

REVITALIZING THE MANUFACTURING SECTOR IN INDIA

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ABSTRACT

Manufacturing is in trouble in India. India's development model is largely at fault. In the absence of a well conceived policy response by the new government, manufacturing will soon be gripped by an even more profound crisis. The new government at the centre as launched the "MAKE IN INDIA" campaign with the object to revive the manufacturing sector in India. Also the abolition of the extra constitutional body namely Planning Commission and creation of NITI-Aayog in lieu of it, are constructive steps that the new government has taken. This paper seeks to address some of the concerns that the manufacturing sector in India is facing and how to tackle the intrinsic and extrinsic issues in order to revitalize the manufacturing sector in India. Finally it also talks about the different measures that the government must adopt to ensure that "Make in India" campaign is a success.

Key Words

Manufacturing Sector, Government, Corporate India, Reforms

Introduction and Review of Literature

Manufacturing is in trouble in India. The sector's share of gross domestic product (GDP) reached 16% in 2006-07, then stagnated and has declined since 2010-11, to little more than 15%, a sliver when compared with the shares in Thailand (36%), South Korea (31%), and China (30%).

Employment in absolute terms has fallen in the formal manufacturing sector from 55 million in 2004-05 (12.2% of India’s overall workforce) to 50 million in 2010 (10.5%). The sector’s growth rate has been declining for four years, actually falling into negative territory in the first quarters of 2012 and 2013. The table below highlights the trend that the manufacturing sector has shown since the 1950’s up till today. It also highlights the Cumulative Growth Rate (in %) along with the % Share of each sector in the Indian context.

S. No.	Time Period	Agriculture and its Allied Sectors	Manufacturing and Its allied Sectors	Services and Its allied Sectors	GDP at Factor Cost	% Share of Agriculture to GDP	% Share of Manufacturing to GDP	% Share of Services to GDP	% Cumulative Growth rate of manufacturing Sector
1	1950-60	57977	18395	44086	120630	48.1	15.2	36.5	10.9
2	1960-70	119836	51595	103116	275095	43.6	18.8	37.5	12.2
3	1970-80	298820	163533	300265	764324	39.1	21.4	39.3	14.1
4	1980-90	895491	613700	1142420	2661050	33.7	23.1	42.9	15.6
5	1990-2000	3203568	2617540	5171799	11017343	29.1	23.8	46.9	12.9
6	2000-10	7709639	8881113	18864734	35455485	21.7	25.0	53.2	NA
7	2010-11	1524552	1763584	3960723	7248860	21.0	24.3	54.6	16.9
8	2011-12	1721814	2061650	4608227	8391691	20.5	24.6	54.9	8.6
9	2012-13	1867342	2238029	5283505	9388876	19.9	23.8	56.3	6.0
10	2013-14	2129000	2371520	5972287	10472807	20.3	22.6	57.0	NA

Source : Economic Survey (2013-14) and Authors Analysis

India’s development model is largely at fault. In the absence of a well-conceived policy response by the next government, manufacturing will soon be gripped by an even more profound crisis.

The sector is marked by a deep dualism—gaps between the formal and informal economies—in virtually every sub-sector. The dualism affects wages, productivity, technological capabilities and working conditions. This, in turn, creates capacity fragmentation, a relative absence of economies of scale and scope that renders the sector globally uncompetitive.

Unlike many other countries, India has not witnessed a stylized sectoral growth process during her developmental process. India’s service sector led growth in the recent years has been viewed with some apprehension in terms of fostering inequalities across regions and sections of population. Concerns have also been raised about the widening regional and sectoral dispersion

of growth (Ahluwalia, 2000) and jobless growth in the context of economic reform process that gathered momentum in the early nineties.

In Table 2.1, we provide a synoptic view of the importance of the manufacturing sector and its two components, viz., registered and unregistered manufacturing in India's real GDP. It can be seen from Table 2.1 that the average share of manufacturing sector in real GDP increased from about 13 per cent during 1970-75 to about 15.1 per cent during 2002-07, i.e., approximately by just about 2 percentage points over a period of more than three decades. Even in the year 2009-10, the share of manufacturing sector in India's real GDP is just about 16.1 percent.

Table 2.1: Contribution of Manufacturing Sector to India's Real GDP

Average GDP (in Rupees Crore at 1999-2000 Constant Prices)

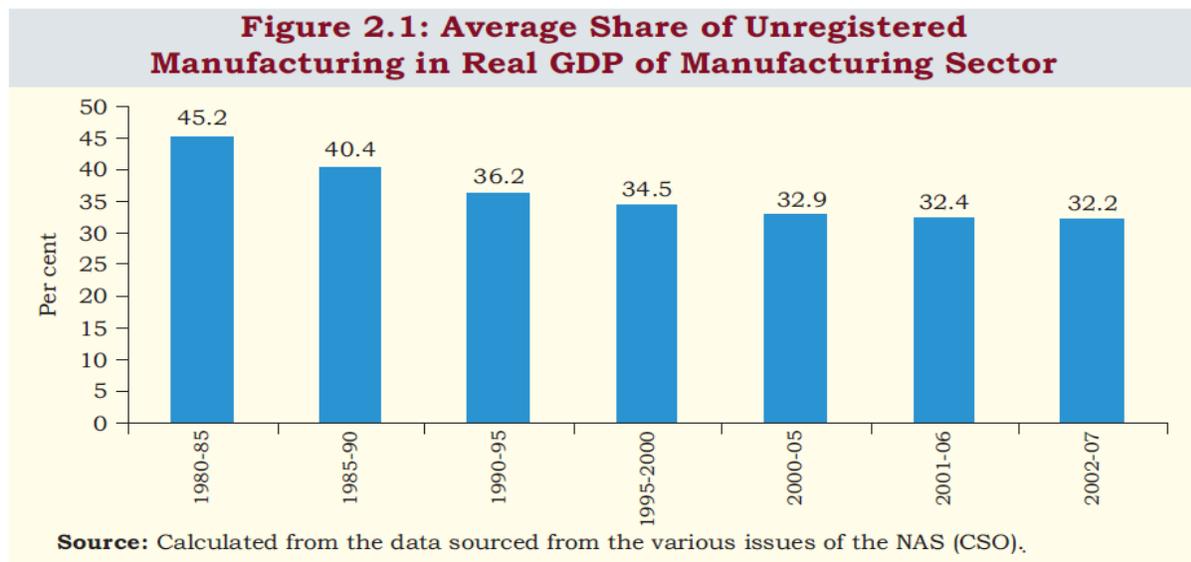
Period	Average GDP of Manufacturing Sector	Average GDP of Registered Manufacturing Sector	Average GDP of Unregistered Manufacturing Sector
1970-75	64405 (13.2)	33545 (6.9)	30786 (6.3)
1975-80	81744 (13.9)	42547 (7.2)	39108 (6.6)
1980-85	101412 (14.3)	55571 (7.8)	45841 (6.5)
1985-90	133812 (14.7)	79756 (8.7)	54056 (6.0)
1990-95	171233 (14.6)	109247 (9.3)	61987 (5.3)
1995-2000	248504 (15.7)	162847 (10.3)	85657 (5.4)
2000-05	316307 (15.1)	212370 (10.1)	103938 (5.0)
2001-06	338105 (15.0)	228619 (10.2)	109486 (4.9)
2002-07	367898 (15.1)	249583 (10.3)	118315 (4.9)
2008-09	(15.6)	(10.4)	(5.2)

Note: Figures in parentheses are % share of the respective sector in the Real GDP (1999-2000 prices), except for 2008-09. For this year, figures are based on GDP at 2004-05 constant prices.
Source: http://www.mospi.nic.in/mospi_cso_rept_pubn.htm, National Accounts Statistics – Back series 1950-51 to 1999-2000 and <http://www.mospi.nic.in/mospi>

During 1970-75, India's real GDP of manufacturing sector was more or less equally distributed between its registered and unregistered segments. Over the years, the growth of real income in the registered manufacturing has been higher than that of unregistered manufacturing sector, resulting in the average contribution of the unregistered sector shrinking to almost half of that of the registered sector during 2002-07. The situation has remained more or less unchanged even

during the post 2007 period. Kochhar et al (2006) demonstrate that given the per capita GDP and size of India, the share of manufacturing sector in GDP was in conformity with the stylised growth pattern of other countries. According to them, manufacturing sector in India underperformed since 1981 and this perception about its underperformance is also due to its comparison with China⁷. China was a significant positive outlier (i.e., China's manufacturing sector contributed more to its national income as compared with the historical evidence on countries of similar levels of development) in 1981. To put it differently, India had approximately the normal share of output and employment in manufacturing in 1981, if compared with countries at a similar level of development and size. Over the next two decades, (when reforms were implemented, so as to remove the constraints on manufacturing sector), it failed to keep pace with the growth of manufacturing sector in other countries with similar levels of development. This is not to deny the fact that India has done reasonably well as compared to its own past performance.

The composition of India's manufacturing sector is also crucial from the point of view of intra-sectoral equity. In Figure 2.1, we provide the proportion of real GDP originating in unregistered manufacturing in the total manufacturing sector.



The un-organized manufacturing sector accounts for about 80 percent of the employment generated in manufacturing sector. However, its contribution to the income generation or to real GDP of manufacturing (as seen in Figure 2.1) is much less in proportion to its employment generation.

Another disturbing feature in the past decade has been the slow but steady exit of established manufacturers, a reflection of an increasingly difficult operating environment. Many have switched to importing their products from China and elsewhere. The recently passed Land Acquisition, Rehabilitation, and Resettlement (LARR) Act, which sharply raised rural land prices and mandated a time-consuming acquisition procedure, will likely accelerate the process of de-industrialization in India.

Given that India needs to find jobs for at least one million new workers every month for the next 15 years, the prospect of a shrinking manufacturing sector should be cause for extreme concern.

This article primarily focuses on the growth and revitalizing of the Manufacturing Sector for the following reasons. First, manufacturing/industrial sector has received much attention of the policy makers in India in terms of financial allocations in planning process. Second, during the process of transition (i.e., when growth of an economy is being driven by manufacturing and tertiary sectors rather than by the primary sector), manufacturing sector is known to generate employment for both unskilled and skilled labour and the employment potential of manufacturing sector is higher as compared to that of the tertiary sector. Third, the growth of manufacturing sector is also necessary for the overall growth of the economy, as it can supply inputs and provide market to other sectors. Lastly, we also view that the solution to the agrarian crisis will also be found in the growth of output and employment of manufacturing sector.

Therefore the main objectives of this paper could thus be classified as:

- *To understand the factors which hinder the growth of manufacturing sector in India.*
- *To understand the role of Government in ensuring the revival of the Manufacturing Sector in an emerging economy like India.*

- *To understand the role of Corporate India in ensuring the revival of the Manufacturing Sector in an emerging economy like India.*

Issues facing the manufacturing sector in the Indian Economy: Internal Challenges

India flourished as one of the world's fastest-growing economies for much of the last decade. However, the past four years have seen a dispiriting collapse of growth close to 5 percent per year, as seen below in the table. While not bad by global standards, it hurts in a country trying to make major advances in human development indicators like childhood malnutrition and poverty. The main reason for this slowdown is a total collapse of investment especially by the private sector. Two recent analyses by IMF economists indicate the slowdown is not due to normal business cycles or external factors. Rather, the business climate, and in particular the impact of uncertainty about government policies, appears to have made a major contribution to this slowdown.

India ranked 132 out of the 185 countries in the World Bank's **Ease of Doing Business survey** in 2013. According to the official data, nearly 70 clearances are required annually for businesses to operate. The greatest cost falls on SMEs, where the proprietor has to bear the entire burden. Such an environment, combined with retroactive changes in tax demands, creates much uncertainty, anathema for investment. Another challenge is the lack of adequate protection against extortion and protection rackets

Many Indian CEOs say the Chinese and Indian economy were almost similar during the 1980s. But China took a giant step forward by making its manufacturing sector the main engine of its economy. M S Unnikrishnan, MD and CEO, Thermax, says that the new Governments intention is very good but there should be action now. Indian companies have inherent advantages against the rest of the world. India will have one of the largest workforces by 2025 and also the biggest market after China. With the consumption base for market place, it has the advantage of becoming an export hub for exports as well.

Table 3 below, illustrates the major concern for India's economic future. It highlights the deeper structural flaws that exist on the Indian Economy. This graph presents the share of employment and GDP attributable to the three broad sectors of the economy. Three key features are readily apparent.

- 1. India's labour force is languishing in low productivity agriculture.*
- 2. Manufacturing is too small a share of both employment and GDP.*
- 3. The service sector has led the Indian economy.*

Research has shown the service industry fuelled the rapid expansion of the Indian economy from 1994 to 2008. However, this can only take the economy so far. The outsourcing and finance segment of services that accounted for the biggest economic gains employs primarily those with postsecondary education, only about 0.7 percent of the population.

The rest of the population has very limited upward mobility. According to some estimates, half of the 48 million non-agricultural jobs added from 2004 to 2012 have been dead-end construction jobs in rural areas. Further, that is only half the number of new jobs India needed. The Indian population is relatively young, compared to the United States and especially to China. That means a beneficial ratio of workers to dependents—India's turn to benefit from a demographic dividend— but only if working-age adults are employed. The World Bank estimates that India must create 1 million jobs a month to keep up with new job seekers.

Rather, the best potential source of future growth lies in India's ability to foster a manufacturing sector that can capitalize on their abundance of labour. More than half of the adult population has the schooling needed for most low-wage manufacturing jobs, and that share could rise above 60 percent in 20 years with reasonable education reform.

Indian industry continues to face an acute skills shortage. It laments this problem but does not even attempt to emulate the efforts of firms in the Information-Technology and other service sectors, which have opened large-scale in-house training programmes. It has also been unable or unwilling to adopt effective forms of collective action to demand government accountability or

to find solutions for shared problems. And it has made no attempt at self-regulation to curb corrupt practices.

Table 3 Sector-wise real GDP and net employment growth

	2004-05 to 2009-10		1999-00 to 2004-05	
	Sectoral GDP growth %	Employment growth,%	Sectoral GDP growth %	Employment growth %
Agriculture	3.1	-8.2	1.8	15.2
Mining	4.1	4.7	4.8	27.7
Manufacturing	9.5	-6.3	6.5	43.4
Electricity & gas	7.2	-5.3	4.2	32.5
Construction	9.3	70.0	9.3	65.0
Trade & hotel	9.1	4.5	9.7	37.3
Transport & storage	12.8	10.8		43.3
Financial Intermediation & business services	12.0	31.4	6.7	90.6
Public admin, social services	8.2	5.4	5.0	25.5
Total	8.6	0.4	6.0	25.3
Total ex agriculture	9.8	11.8	7.3	41.5

Source: CRISIL Research estimates using NSSO and CSO reports

On another front, small and medium enterprises (SMEs) often do not receive payments on time from their larger buyers, a far cry from the nurturing that such companies enjoy in Japan and South Korea. Finally, because Indian industry is in large parts cartelized, there is much resistance to price competition, a short-sighted stance works against achieving global competitiveness. All of these weaknesses should be addressed by the industry itself if it hopes to improve its competitiveness and credibility

Understanding the role of the Government

There are two schools of opinion on the government's policy reform priorities for manufacturing. The first believes that structural conditions do not permit the growth of mass manufacturing in

India. By putting a statutory floor under the price of both, labour and land, the principal factors in production, the political process has effectively raised their cost. Moreover, the complicated resettlement and rehabilitation (R&R) provisions enshrined in the land acquisition law make land procurement highly cumbersome. This school also argues that the new generation of workers, being more educated and IT-savvy than earlier ones, will not accept low-productivity shop floor jobs.

Given these conditions, this school holds that India should give up trying to enter mass manufacturing and instead support so-called sunrise industries—sectors that use frontline technologies, require highly skilled labour, and are design-and technology-intensive. Government policy would focus on creating and sustaining a learning environment for businesses. India could emulate Japan and South Korea, where private firms, government science and technology agencies and technology institutes come together to produce large-scale product and process innovations, which are then commercialized by dynamic entrepreneurs.

This is a seductive model, but a number of factors make it somewhat unfeasible, including the low R&D orientation of Indian industry and the low penetration of broadband connectivity and Internet access.

The alternative approach for policy reforms—which represents the more desirable way forward—is not to accept the high cost of labour and land as a given. Instead, it assumes that the large majority of new workers will continue to be semi-skilled and willing to accept productive jobs in the formal manufacturing sector (though not in the unorganized sector). Thus, this option requires government policy to be directed toward more conventional intervention.

Land costs: These costs can be kept at acceptable levels by using the land already acquired by industrial development corporations in various states; increasing the ratio of floor area to space; releasing the vast stock of land owned by government and public sector entities; and amending the land acquisition law to remove the R&R requirement for the private purchase of land.

Labour conditions: It is pointless to argue for the removal of Article 35A in Chapter V of the Industrial Disputes Act and give employers permission to hire and fire at will and without due

process. This is a non-starter in the present Indian context. Instead, other ways have to be found for the desired level of flexibility in labour deployment. The proposal in the new manufacturing policy, for example, for the creation of a resource pool to retrain retrenched workers and to give them unemployment security for a minimum period while they are re-trained is well worth considering. Another change would reduce the welter of labour laws to four or five comprehensive statutes.

Business environment: Among the measures that could improve the environment almost immediately include introducing a combined application form for obtaining clearances, cutting the time needed for starting and exiting a business, licensing some private-sector banks to cater to the needs of the MSMEs.

To revive manufacturing, industry and the government (central and states) must implement a reform agenda together—to increase competition, reduce dualism, make the regulatory process more transparent and cut the compliance burden.

The two approaches described above are not necessarily in conflict. Expanding islands of innovation can coexist with a manufacturing sector that is reining in its informal side. But reforms must be urgently implemented. If India is to achieve its strategic and development objectives, its manufacturing base can't be shrinking.

In recent times Prime Minister Narendra Modi's "Make in India" initiative could transform India to an international manufacturing hub, giving tough competition to China.

However, to realize this goal, reforms in labour laws, special economic zone policy, foreign direct investment rules, taxation policy, and land acquisition policy are very crucial. Though India has missed the bus, the country can still make an impact on the global manufacturing sector through innovation and reducing costs. Some reforms that will help the "**Make in India**" campaign are:

A stable tax regime – Reforms proposed in the budget should be in line with the long-term vision for India. There should be no surprise addition of taxes or removal of tax holidays or deductions.

Clarity on tax law - Taxation in India is subject to multiple interpretations by the taxpayer and the tax department, and some of them need to be addressed at the earliest. For example, the rule on taxability of offshore transactions resulting in an indirect transfer of assets in India needs clarification. The government should come out with detailed guidelines on the methodology to compute the tax liability in India in case of such indirect transfers. The deferment of General Anti-Avoidance Rules till the tax regime stabilizes would be helpful.

Further, there are many industry-wide tax issues wherein tax officers in different jurisdictions have taken different positions. The government needs to set up a panel which would address specific industry issues, and the same should be made enforceable through the country.

Tax sops for investment in key sectors and reduction in the Minimum Alternate Tax (MAT) rate – Tax holidays for new manufacturing facilities set up across sectors would boost investment. Such new facilities should not be subject to taxes under the MAT regime. Also, the existing MAT rate should be reduced for units currently availing tax holidays.

Implementation of GST - Implementation of a nationwide goods and services tax (GST) and removal of the numerous indirect tax laws would have a major impact on businesses. A clear roadmap for implementation of GST would enable investors to take calculated calls on their investment/expansion plans in India.

Transparent and quick resolution of disputes – Increasing the scope and power of the Dispute Resolution Panel could help tackle the long list of unresolved litigation matters. Also, additional benches of the Authority of Advance Rulings (AAR) would strengthen the tax tribunal and result in speedy disposal of applications for advance rulings.

Transfer Pricing – Introduction of the concept of the rollback provisions for advance pricing agreements (APAs) in the 2014 budget was a welcome move. One expects the necessary legislative amendments being introduced in the upcoming budget to prescribe the extent and manner of the applicability of these provisions.

Going forward, the government should consider creating a financial zone to turn India into a manufacturing hub. Benefits such as lower taxes, no permanent establishment issue and non-

applicability of transfer pricing provisions could be provided to businesses in this zone. They would act as enablers to convince firms to conduct their business without having to worry about the tax consequences on their overseas income in India.

Understanding the role of the Corporate Sector

Industry can implement a series of steps that are in its direct control. Private companies are just beginning to tackle the skills shortages by entering into a partnership with the government on managing about 110 industrial training institutes. They would do well to collaborate with vocational skill providers in growing capacities, designing curricula, and offering assured placements.

They should also empower their chambers and associations to take collective action to demand the timely delivery of high-quality public services. Because collective action requires credibility, they will first have to improve their record of self-regulation.

Finally large businesses must adopt a nurturing attitude toward their suppliers, which invariably belong to the MSME category of micro, small and medium enterprises. To become global players, they should substantially increase spending on research and development.

Conclusions

To revive manufacturing, industry and the government (central and states) must implement a reform agenda together—to increase competition, reduce dualism, make the regulatory process more transparent and cut the compliance burden.

Identifying important reforms is a relatively easy job in India because of the plethora of expert committee reports on so many topics. The challenge is in implementation. India may therefore face a watershed moment when a prime minister known for getting things done has an unusually strong political base from which to act. He has indicated that reviving manufacturing is a critical priority for his administration, and its earliest moves back this up. Finally, the demographic

dividend of young workers presents perhaps the last good opportunity India will have to experience sustained, high economic growth, and it can only happen through expanding manufacturing. The new government has all the right pieces to enact the four tough reforms and reignite India's economy.

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