CHAPTER - I

INTRODUCTION

The prime concern of developing countries is to raise the per capita incomes and living standard of their people. The successful pursuit of this aim involves planning for the efficient and co-ordinated development of the major sectors, of the economy. Industrialization is seen as a means towards this end and so is economic diversification; when linked with trade, they constitute a powerful forces for economic growth. Their role in raising income and reducing dependence upon hard-hit traditional lines of production and export, as well as in nurturing new skills and techniques, is clearly recognised by the developing countries in their growth strategies, and the twin techniques of import substitution and export diversification are being vigorously used to assist in achieving these aims. Most of the developing countries are moving in this direction and have been doing so for the last two decades with varying degree of success.

However, the course of development has not always been either smooth or easy, its achievements at a satisfactory rate has been inhabited by many problems, chief among such had been the crucial shortage of food-stuffs resulting from the lagging and uncertain progress of the agricultural sector, and the over-ambitious nature of certain capital-intensive
programmes which has led to demands for large amounts of foreign capital, together these had created severe and mounting foreign exchange difficulties for the developing countries. From this view point, import substitution may be seen as instrument in the move towards removing, or at least reducing the external deficit.

The two gap theory also gives justification for import substitution. According to this theory, there are two constraints to economic development, i.e. the trade constraints and the savings constraints, the two gaps i.e. trade gap-and savings and investment gaps widened more and more as the pace of development had to be increased. Import substitution policy has been supposed to reduce these gaps by reducing trade gap and by generating income in the economy.

In short the developing countries have been experiencing balance of payments difficulties, as a result of difficulties in the exports of primary products arising from adverse terms of trade, stationary export volumes and fluctuating prices. These have been aggravated by the need for ever increasing imports to sustain ambitious development programme. Accordingly the countries have turned to import substitution especially in the manufacturing sector, in an attempt to alleviate the problem.
The first phase of industrialization is usually based on the home market in the form of import substitution with a ready market, a small degree of protection will provide incentives to develop these industries, and their domestic production will conserve foreign exchange for import of capital equipment and other essential products which cannot immediately be produced. Some of the import substitute commodities may be exported to earn additional foreign exchange if they are developed successfully. It is a simple process of import substitution in general.

Nevertheless, planning for import substitution should be undertaken with extreme care, in order not to waste scarce resources or lead to frustration and disappointment and reduce the initiative and momentum for future growth. The cost and quality should be paid proper attention in case of import substitutes. One of the main effects of import substitution programmes is that they usually result in an increased demand for foreign exchange at least in the initial stages. Apart from this initially higher domestic cost may mean for the privilege of producing its own commodities than importing them. These considerations emphasize the necessity for close scrutiny of proposals for domestic production of imported goods.

The inducement of structural changes accompanying a policy of import substitution has been a fairly important
criterion in guiding the allocation of investible resources for industrial development in the Indian economy. Since the beginning of five year plans in 1950, the domestic production of hitherto imported (and importable) goods has been attempted over a broad range of industrial products with varying degree of success.

It is well known that India has been experiencing a serious balance of payments problem, particularly since 1958 when the sterling reserves were virtually wiped out, as a result of difficulty in increasing the export of traditional primary commodities. The difficulties arise from the facts of virtually stationary export value and fluctuating world prices. The International payment deficit is, of course, aggravated by the need of ever increasing imports of capital goods and essential raw materials to sustain ambitious programmes of industrial development. Indeed the greater part of the strategy of Indian development revolves around the problem of reconciling the growth of industrial capacity with a tolerable balance of payments. Evidently, an easing of a balance of payments crisis can be accomplished either by increasing export earnings or by restricting imports. In India's case, it seems reasonable to admit that it would
be extremely difficult to secure a substantial net increase in earnings from traditional exports. The constraints on the ability to reduce imports are equally binding.

Therefore, keeping the above reason a major role has been assigned to industrialization via import substitution. The object was to lay foundation for sustained economic growth and to achieve rapid increase in the standard of living of the people within a democratic socialistic framework. A large number of industries have been set up to produce goods that were previously imported. These industries have been protected from foreign competition by means of tariffs and controls. The organised industrial sector of the country grew very rapidly under the policy of import substitution.

OBJECTIVE AND SCOPE OF THE STUDY:

The structural changes accompanying and resulting from such policies are being induced within the general context of development plans and indeed, constitute an integral and important part of these plans. Thus a study of process of import substitution and of their implication and repercussion upon basic economic aggregates such as employment, production, trade, capital formation & income is essential.
One of the basic objectives of this study is to examine the role of import substitution policy in industrial development of India. Import substitution has brought structural change in industrial production and foreign trade of India, which has been discussed in detail in this study. It has brought dynamic change in industrial sector. Initially economy was traditional agricultural based which turned to be industrial economy since the Second Five Year Plan from which import substituting industrialization was followed. It is a must to measure the degree and magnitude of import substitution in the manufacturing sector (ASI Sector) in order to analyse the role played by import substitution in the industrial development of India. Measurement of import substitution has been analysed in order to examine the sources of output growth in Indian manufacturing sector through appropriate measures during 1960 to 1980-81. The progress of major industry sectors has been evaluated in the present study to analyse the pattern of industrial growth in India.

It is hoped that the analysis presented in the following study will provide a basis for a more precise understanding of the role of import substitution in industrial growth than can be observed from the aggregative indicators of growth.
The concept of import substitution is not a very clear analytical concept. Chapter II, therefore, provides a detailed explanation of the trade and development in international context and the explanation of definition, meaning, nature and scope of the import substitution policy. The historical background and motives & process for import substitution is, next, traced out under this chapter. Finally, the chapter points to the various criticism levelled against import substitution policy.

Import substitution in an open economy is easily recognised when an increase in domestic production results in a decrease of imports. In such a case the extent of import substitution may be measured as the algebraic difference between the change in domestic production and the change in imports during any time periods, alternatively, the saving in foreign exchange. But in growing economies the above measurement of import substitution would be meaningless where the domestic production of a commodity increases, but the amount of increase is less than the growth of domestic demand, imports will continue to rise, and there would actually be no saving of foreign exchange. Therefore, it is necessary to examine the source of output growth in a particular sector to measure
the relative importance of import substitution. Chapter III discusses the various measures of import substitution, their limitation and application. This chapter summarises the findings of various studies of measurement of import substitution and relates it to the indicator of economic growth. This chapter also explains in short the economic efficiency of import substitution; various estimates of efficiency with the reference of recent studies have been given in this chapter. It was must to refer the problem of economic efficiency as it determines the success or failure of import substitution policy.

Chapter IV deals with the process of industrial development in India - Its industrialisation and trade policy. India's experience in process of industrialisation is like those of developing countries. India has now reached in ten most industrialized nation of world, which itself indicates her strong capacity of transformation from a traditional economy to industrial economy. Industrial development in India has been guided by her economic policies in general and by trade and industrial policy in particular which has been discussed in Chapter IV.

A quick review of the Indian economy during the last decades is intended to show that industry got a lions share
of additional resources mobilised during the planned development process and that foreign trade played a declining role in relation to G.N.P. Chapter V analyses and reviews the progress of Indian economy in the last three decades. Rationale of import substitution policy which has been assigned a major role in bringing structural changes in Indian industry and trade is also discussed in this chapter.

Chapter VI analyses the structural changes in India's foreign trade with special reference to the import substitution policy. Policy of import substitution has been overviewed by analysing the structural changes in India's foreign trade during, 1951 to 1981. Structural change has been experienced in composition of exports, imports and the import dependence of the manufacturing industry. The commodity concentration of exports and imports and their relative importance have been discussed in relation to other variable, i.e. income, capital formation, domestic production, savings etc.

Chapter VII, analyses the pattern of industrial growth in India. The existing industrial structure is the product of the economic and the industrial policies, pursued by government since independence. Although there was an industrial base in terms of traditional industries like textiles, jute, sugar, tea and also some engineering industries, but there was not a
sufficient industrial base at the time of independence. The development of industries during the last thirty five years has somewhat compensated almost a century of stagnation and arrested growth in Indian economy prior to 1947. Import substitution has been instrumental to induce industrialization in the country during the last three decades which has been discussed in the Chapter VII.

It is essential to know the magnitude and direction of import substitution while analysing the role of import substituting industrialization in a developing economy. Import substitution not only brings structural change in import and domestic production but also affects the external demand and internal demand of the economy.

Chapter VIII deals with the choice of measures of import substitution adopted in the study. The other two section of the chapter discuss, the extent of import substitution achieved in Indian manufacturing sector during 1950 to 1960 and the 1960 to 1980-81. It is assumed that import substitution have been instrumental in output growth in Indian manufacturing sector. Relative importance of import substitution to other sources of output growth have been discussed in this chapter. Such an analysis will help in future planning for import substitution and in
framing of industrialization and trade policy. The data used in this analysis are of benchmark years of Annual survey of industries production data at 2 digit level and also at three digit level. The corresponding export and import statistics have been taken from Monthly statistics of Foreign Trade of India, various issues.

Chapter IX deals with the conclusion of the analysis of study. It also deals with the suggestion and recommendation for the successful implementation of the import substitution policy in India.