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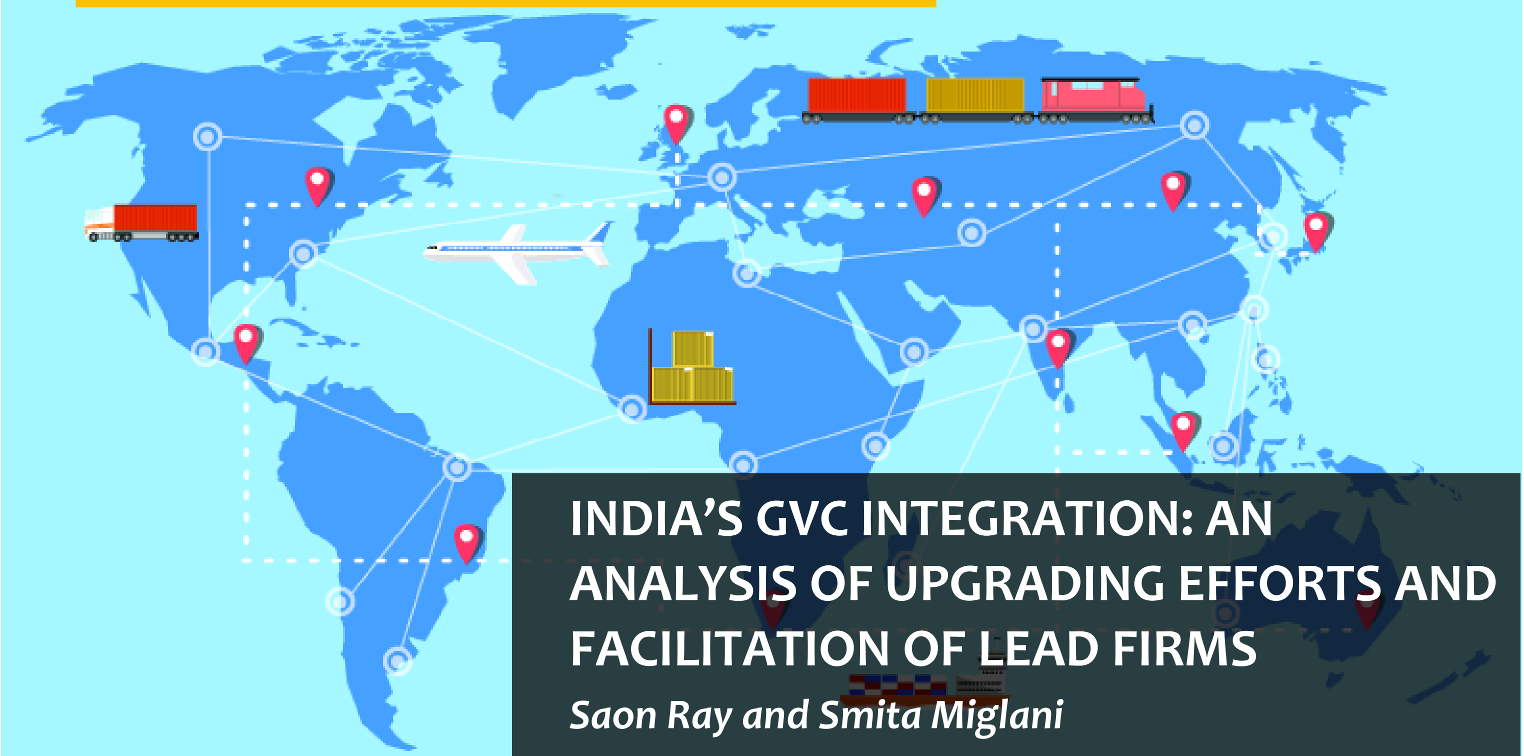


INDIA'S GVC INTEGRATION: AN ANALYSIS OF UPGRADING EFFORTS AND FACILITATION OF LEAD FIRMS

Saon Ray and Smita Miglani

Key Highlights

- India presents a unique example of manufacturing capability in most sectors, but low integration into GVCs. This paper examines the reasons for India's low integration into GVCs in the manufacturing sector.
- One of the main reasons for India's low integration into GVCs is its primary focus on the domestic market. The second reason is the limited role played by the lead firms.
- India has enacted several horizontal and vertical policies; there are fewer instances of GVC specific policies which lead to the encouragement of lead firms.
- Many of the barriers have resulted from the fact that India has adopted a largely piecemeal approach to policy-making with regard to value chains till now. GVCs do not respond to piecemeal approaches to policy changes and a holistic approach is needed.

EXECUTIVE SUMMARY

India presents a unique example of manufacturing capability in most sectors, but low integration into GVCs. This paper examines the reasons for India's low integration into GVCs in the manufacturing sector. It argues that one of the reasons for India's low integration into GVCs is its primary focus on the domestic market. The second reason is the limited role played by the lead firms. In this paper, we show that while India has enacted several horizontal and vertical policies, there are fewer instances of GVC specific policies which lead to the encouragement of lead firms. The policy implications from the paper are the processes that emerging countries can follow in nurturing lead firms.

International trade has been dominated by trade in intermediate goods and services since the mid-1990s. The emergence of global value chains (GVCs) has occurred, with the fragmentation of production, whereby value is added in multiple countries, leading to an increase in trade in intermediate parts and components.

The emergence of GVCs worldwide has been uneven, with a limited number of emerging economies taking the lead in supplying intermediate inputs and final assembly. While there are several papers examining the reasons for success of countries in engaging in GVCs, fewer studies document the reasons for countries failing to integrate into GVCs. This paper examines the reasons for India's low integration into GVCs in the manufacturing sector, using findings from a firm level primary survey. While India has several horizontal and vertical policies, there are fewer instances of GVC specific policies which lead to the nurturing of lead firms. The policy implications from the paper are the

processes that emerging countries can follow in encouraging lead firms.

ROLE OF LEAD FIRMS IN GVCS

Lead firms have been defined as small, medium, or large firms that have forward or backward linkages with a large number of medium and Micro, Small and Medium Enterprises (MSMEs). GVCs generally involve a key role for lead firms, often known under global brands, such as Levi in garments, Carrefour in food retailing, Ford in automobiles, or Ericsson in telecommunications. Usually lead firms are multinational corporations (MNCs), and these firms create networks by breaking down the value chain into a variety of discreet functions and locating them wherever they can be carried out most effectively. These firms generally outsource 'commodity like' activities that add little value, while they retain direct control over intangible, high value added activities as opposed to low value added activities.

Lead firms' activity in developing countries has not been sufficient enough in the GVC framework. Lead firms have also played a limited role in India's GVC integration, in line with its low participation rate.

THE CASE OF INDIA

Participation of a country in GVCs is defined by its engagement with a particular part of the production process, that is, trade in intermediary goods and services. This is defined as the sum of the share of foreign value added in gross exports (backward linkages) and the share of domestic value added in exports of intermediate goods (forward linkages).

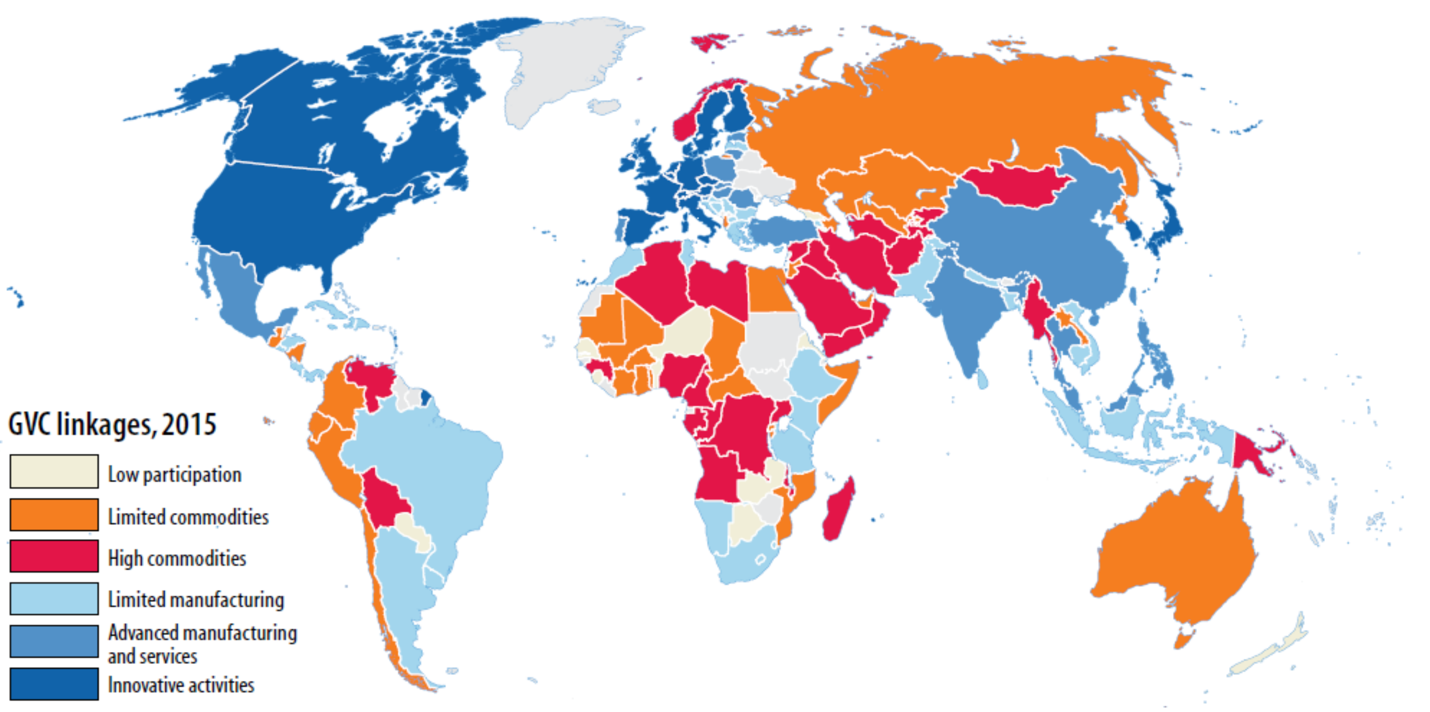
India's integration into GVCs remains low despite the strong growth in trade flows over the last two decades. Its participation index stands at around 40%, obtained by combining the measure from the buyer's and seller's perspectives.

Figure 1 shows the nature of India's participation in GVCs and also of the other countries of the world, as pointed out in the World Bank's World Development Report 2020. According to the Report, India has been making a transition from limited manufacturing to advanced manufacturing and services in recent years.

To corroborate findings from secondary sources, a firm level primary survey was conducted in the years 2014 and 2015 to capture the elements of value chain activity in India. It covered 123 firms across six states in five selected sectors. The survey helped in identification of the role of lead firms across sectors and provided an idea about the integration and upgrading in the chosen sectors. Table 1 gives a snapshot of the role played by lead firms in selected sectors of GVCs, along with their examples in India.

The survey confirmed that India faces a gamut of issues that have impeded its

Figure 1: Countries' participation in GVCs



Source: World Development Report 2020, World Bank.

Table 1: Evidence of integration and role played by lead firms in GVCs; examples from India

Sector	Integration	Upgrading	Role of lead firms	Whether present, and examples of lead firms (MNC and Indian)
Automobiles	Yes	Yes	Catalyst for innovation, harbingers of technology, financial investment, and skilling workforce	Yes, a few (Tata Motors)
Chemicals (specialty)	No	Limited	Heralded innovation and stimulated demand	Yes, very few (BASF)
Diamonds	Yes	No	Skilling workforce and attracting important investors	No
Garments	No	Limited	Reduction of lead times, standardisation of the production process, and preferential transportation and logistics through long-term relationships	Yes, very few (Gap, VF)
Paper	No	-	Introducers of modern technology	No
Petrochemicals	Yes	No	Overcoming problems of feedstock access, attracting investment, and forward integration	Yes, very few (Reliance)
Pharmaceuticals (Formulations)	Yes	Limited	Significant role in establishment of IP compliance	Yes, a few (Ranbaxy)
Reactive dyes	Yes	No	Introduction of environmental standards and greener options	Yes (Sudarshan Chemicals)
Semiconductor microchips	Yes	No	Innovation leading to reduction in costs	Yes, a few (Texas Instruments)

Table 2: Some recent policy enactments

Horizontal policies – GST 2017, Labour reforms – Unified labour and industrial portal, Labour Inspection scheme 2014, Make in India 2014, Skill India 2015, Digital India 2015, IPR 2016, Sagarmala 2015, Bharatmala 2017, FDI policy reforms (various years)

GVC policies aimed at all sectors - Logistics sector schemes, Indian Trade Portal 2014, Investor Facilitation Cell 2014.

	Sector specific/ vertical policies	GVC related sector specific policies
Automobiles	• Automotive Mission Plan 2016-26 • National Electric Mobility Mission Plan 2020 • Faster Adoption and Manufacturing of (Hybrid &) Electric Vehicles • The National Automotive Testing R&D Infrastructure Project • New Green Urban Transport Scheme, 2017	Customs duty on specified parts/accessories of motor vehicles, increased during 2018 and 2019
Chemicals (specialty)	• Policy to establish PCPIRs	-
Diamonds	• Special Notified Zone: opened in Mumbai in December 2015. • Development of 310 National Occupational Standards	Customs duty increase (2018)
Garments	• Scheme for Integrated Textile Parks for funding of infrastructure, buildings for common facilities. • The Integrated Skill Development Scheme to provide skills to 26.75 lakh persons between 2010-11 and 2014-15 for employment in textiles. • Amended Technology Upgradation Fund Scheme for textiles approved in January 2016	Customs duty increase (2018)
Petrochemicals	• PCPIR, Setting up of "Centres of Excellence" for research.	-
Pharmaceutical (Formulations)	• The National Pharmaceutical Pricing Policy, 2012. Regulation of prices of drugs on the basis of regulating prices of formulations.	-

Source: Authors' compilation

integration into GVCs. These range from slow turnaround at ports, lack of resources (finance and skill), constraints, technological backwardness, lack of R&D, delays in approvals and operational issues across sectors.

The Indian policymakers have recognized the gaps in different areas and while many of the recent changes in policy are a step in the right direction, the focus on facilitating national champions or lead firms has been missing. Most of the recent GVC specific policies are increasing the cost of intermediates and can only be attributed to the lack of a holistic approach to this issue. Table 2 summarizes the recent policy enactments in India.

Previous studies have discussed the need for policy reform measures (related to land, labour, taxation, infrastructure development, and setting up SEZs, among others) which can stimulate FDI inflows into manufacturing and improve the environment for domestic investment. The same measures are also considered useful in boosting competitiveness as a GVC location by strengthening MSMEs, making it easier for multinational firms to outsource processes to these enterprises. The automobile industry in India has been a successful example of this. Studies have also noted that the development of functional and manufacturing capabilities requires GVC appropriate industrial policy. Such a policy needs to focus on segments within sectors and support different forms of upgrading.

Traditionally, India's trade and manufacturing policy has primarily targeted the domestic market. This has also been true for the FDI policy. Unlike other countries such as China or Vietnam, whose FDI policy has been focused on inviting multinational firms with GVC linkages to their countries, India has not been selective about its approach. In an integrated approach to be a part of GVCs, it needs to specifically select and attract the GVC linked firms – the large sellers and large markets or buyers of the produced goods. This kind of approach will forge links between local and global lead firms. A second step in this would be ensuring inter-ministerial coordination in taking policy decisions which stay aligned to the GVC integration priorities. Exercising caution and prudence while finalising international trade agreements would help policymakers identify the right partners and markets for the set goals.

CONCLUSION

The paper identifies a number of impediments which if removed can lead to greater engagement in GVCs for the country through emergence of lead firms. Important areas of reform action are reduction of the administrative costs associated with traceability of products; harmonisation/mutual recognition of standards along the GVCs; reduction of barriers at the border, including customs and trade facilitation processes. The need of the hour is to lift productivity levels across sectors and create jobs. The policies followed by India have not been particularly conducive to encourage GVC integration or the development of lead firms.

Many of the barriers have resulted from the fact that India has adopted a largely piecemeal approach to policy-making with regard to value chains till now. GVCs do not respond to piecemeal approaches to policy changes. Rather, a holistic approach is needed, in cooperation with the international community and businesses.

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