international levels. Government plays a prominent role in fostering international competitiveness. Various trade policies have been introduced by the government to upgrade the competitive advantage of a nation in trade, as trade policy in the form of trade liberalization is considered as a tool of increasing competitiveness. The idea that international competition through trade liberalization can act as a substitute for domestic competition stems from Bhagwati (1965), where potential imports as well as actual imports, discipline the behavior of the domestic producers. The liberalized import policy can also positively influence the export sector, which would be able to access the international supply market for both capital goods and intermediates at a lower transaction and landed cost. Due to liberalized trade, producers in the export sector can import new technology and raw material at low cost. Therefore, these producers can be capable of producing products at low cost. These low cost products compete in the international market favourably with other products. Therefore, with the liberalization in trade, the cost and prices of different goods decreases and it helps to increase competitiveness in trade (Singh and Dhumale, 1999).

India’s latest phase of economic reforms was initiated in mid-1991 with a primary focus on trade policy reforms. The trade policy changes of India since 1991 aimed at creating a far more open and competitive environment. Since 1991, the Government eliminated quotas, along with sharp tariff cuts, from a peak of 350 per cent to about 20 per cent which now resulted in significantly opening up of the economy to global competition. Duties on capital goods also came down. The import weighted tariff rate dropped from 87 per cent in 1990-91 to 15 per cent in 2005. The value of Indian rupee became more market determined and foreign transactions on
current account were made free from control. The reforms like removal of product specific export incentives coupled with two-stage devaluation of Indian rupee; use of exchange rate as the general instrument for export promotion and import management; removal of quantitative restriction on bulk of import items; reduction in level of tariffs on a large number of imports, including special provisions for preferential duty regime on imports for export production; some minor administrative measures such as removal of minimum price restrictions on some exports and streamlining of the procedural regime were designed to reduce transaction costs. With the establishment of WTO in 1995, India became the founding member of WTO and enjoyed the benefit of MFN treatment. India participated actively in the Ministerial Conference held in Cancum in which working group was set up to examine interaction between trade and competition policy, including anti-competition practices. WTO’s Agreement on Agriculture (AOA) provides for commitments in the area of market access, domestic support and export competition. Agreement on trade in textiles and clothing which was provides for phasing out the import quotas on textiles and clothing in force under the Multi-Fiber Arrangement (MFA) since 1974, over a span of 10 years, i.e. by the end of the transition period on January 1, 2005. Under the Agreement on Market Access (AMS), the member nations were to cut tariffs on industrial and farm goods by an average of about 37 per cent. The agreement on Trade Related Investment Measures (TRIMs) calls for introducing national treatment of foreign investment and removal of quantitative restrictions. Trade Related Intellectual Property Rights (TRIPS) Agreement provides for granting product patents in food, medicines, drugs and chemical products. Protection will be available for 20 years for patents and 50 years for copyrights. The General Agreement on Trade in Services (GATS) provides a multilateral framework of principles and services which should govern trade in services under conditions of transparency and progressive liberalization. Under this agreement, India has made commitments in 33 activities. With these trade policy reforms, at world level, the operation of free market forces
and removal of product specific incentives system should allow reallocation of resources according to the country’s dynamic comparative advantage.

Since the setting up of WTO and initiation of economic reforms, India’s outward orientation has increased considerably. The destination pattern of Indian exports has remarkably changed in the sense that the importance of developing countries as an export market has considerably increased. There are, however, concerns about the country’s ability to fully utilize its potential in international trade. In contrast to the dramatic changes in exports of East Asia, India’s experience has seemingly fallen short of expectations. India’s share in global trade did not rise impressively and the commodity structure of India’s exports remained almost unchanged until the mid-1990s (Basin, 2005). The composition of India’s exports by major commodity groups in 2007 was highest for ‘Manufactured Goods’ (68.6 percent) followed by ‘Engineering Goods’ (23.3 percent), ‘Primary Products’ (15.1 percent), ‘Petroleum, Crude & Products (including Coal) (15.0 percent), ‘Gems & Jewellery’ (12.6 percent), ‘Textiles including RMG’ (percent 12.5 percent), ‘Chemicals, Related prod.’ (11.2 per cent), ‘Agriculture & allied’ (10.3 per cent), ‘Ores & Minerals’ (4.8 per cent), ‘Handicraft’ (1.1 per cent) (Govt. of India, 2006-07). The share of total manufactured export increased from 58 percent in 1980 to 70 percent in 2007. India’s export drivers, viz. gems and jewellery, textiles, engineering goods, chemicals, and ores and minerals have recovered strongly, and services exports have imparted the fastest thrust to overall export growth.

The changing structure of India’s exports throw some interesting light on both the demand pattern and supply factors that are increasingly influencing India’s exports and the manner in which its production structures, institutions and policies are responding to it. The nature and extent of the export performance, however, need to be assessed not only by India’s share in global exports but also with regard to its structural pattern, compositional shift and competitiveness. The importance of primary
products in the export basket has witnessed a steady decline over the years and especially since the 1990s whereas petroleum products exports have shown a dramatic rise since 2000-01.

Contrary to India’s experience, the development in technology intensity of exports has been almost remarkable for most of the East Asian countries and also to somewhat for China. The areas wherein South East Asian countries attained their highest export growth during the 1980s were relatively low technology and labour intensive products such as sports goods, textiles, shoes, clothing and toys. Afterwards, during the 1990s, they graduated up to some extent higher technology and capital intensive sectors such as petrochemicals and capital goods.

The above discussion on the structure and composition of India’s exports indicates significant improvements since the initiation of the reform process. But at the same time, it is also revealed that export performance of the country has not been able to fully utilize the potentials in comparison to East Asian countries.

Furthermore, unlike the East Asian countries where industry has been the main driver of exports growth, the contribution of industrial exports in India has been comparatively low. This could be attributed to reservation for small scale industries and rigid labour laws as well infrastructural bottlenecks. Reservations for the small scale industries, low levels of factor productivity and high transportation costs are the factors, which are quoted as reasons for poor export performance by the country. The labour cost of producing a unit of manufacturing exports is one of the lowest among the developing countries (RBI). India has great potential of exports of labour intensive products to developed countries.

It is expected that the future export drivers for India will be textiles, engineering goods, including automobiles and capital goods and processed food items. Textiles have long been a traditional export item for India accounting for nearly one-fifth of the total exports during the 1990s. India’s
advantage in textile production, which is labour intensive, lies in its competitive advantage in terms of labour, raw materials including cotton and low import intensity. However, the textiles industry has, to a large extent, been reserved for the small scale industry, with the entry of the organized sector not permitted until recently. This has led to fragmentation of the sector leading to lack of economies of scale, low productivity, weak quality control and technological obsolescence. To tap the potential, the textile industry requires significant technological upgradation, scale building and a shift in focus from low value fabric exports to high value apparels and garments. (Basin, 2005)

The Indian automobile industry has witnessed significant growth in recent years which has resulted in associated growth across various automobile component supply segments (Suratwala, 2006). Today, the Indian automobile industry is ranked first in the world in the production of three wheelers, second in the production of two wheelers, fourth in the production of commercial vehicles and ninth in the production of passenger vehicles. In the last few years, the Indian automotive industry has grown at a healthy rate by reducing costs and improving efficiency (Kant, 2008). The liberalization steps, such as, relaxation of the foreign exchange and equity regulations, reduction of tariffs on imports, and refining the banking policies, initiated by the Government of India, have played an equally important role in bringing the Indian automotive industry to great heights (Katay, 2007).

India’s Tenth Plan recognized the fact that higher growth could not take place without tapping the opportunities offered by the international economy in terms of markets, investment and technologies along with improvement in competency and utilizing excess capacity available in the economy. An important prerequisite for establishing a more open economy is to build an expanding production base of tradable goods and services, which will provide the surplus necessary to ensure sufficient export earnings for meeting the import needs of the country and carry on external competition.
Another prerequisite is to make an environment under which the export market becomes progressively more competitive, so that there is both a shift from selling in the domestic market to exports and developing capacities to specifically target such export opportunities.

The observed growth of 7.8 per cent in the Tenth Five Year Plan (2002-2007), is the highest so far for any plan period and is only marginally short of the target of 8 per cent. A notable feature of growth during the Tenth Plan was the resurgence of manufacturing. There was a sharp acceleration in the growth of manufacturing from 3.3 per cent during the Ninth Plan to 8.6 per cent during the Tenth Plan. The growth in the services sector continued to be broad based (Govt. of India, 2008-09).

Despite trade liberalization measures introduced since 1991, India has not yet reached a sustainable position. India has only one percent share in world exports in 2006. India has dropped in its global competitiveness ranking to the 50th place from 48th, while neighbouring China has improved its ranking to the 30th spot from 34th position last year in the latest list compiled by the World Economic Forum. Even as the financial turmoil is ravaging the economy, the US has topped the league of 134 countries.

**NEED OF THE PRESENT STUDY**

Basic objective of Liberalization, Privatization and Globalization (LPG) strategy adopted by Government of India was to increase export competitiveness of India by free flow of goods and investment. As a result, sources or determinants of competitiveness might have changed from traditional Ricardo and Hecksher Ohlin theory of comparative advantage to new sources of competitiveness.

In view of the above discussion, the study of India’s competitiveness, its measurement, and determinants assumes importance. Present study has been undertaken with this perspective in view.
OBJECTIVES OF THE PRESENT STUDY

The study has tried to find out changes in competitiveness of manufactured exports at disaggregated levels and sources of competitiveness during the period 1980-2005. The specific objectives of the study are:

1. To study India’s competitiveness in global market.
2. To measure competitiveness of India’s manufactured exports at disaggregated level.
3. To bring out determinants of competitiveness of manufactured exports of the country.
4. To suggest measures to improve the competitiveness of the country.

HYPOTHESES OF THE STUDY

In light of above mentioned objectives, the study attempts to test the following hypotheses:

1. Competitiveness of India at global level is increasing.
2. Competitiveness of India’s manufactured exports at disaggregated level is increasing.
3. Commodity diversification has been taking place in manufactured exports of India.
4. Manufactured exports of India are diversified to large numbers of markets.
5. India’s exports are increasing due to favorable world trade effect, commodity composition effect, market distribution effect and competitiveness effect.
6. Manufactured exports of India have been diverting towards technological intensive products.
PLAN OF THE STUDY

The study has been divided into nine chapters.

First chapter introduces the study and outlines objectives, and plan of the study. Second chapter examines theoretical issues and critically examines the different theories of competitiveness of exports. Third chapter reviews the literature related to competitiveness of exports. Fourth chapter describes research methodology and data sources of the study. Fifth chapter examines the trends in international competitiveness. In this chapter 85 countries have been studied for the period 1985-2005. Sixth chapter provides in detail an empirical analysis of competitiveness of India’s manufactured exports during the time period 1980-81 to 2005-06. Seventh chapter examines the determinants of competitiveness of manufactured exports of India during the time period 1980-81 to 2005-06. Eighth chapter evaluates trade policy of India since 1980-81 in the context of competitiveness. Ninth chapter summarizes the study and derives implications from the analyses.