

## **Need for an Industrial Policy in India**

### **What is the issue?**

- The economic developments in the recent times in India demand a dedicated industrial policy to boost manufacturing.
- In this backdrop, here is an overview of the inevitable role played by industrial policies elsewhere and the need for India to have one.

### **Why is manufacturing significant?**

- No major country has managed to reduce poverty or sustain growth without manufacturing-driven economic growth.
- This is primarily because productivity levels in manufacturing sector are much higher than in either agriculture or services.
- Manufacturing is a key engine of economic growth because it -
  - i. offers economies of scale
  - ii. embodies technological progress
  - iii. generates forward and backward linkages that create positive spill-over effects in the economy

### **How is it approached elsewhere?**

- In the U.S. and Europe, the approach towards manufacturing shifted after the 2008 financial crisis.
- Even the erstwhile proponents of neo-liberal policies started strategic government efforts to revive their industrial sectors.
- They, notably, defied in principle their own prescriptions for free markets and trade.
- The European Union too identified sector-specific initiatives to various industries.
- The United Nations Conference on Trade and Development (UNCTAD) finds that over 100 countries have, within the last decade, articulated industrial policies.

### **What is the case with India?**

- India still does not have in place a dedicated manufacturing policy.
- Programmes as “Make in India” focusses on increasing foreign direct

investment and ease of doing business.

- While important, they may not constitute an industrial policy per se.
- The contribution of manufacturing to GDP in 2017 was only about 16%.
- This signals a stagnation since the economic reforms began in 1991.
- Significantly, this is in sharp contrast with the major Asian economies.
- E.g. Malaysia roughly tripled its share of manufacturing in GDP to 24%, Thailand's share increased from 13% to 33% (1960-2014).
- In contrast, in India, manufacturing has never been the leading sector other than during the Second and Third Plan periods.

### How does an industrial policy help?

- It is widely agreed that government intervention is crucial in the case of market failures which may include -
  - i. deficiencies in capital markets, usually as a result of information asymmetries
  - ii. lack of adequate investments inhibiting exploitation of scale economies
  - iii. imperfect information with respect to firm-level investments in learning and training
  - iv. lack of information and coordination between technologically interdependent investments
- Given the present economic situation in India, these are good reasons why an economy-wide planning mechanism is needed.
- However, the Indian state should shift away from the "command and control" approach that was the case in pre-1991 days.

### Why is an industrial policy crucial for India now?

- **Investments** - There is the need to coordinate complementary investments.
- The East Asian States largely managed this role of industrial policy successfully.
- This is essential especially when there are significant economies of scale and capital market imperfections.
- While preventing coordination failures on the one hand, it is also essential to avoid competing investments in a capital-scarce environment.
- As, excess capacity leads to price wars, thereby adversely affecting profits of firms.
- These, in turn, may lead to bankruptcy of firms or slowing down investment, both happening often in India (E.g. the aviation sector.)
- Even worse, price wars in the telecom sector in India have slowed profits (even caused losses).
- This hampers investment in mobile/Internet coverage of rural India where

access to mobile phones and broadband Internet needs rapid expansion.

- **Human capital** - Industrial policies are needed to address externalities such as subsidies for industrial training.
- In fact, industrial policy was reinforced by state investments in human capital in most East Asian countries.
- General academic as well as vocational education/training was aligned with the industrial policy.
- However, a lack of human capital has been a major constraint upon India in attracting foreign investment.
- **Organising** - The state can play the role of organiser of domestic firms into cartels in their negotiations with foreign firms or governments.
- This role of government is particularly relevant in the 21st century after the big business revolution of the 1990s.
- As, post 1990 is marked with mega-mergers and acquisitions among transnational corporations.
- Notably, a key objective of China's industrial policies since the 1990s has been to support the growth of such firms.
- E.g. Lenovo computers, Haier home appliances, and mega-firms making mobile phones
- **Production capacity** - In India, the medium/middle scale enterprises are largely missing in the overall share, a shortfall of failure of industrial strategy.
- This was more because of reservation of products exclusively for production in the small-scale and cottage industries (SSI) sector.
- Large firms were largely excluded from India's 1956 Industrial Policy Resolution onwards.
- E.g. by the end of the 1980s, 836 product groups were in the "reserved" category produced only by SSIs, which encouraged informal enterprises.
- In 2005, there were still 500 products in this category, 15 years after the economic reforms were launched.
- Thereafter the reservation of products of small firms was cut sharply to 16 products.
- But by then, small scale and informality had gotten entrenched in Indian manufacturing.
- In this context, an industrial policy should balance between the industrial capacity installed and the production efficiency/capacity.
- Choosing too small a scale of capacity can mean a 30-50% reduction in production capacity.
- **Structural change** - In a fast-changing market, losing firms will block structural changes as the above that are economically beneficial but make their own assets worthless.

- East Asian governments prevented such firms from undermining the structural changes.
- Moves such as orderly capacity-scraping between competing firms and retraining programmes to limit such resistance were taken.
- An industrial policy in place in India could facilitate the process when structural change is needed.
- **Jobs** - The share of manufacturing in total employment fell from 12.8% to 11.5% over 2012 to 2016.
- A well drafted industrial policy can go a long way in creating jobs in the economy.
- **Exports** - Increasing export of manufactures will need to be another rationale for an industrial policy.

### What does the East Asia industrial experience show?

- The growth in manufacturing in East Asian countries was primarily founded upon export-oriented manufacturing.
- They employed the surplus labour released by agriculture, thus raising wages and reducing poverty rapidly.
- This outcome came from a conscious, deliberately planned strategy (with Five Year Plans).
- The growing participation of East Asian countries in global value chains (GVCs) was a natural corollary to the industrial policy.
- They had graduated beyond simple, manufactured consumer goods to more technology- and skill-intensive manufactures for export.
- In contrast, India has been practically left out of GVCs.

### What does India's own IT success imply?

- The government's role had been crucial in the success story of India's IT industry.
- The government invested in creating high-speed Internet connectivity for IT software parks.
- This significantly enabled integration of the Indian IT industry into the U.S. market.
- Also, the government allowed the IT industry to import duty-free both hardware and software.
- Moreover, the IT industry was able to function under the Shops and Establishment Act.
- So they were not subject to the 45 laws relating to labour and the regulatory burden these impose.
- Importantly, the IT sector had the benefit of low-cost, high-value human capital created by public investments earlier in technical education.

- These concerted measures offer insights to the potential for industrial policy and the critical State's role in manufacturing growth in India.
- The government has to replicate the approach now, suited to the manufacturing sector, with an industrial policy.

**Source: The Hindu**

