ISSN 2278-8808 IMPACT FACTOR: 1.38
An International Peer Reviewed
SCHOLARLY RESEARCH JOURNAL
FOR INTERDISCIPLINARY STUDIES

The role of monetary and fiscal policy in industrial development: industrial revolution in developing countries.

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Abstract

The purpose behind to construct the macroeconomic policies is to stabilize the fluctuation in business cycle. Usually, fiscal and monetary policies in industrial countries have been expansionary in response to weak domestic conditions.In spite of high prevalence of vulnerable employment and working poverty in developing Asia, full employment is not a legislated objective of any industrial countries. This paper presents a broad overview of fiscal issues dealing with developing countries. We focus the factors which associated to weak institutional framework that play a key role in explaining sub-optimal policy decisions and weak integration to either domestic or international financial markets.In this paper we investigate the multifaceted correlation between industrial development and economic structure, by focusing on one of its trade implications, the effect of international specialization patterns on export performances of countries.This analysis is stand on secondary data which is based on industrial policy of India, ILO, Indian government-annual industrial growth data and World Bank report. This study is favored by critical approach and shows that the trade performances and their evolution over time can be explained by the specialization pattern in the international distribution of economic activities as well as macroeconomic aspects.

Key words: *monetary policy, fiscal policy, industrial growth and economy.*

INTRODUCTION

Development is considered synonymous with industrialization. Development policies included government expenditures, monetary policies, inflation rate and foreign direct investment, resource allocation, structural changes and labor market.

In current scenario, Industrial growth entered the positive territory after three months in January by growing 0.1% while consumer inflation moderated to a two-year low of 8.1% in February on the back of fall in food prices. In our study we focus on the industrial growth year by year. From last two- three years industrial growth was not moving in positive side it was in negative direction by 1 to 2%. Industrial growth recovered after contracting for three months in a row although industry and experts said there were no visible signs of an economic recovery. The marginal improvement in the Index of Industrial Production (IIP) was mainly on account of higher power generation and mining sector output, while manufacturing declined. In this analysis, two things are taken together to explain the industrial development i.e. public policies (monetary and fiscal policies) and inflation rate in India. As we know these two things provide a base for economic growth. Index of Industrial Production is one of the prime indicators of the economic growth,it detailing out the growth and trend of various sectors. The scale of IIP represents the status of production in the industrial sector for a given period, as compared to a reference period.

In this paper we explained the inter-linkages among public policies, inflation rate and industrial development. This paper evaluates how and where industrial growths affect our economy growth how we can decide the positive relationship between inflation rate and industrial growth and economy.

India is developing country and it recorded a fast growth after 90's. Yes, we can say from the last 3-4 years it slowed down but still it trying to move upward. There are lots of policies are being formulated for the development of economy in which a large share contain industrial development policies. The Indian Constitution provides the overarching framework for the country's fiscal policy. India has a federal form of government with taxing powers and spending responsibilities being divided between the central and the state governments according to the Constitution. There is also a third tier of government at the local level. Since the taxing abilities of the states are not necessarily commensurate with their spending responsibilities, some of the Centre's revenues need to be assigned to the state governments. These above are responsible for industrial growth in any developing countries.

OBJECTIVE OF THE STUDY:

- To analyze the industrial growth in Indian economy.
- To evaluate the inter-linkages between inflation and industrial growth.
- To find how monetary and fiscal policy affect the industrial development.

RESEARCH METHODOLOGY:

In this study we use secondary data from various sources like ministry of statistics and program implementation, Indian economy advisory council etc. We applied critical approach in this study.

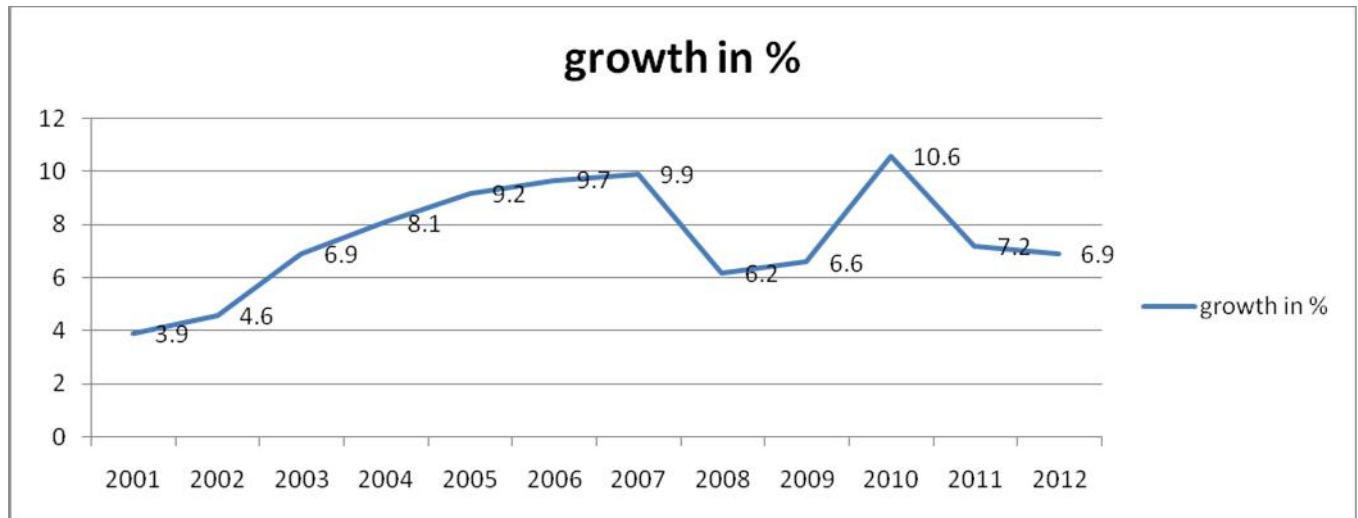
GROWTH OF INDIAN ECONOMY:

"India Shining" has been the unofficial slogan for India since the turn of the 21st century. India averaged 8% annual GDP growth in the three years before the recent global financial crisis. Armed with population strength of more than a billion people, India is now the 11th largest economy in the world. According to data, from India's Planning Commission, rapid economic growth has contributed to a decline in the poverty rate with 37.2% in 2005 to

29.8% in 2010,a drop of 40 million people in the absolute number of the country's poor. Per capita income doubled during those five years.

Developing economies: rates of growth of real GDP, 2002-2012

	2001	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*[c]
India	3.9%	4.6%	6.9%	8.1%	9.2%	9.7%	9.9%	6.2%	6.6%	10.6%	7.2%	6.9%



Source-**United Nations *World Economic Situation and Prospects 2011* Statistical Annex**

INDUSTRIAL GROWTH IN INDIAN ECONOMY:

Industrial growth was volatile across all sectors in this period. In terms of the use- based classification of industries, the capital goods sector sustained negative growth in the last six quarters. Growth in the consumer durable sector continued to fluctuate, turning negative in q4 of 2011-12, 0.7 % in q2 and 3.2% in q3 of 2012-13. Pickup in growth in October was generally broad based with consumergoods, capital goods, and intermediates showing improvement in performance. The growth of consumer durables 16.9 per cent was the highest in the last 20 months.

In India, industrial production measures the output of businesses integrated in industrial sector of the economy such as manufacturing, mining, and utilities. It is reported by the Ministry of Statistics and Program Implementation (MOSPI) in India. Industrial Production averaged 6.79% from 1994 until 2014, reaching an all-time high of 20 Percent in November of 2006 and a record low of -7.20 % in February of 2009.

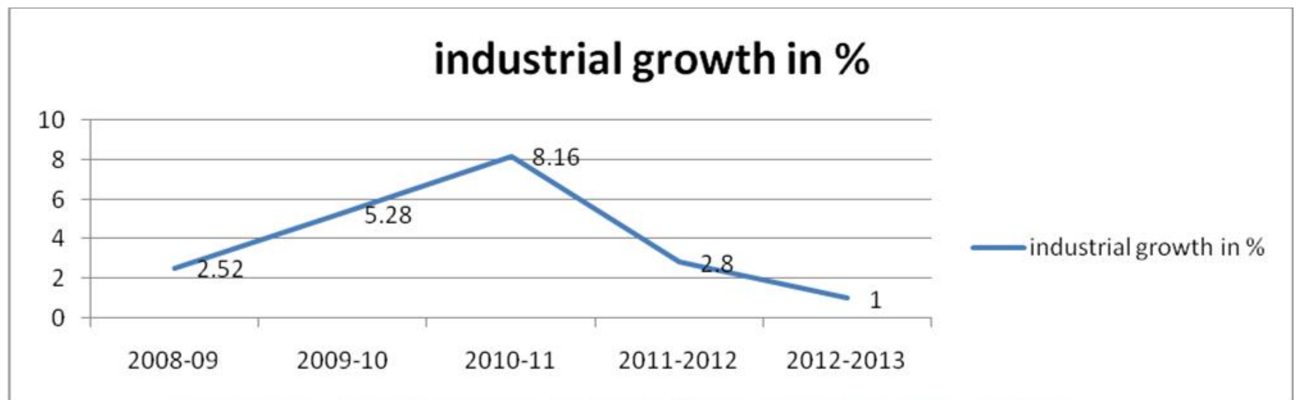
Industrial growth slowed to a 20-year-low of 1% in 2012-13, raising fresh worries about the health of the crucial sector despite rising 2.5% in March on the back of some signs of feeble revival in manufacturing and electricity.

The looming political uncertainty in the run-up to the general elections in 2014 could impact even the strength of the tentative recovery and hurt growth which is estimated to have slowed to a 10-year-low of 5% in 2012-13. The government expects growth in the current fiscal year

(2013-14) to revive following reform steps announced since September and expects it to be close to 6% but experts say continued policy logjam may upset plans.

The persistent slowdown in the industrial sector has hurt the government's plan to raise the share of manufacturing in the country's economy and will deal a blow to efforts to create millions of jobs.

In brief annual industrial growth has shown in graphical chart that explain the ups and down in industrial growth year by year.



Source- Indian economy advisory council

Literature review:

For developing countries aiming to maintain growth while sustaining job creation, manufacturing offers an opportunity not only to rebalance the economy towards higher value-added sectors but also to provide a relatively wide employment base with higher labor productivity. The transition from agriculture to services, especially for low-income countries, offers the opportunity to achieve only the first objective, not the second.

C. Rangrajan (1982) he draw a conclusion that emerge from his analysis that agriculture exercise a reasonably strong influence on the growth of industry. According to his study 1% growth rate in agriculture can generate itself 0.5% industrial growth. This is strong influence considering that industrial growth is not totally dependent on agricultural growth because the ability to raise the agriculture growth rate limited that's why industry cannot rely on agriculture alone to stimulation growth.

Waa lee Jong (1995) in study he found that trade protection reduced growth rates of labor productivity and total factor productivity, while industry policies, such as tax incentives and subsidized credit were not correlated with total factors productivity growth in the promoted sectors. The evidence, then implies that less government intervention in trade is linked to higher productivity growth.

Aghiobnphilippe, devidhemons and Enissekharroubi (2005) have argued that higher macroeconomic volatility affects the composition of firm's investment and in particular pushes towards more pro-cyclical R&D investment in firm that are more credit constrain.

Ajit Singh (2008) has taken in his study a wide view of industrial policy, emphasizing the coordinating role of the government in various spheres. He has examined the country's past and present industrial policy and speculated about the role and content of future industrial policy. He also argued that the Planning Commissionis a major institutional advantage for the Indian people.

M.S. Mohanty (2012) found in his study that foreign currency debt issuance can contribute Significantly to the growth of foreign exchange reserves, it can cause serious difficulties in assessing reserve adequacy. This is especially the case during a crisis when it becomes almost impossible to refinance maturing debt at a time when, for various reasons, the reserve requirement may be rising still further.

DRIVERS FOR THE INDUSTRIAL GROWTH:

Interest Rates

Interest rates can impact the growth of an industry in several ways. If interest rate decreases then money supply in the market increases and it also increases the industrial growth. In large-ticket industries such as vehicle manufacturers or cruise companies, an increase in interest rates can prevent customers from borrowing to finance the purchase of these types of products and services. High interest rates also deter companies from investing in new capital and expansion. On the other hand, falling interest rates can stimulate industries to grow, which can lead to innovation and higher employment levels.

Currency Strength:

A currency level has a direct impact on the various aspect of industrial growth i.e. trading, export and import in general terms, the week currency will stimulate export and make import expensive, thereby decreases a notation's trade deficit vice versa, a significantly stronger currency can reduce export competitiveness and make imports cheaper, which can cause the trade deficit to widen further, eventually weakening the currency in a self-adjusting mechanism. But before this happens, industry sectors that are highly export-oriented can be decimated by an unduly strong currency. Companies in the industry that purchase inputs from other countries are able to be more competitive in pricing. In industries that are heavily reliant on foreign raw materials and processing, such as the clothing industry, the entire sector can be lifted or depressed with a strengthening or weakening of the rupee.

Government Intervention

Many industries are regulated by the government in several ways. Government agencies such as the Environmental Protection Agency, the Food & Drug Administration or the Department of Agriculture maintain standards that all operators in an industry must follow for the safety of consumers, employees, or natural resources.

According to J.W. Lee (1995) in his paper he mentioned that less government intervention in trade linked to higher productivity growth that encourages investment in industry sectors.

Some industries are more heavily regulated than others and new laws and rules can shake up an entire industry and depress growth. For example, new child toy safety laws implemented under the Consumer Product Safety Improvement Act in 2009 threatened to wipe out many small toy producers as the requirements to test and certify the toys were cost-prohibitive to all but large toy manufacturers. Proposed changes to the Act may help alleviate the burden on small manufacturers and resellers.

Environmental Impact

Economic growth in an industry can be impacted not only by the environmental effect the products or services have but also by consumers' perceptions of that impact. For example, the market for fur apparel declined drastically over the course of a few years in the 1990s when consumers perceived that raising and killing small animals for their fur was both inhumane and a poor use of land. Although the industry is once again picking up with international demand, the number of fur farmers in the country has substantially declined. If the public views an industry's products or services as being harmful or unsafe, most companies within the sector can experience a marked decline in sales quickly.

Overall Economic Health

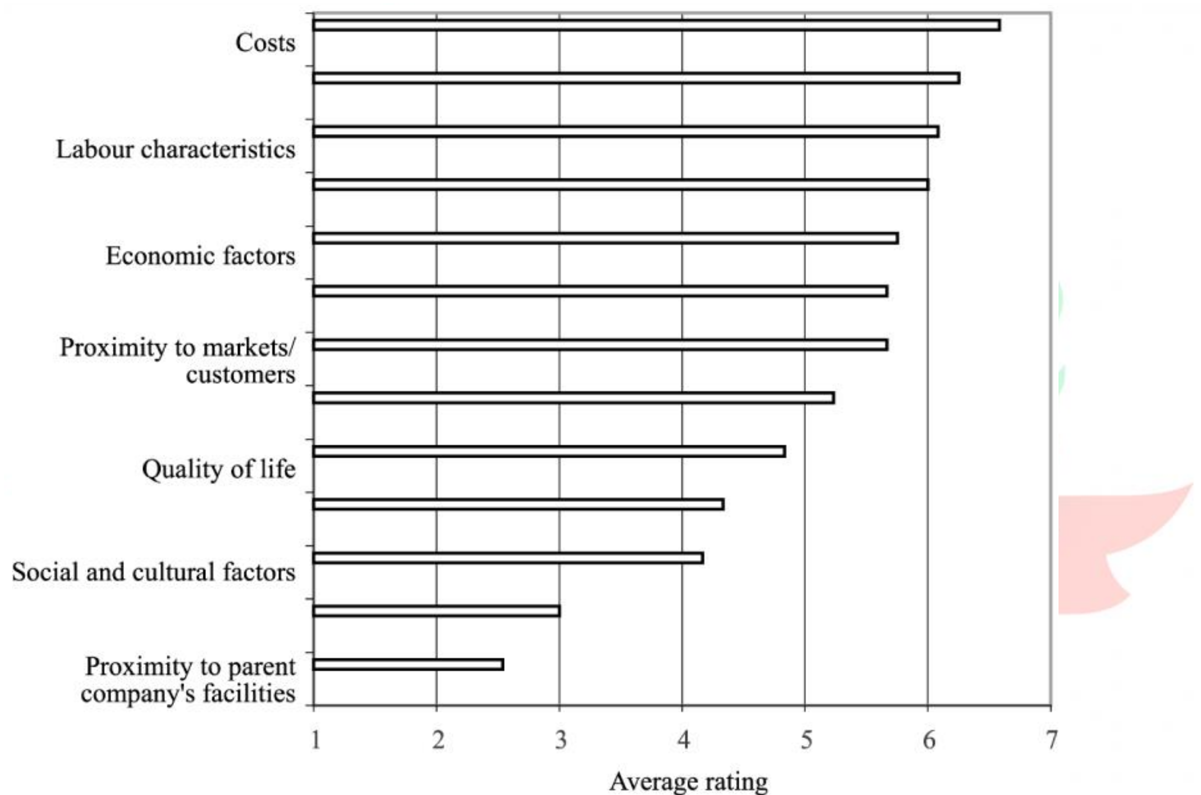
The economic state of the country and consumer confidence can also encourage growth and development or harm it. In recessionary times, consumers begin limiting their purchases to the essentials, foregoing luxury or big-ticket items. Companies also scale back production, hiring and the development of new products and services to ensure that their finances can weather the storm. In periods of overall economic growth, these companies once again expand. The opposite is true in industries that deal in basic consumer goods that everyone needs regardless of the economy: food, diapers, and staple goods. Demand picks up for these necessities as consumers stock up on them and substitute basic goods for luxury goods (example: people buy more groceries to eat in rather than go to a restaurant). In inflationary times, the demand for staple goods declines as consumers can afford more luxury substitutes.

Co-operating internationally:

International co-operation on industrial changes requires preventing any race to the bottom. Firm’s inrich countries could be tempted to relocate to lowincomecountries with lower labor costs, less restrictive labor laws and weaker monitoring of labor conditions and environmental impacts. At the same time, to address these challenges, national regulators need a measure of policy autonomy, a position that may beat odds with international cooperation through trade agreements.

Other factors influence economic growth that are Infrastructure, Market competition,Capital investment, Human resource (labor market) and Availability of resources. We draft a diagram in descending order of the factors according to their rating. As we can see in diagram the cost having 6.67 highest ranking the second factors which affect most labor characteristics. This cost include raw material cost, wages, warehousing inventory etc. the second one is labor

characteristics it's rating is 6.2 that mean regular labor, permanent or on pay-roll labor, contractual labor also affect the productivity. Which are directly related to industrial growth? Third is economic factors that is also explained earlier, the nature of production in inflationary time or in recessionary time. Other economic input also related to the industrial growth like agriculture inputs, animal production, rural and sub urban area development etc. fourth is proximity to market/customer that explore the market condition like monopoly or oligopoly or perfect competition. Industrial growth can be also influenced by the consumer attitude toward the productivity of any industry; hence this factor has been rated at 5.67. Fifth is quality of life that influence to the customer to spend their money in market. It encourages the industrialist to produce more commodities that improve the easiness of life. Industrial growth can also be affected by the social and cultural factors 4.2 and the which also contribute in industrial growth that is the parent company facilities.



RELATIONSHIP BETWEEN INDUSTRIAL GROWTH AND INFLATION RATE:
Inflation is broadly understood as the general rise in the prices of goods and services year on year, inflation is a more complex phenomena associated with the money supply and currency values.

Economic growth and inflation are both positively correlated. This means that inflation is one of the inherent economic growth's features. Hamilton (1952) claimed that inflation is an important stimulant for creating growth and Rostow (1960) also argued that inflation is necessary for developing industrial take-offs. Keynes argued that investment can generate its own saving by raising the level of income when the economy is not performed, and inflationary policy can redistribute income from wage earners with low propensity to save to profit earner with high propensity to save when economy perform at full capacity. The second argument of Keynes is, the inflation can encourage investment by raising the nominal rate of return on investment and reduce the real rate of interest.

Inflation rate in India

We have given an overview of historical Indian inflation. This inflation rate is based upon the consumer price index. In this data, the annual inflation rate is given by year December to December.

Annual inflation of the year	Inflation rate
1994	9.47%
1995	9.69%
1996	10.41%
1997	6.29%
1998	15.32%
1999	0.47%
2000	3.48%
2001	5.16%
2002	3.20%
2003	3.72%
2004	3.78%
2005	5.57%
2006	6.53%
2007	5.51%
2008	9.70%
2009	14.97%
2010	9.47%
2011	6.49%
2012	11.17%
2013	9.13%

1. Source: inflation.ew: worldwide inflation data

According to public finance argument, two mechanisms relate inflation and development. First: if a poor country catches up and grows, then productivity increasing in the tradable sectors, thereby increasing wages and leading to an increasing in the price of non-tradable goods, the result is inflation

Secondly, it is expensive to keep a well-functioning fiscal system, countries with lower GDP per capita income will find it more difficult to levy taxes, government therefore have an incentive to switch from taxes to inflation financing.

Still we can't say the direct relationship between inflation and industrial growth. Growth of industrial sectors is related to various variables like, political issues and social structure issue that are indicators of GDP level of country.

HOW MONETARY AND FISCAL POLICIES AFFECT THE INDUSTRIAL GROWTH:

Monetary policy refers to the use of instruments under the control of the central bank to regulate the availability, cost and use of money and credit. The main objective of the monetary policy in industrial development is to ensuring adequate flow of credit to the productive Sectors of the economy to support economic growth. To Keynesians, a discretionary change in money supply permanently influences real output by lowering the rate of interest and through the marginal efficiency of capital, stimulate investment and output growth. In contrast to Keynesian policy prescription, McKinnon and Shaw in advocating the financial liberalization hypothesis argued that a market force persuaded higher interest rate, would enhance more investment by channeling saving to productive investment and stimulate real output growth. In India govt has to control over the policy objectives thorough the various methods that include general quantitative method (open market operation), direct instruments (CRR, SLR) and indirect instruments (liquidity adjustment facility and margin standing facility).

Expansionary monetary policy implemented can be affect real economic sector noticeably by reduction in the legal deposit rates or increase in the banks debt to the Central Bank and can be positive effects by increase in the production and employment level and increase in the components of total demand and consequently improvements in public welfare. In this pattern, exchange policies implemented by increase in the nominal exchange rate causes to decrease imports and gross domestic product (GDP). Contrary to expectations, this policy affects non-oil export and increases in the production noticeably.

Fiscal policy deals with the taxation and expenditure decisions of the government.These include, tax policy, expenditure policy, investment or disinvestment strategies and debt or surplus management. Fiscal policy also feeds into economic trends and influences monetary policy. When the government receives more than it spends, it has a surplus. If the government spends more than it receives it runs a deficit. To meet the additional expenditures, it needs to borrow from domestic or foreign sources, draw upon its foreign exchange reserves or print an equivalent amount of money.

The fiscal policy of 2013-14 has been calibrated with two fold objectives - first, to aid economy in growth revival; and second, to bring down the deficit from 2012-13 level so as to leave space for private sector credit as the investment cycle picks up.
The central government's FY2013 fiscal deficit came in better than expected. Revised data show that the central government's fiscal deficit in FY2013 reached 4.9 percent of GDP, well below last October's target of 5.3 percent and better than the 5.2 percent estimate in March. Lower current expenditures and higher non-tax revenue were the main components responsible for the reduction.
Despite the improved fiscal performance, the decline in the debt-to-GDP ratio has lost momentum**.** The central government's debt-to-GDP ratio inched up marginally to 53 percent in FY2013 from 52.9% in the previous year, reversing the strong downward trend seen during the second half of the 2000s. Following the adoption of the Fiscal Responsibility and Budget Management Act in 2003, the ratio of central government's debt-to-GDP fell by more than 10 percentage points. This decline in the debt ratio, however, can be attributed mostly to a favorable macroeconomic environment. Rapid GDP growth in the later period favoured very low real interest rates. A deceleration in growth and increase in the primary deficit slowed the decline in debt-to-GDP and the internal liabilities ratio of the central government rose for the first time in eight years from 48.3 in FY2012 to 48.6 percent in FY2013. External sovereign debt, however, declined marginally (in US$) by 0.3% to US$81.7 billion in FY2013.

Deficit targets have come under pressure in FY2014. According to the Controller General of Accounts, the central government incurred a fiscal deficit of 3 percent of GDP during the first four months of FY2014, equivalent to 62.8% of its fiscal deficit target for the year. In comparison, fiscal performance during the first four months of FY2013 was closer to target as the authorities ran a fiscal deficit of 51.5 percent of the total budget estimate during that time. A significant portion of the shortfall can be attributed to lower tax collection due to a slower pace of economic activity. The central government collected just 16.4% of its total budgeted tax revenue between April and July 2013, compared with 18.5 percent of budget estimates over the same period last year.

Government's key initiatives to Boost Manufacturing:

Apart from the government's recent steps to uplift overall business sentiment and boost investment, several specific enterpriseshave been initiated to strengthen industry and in particular the manufacturing sector in the country. The Twelfth Five Year Plan document lays down broad strategies for encouraging industrial growth and recommends sector specific measurescovering micro, small, medium and large industries in the formal as well as informal sector. Some of major initiatives that canchange the manufacturing scene of the country are announcement of National Manufacturing Policy (NMP),implementation of the Delhi Mumbai Industrial Corridor (DMIC) Project and policy reforms to promoteforeign direct investment (FDI) and an e-Biz project.

The national manufacturing policy was approved by the government in October, 2011. It is associated with its major objectives of the policy are enhancing the share ofmanufacturing in gross domestic product (GDP) to 25 per cent and creating an additional 100 million additional jobs overa decade or so. The Policy also provides special focus to industries that

are employment intensive, those producing capitalgoods, those having strategic significance, small and medium enterprises, and public sector enterprises besides industrieswhere India enjoys a competitive advantage. The NMP provides for promotion of clusters and aggregation, especiallythrough the creation of national investment and manufacturing zones (NIMZs). Out of twelve NIMZs so far announced,eight are along the DMIC. Besides, four other NIMZs have been given in-principle approval (i) Nagpur in Maharashtra, (ii)Tumkur in Karnataka, (iii) Chittoor district in Andhra Pradesh, and (iv) Medak district in Andhra Pradesh.

Industrial development initiatives under DMIC project presently cover eight industrial cities that are proposed to bedeveloped along the railway corridor. The Master Planning for the investment regions and industrial areas taken up initiallyto be developed as new cities in Gujarat, Madhya Pradesh, Haryana, Rajasthan and Maharashtra have been completed andmaster planning in Uttar Pradesh has started. The State governments have initiated the process of obtaining land for the newindustrial regions/areas as well as for the Early Bird Projects. Environmental impact assessment (EIA) studies have beeninitiated for five industrial cities.

As a part of policy reform process, the FDI policy is being gradually liberalized on an ongoing basis in order to allow FDIin more industries under the automatic route. Some recent changes in FDI policy, besides consolidation of the policy into asingle document include FDI in multi-brand retail trading up to 51 per cent subject to specified conditions; increasing FDIlimit to 100% in single-brand retail trading; FDI up to 49 percent in civil aviation and power exchanges; FDI up to 49percent in broadcasting sector under the automatic route and FDI above 49 percent and up to 74 percent under theGovernment route both for teleports and mobile TV.

The government has announced the setting up of -'Invest India'-, a joint-venture company between the Department ofIndustrial Policy and Promotion and FICCI, as a not-for-profit, single window facilitator, for prospective overseas investorsand to act as a structured mechanism to attract investment. In addition, the Government has initiated implementation of thee-Biz Project, a mission mode project under the National e-Governance Plan (NeGP) for promoting an online single windowat the national level for business users. The objectives of setting up of the e-Biz portal are to provide a number of services tobusiness users, covering the entire life cycle of their operation. The project aims at enhancing India's business competitivenessthrough a service oriented, event-driven G2B interaction.

Conclusion:

This article traced the major developments in India’s major fiscal policies. By the above analysis we may draw a inference that the basic role of monetary and fiscal policies is to create the final demand for goods and services in market and this system required government action to control the all expenditure occurred in encouraging industrial growth. Government also control the inflation through the monetary policy as we seen there is positive relationship in inflation and industrial growth.by monetary policy we control over the supply of money .In inflation there is full control over the supply of money.

In the last section of the study we found that the Government announced roadmap for fiscal consolidation with a view to limit governmentspending and provide enough room forencouraging private investment along with continuingreforms process to attract capital investment / inflows.The strategy was to provide confidence to market,reduce inflationary

pressure and create room foreasing of monetary policy. Government workedtowards this goalpost in later part of 2012-13 andintends to take forward the process in 2013-14. Theexpenditure and revenues have been thus targetedat realistic levels to retain net market borrowing of thegovernment within comfortable levels.

As we can say by the above analysis there can be seen a small slowed down in industrial growth but can also be absorbed some positive sign of industrial growth in 2014. Government policies are supporting employment, investment and liberalization in country. Government is focusing on state-wise agenda and trying to implementing those agenda for the regional development as well as industrial development in that state like NMP,DIMC and FDI policies etc. these government policies are also favoring the overseas investors and joint ventures in India that increase the currency strength of India.

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