Lagging Of Manufacturing In India – The Puzzle of India's Industrialisation

Mains: *GS III –Indian Economy*

Why in News?

Recently, there has been questions surrounding the declining share of manufacturing ion the Indian economy and it is important to know the background and theoretical perspective.

What is the issue?

- **Underperformance of manufacturing** – One of the enduring puzzles of India's development trajectory is *the persistent underperformance of its manufacturing sector.*
- India's manufacturing sector has remained stagnant at around 15–17% of GDP, and in recent decades has even ceded space to services.
- **Performance of other economies** – This is significant especially when compared to non-Western economies such as China and South Korea, which started from broadly similar economic positions in the early 20th century.
- These economies successfully transitioned from agrarian structures to manufacturing-led growth.
- **Comparative Perspective** – China and South Korea followed export-oriented industrialisation strategies, combining state support, disciplined labour markets, and technological upgrading.
- Manufacturing in these economies expanded rapidly, creating millions of productive jobs and driving sustained productivity growth.
- **India's contradiction** – India witnessed a phenomenon often described as *"premature deindustrialisation*", where the economy shifted directly from agriculture to services without a strong manufacturing base.
- **Service sector dominance** – Services today contribute over 55% of India's GDP, but this growth has been capital- and skill-intensive, limiting its ability to generate broad-based employment.

What are the Explanations of Economists?

- **Arvind Subramanian's Argument** – Economist Arvind Subramanian, in his book *A Sixth of Humanity*, offers a provocative explanation by applying the concept of the Dutch disease to India's development experience.
- **Concept origin** – Originally coined to explain the decline of Dutch manufacturing after the discovery of the Groningen gas fields in 1959.

- The *Dutch disease refers to a situation where a booming sector crowds out other tradable sectors through wage and price effects*.
- **Effect of government sector** – Subramanian argues that in India's case, the expansion of the government sector with relatively high salaries functioned like an economic windfall.
- **Result of high wages** – High public-sector wages drew labour away from manufacturing, raised economy-wide wage expectations, and increased domestic prices.
- As a result, Indian manufacturing found it difficult to remain competitive both domestically and internationally.
- **Working of dutch disease** – The Dutch disease operates through two main channels:
    - **Resource Movement Effect** – Labour shifts from manufacturing to the booming sector (in this case, government services), raising wages across the economy.
    - **Spending Effect** – Higher incomes increase demand for domestic goods, pushing up prices.
- In a regime of free trade, rising domestic prices make imports cheaper relative to domestic manufactured goods, reducing demand for local manufacturing.
- Even without a change in the nominal exchange rate, the real exchange rate appreciates, eroding export competitiveness.
- **Limits of the Dutch Disease Framework** – While analytically appealing, this explanation has important limitations.
- The Dutch disease was originally developed to analyse exogenous windfalls, such as natural resource discoveries.
- High government salaries, by contrast, are the result of deliberate policy choices in a democratic polity.
- This distinction matters because policy-driven wage increases can, in principle, be accompanied by complementary investments in productivity and technology.
- Treating government salaries as an unavoidable windfall risks underplaying the role of private sector responses and long-term technological change.
- **Alternative perspective –** This theory suggests that high wages and labour scarcity can stimulate technological progress, encouraging firms to adopt labour-saving and productivity-enhancing technologies.
- **Historical evidence** – Economic historians such as Robert C. Allen argue that Britain's high wages in the 18th and 19th centuries created incentives for mechanisation, triggering the Industrial Revolution.
- Daron Acemoglu shows that ageing labour forces in countries like Germany, Japan, and South Korea encouraged automation, leading to higher productivity and wages.
- From this perspective, high public-sector wages in India should have pushed manufacturing firms to innovate rather than stagnate.

What are the problems identified?

- **Technological Stagnation in Manufacturing** – The failure of Indian manufacturing to respond with technological upgrading suggests deeper structural issues.
- **Lack of linkages** – Unlike East Asian economies, India did not build strong linkages between the State, industry, and technology adoption.
- **Policy & Other issues** – Industrial policy remained fragmented, and firms often relied

on cheap and abundant labour instead of investing in capital and skills.

- This pattern is evident even in India's celebrated private sector growth. Despite rapid expansion, wage growth has remained subdued, and productivity gains have been uneven.
- **The Services Sector Paradox** – India's services-led growth further complicates the picture.
- High-growth sectors such as IT and software services have generated wealth but limited employment elasticity. Entry-level wages in major IT firms have shown little real growth since the early 2000s, despite rising corporate profits.
- Moreover, many new-age "unicorns" such as Swiggy, Zomato, Blinkit, and Ola rely heavily on India's vast pool of informal labour rather than frontier technological innovation.
- This reinforces a growth model that creates value without raising average productivity or wages.
- **Inequality and the Nature of Growth** – The consequences of this development path are visible in rising income and wealth inequality.
- While both the public and private sectors have expanded, the benefits have been unevenly distributed.
- Manufacturing, which could have provided stable, middle-income jobs at scale, failed to play its transformative role.
- If public-sector wages once kept incomes higher, it is legitimate to ask why private manufacturing did not match this through innovation and productivity growth.

What lies ahead?

- India's manufacturing stagnation cannot be explained by a single framework.
- While the Dutch disease provides useful insights into wage and price dynamics, it is insufficient on its own.
- A comprehensive analysis must incorporate technological choices, labour market structures, industrial policy, and inequality dynamics.
- The central challenge for India today is not merely expanding manufacturing, but ensuring that growth is productivity-driven, technologically progressive, and employment-intensive.
- Without addressing the underlying incentives that shape innovation and wage growth, India risks remaining trapped in a model of high GDP growth with limited structural transformation.
- A renewed focus on technology-driven manufacturing, skill development, and coherent industrial policy is essential if India is to achieve inclusive and sustainable growth in the decades ahead.

Reference

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