



## Key Reasons for an Indian Industrial Policy

This editorial is based on the article ['Why an industrial policy is crucial'](#) which appeared in The Hindu on 17<sup>th</sup> May, 2019. The article talks about what an industrial policy for India must address.

India's manufacturing sector has been stagnating since the beginning of the Liberalization, Privatization and Globalization (LPG) reforms of 1991; **For example:** the contribution of manufacturing to GDP in India for 2017 was only about 16%.

If India wants to grow at a sustained rate of growth and reduce poverty it can't come without a robust manufacturing sector. But India's economy shows a classic case of **Market Failure** (*the transition of Indian economy directly to a service-led economy from an agrarian economy without developing its manufacturing sector*).

### What is the significance of manufacturing sector for an economy?

**Historically, no major country has managed to reduce poverty or sustain economic growth without a robust manufacturing sector.**

- Manufacturing is an engine of economic growth as it offers:
  - **Economies of scale** [*In microeconomics, economies of scale are the cost advantages that enterprises obtain due to their scale of operation, with cost per unit of output decreasing with increasing scale*];
  - Technological progress;
  - Generation of forward and backward linkages;

These factors collectively create a positive spillover effect on other sectors of the economy like employment, demand and production etc.

- **Neoliberal economics argues for laissez-faire or freedom of market.**

- But in the U.S. and Europe, after the 2008 Eurozone crisis, neoliberal principles were defied and there was very less (if none) intervention in market;
  - These neoliberal countries made strategic efforts (*efforts which were not neoliberal*) to revive their industrial sectors, for eg: quantitative easing (*which is a monetary policy whereby a central bank buys predetermined amounts of government bonds or other financial assets in order to inject money directly into the economy*) done by USA.
- **Even though India articulated the Make in India policy, which focused on increasing foreign direct investment and ease of doing business, but it is more of a financial policy than a manufacturing policy.**

### Why India's manufacturing sector is stagnant even after the 1991 economic

## reforms?

- A lack of human capital (this has been a major constraint upon India);
- After 1991 reforms till 2005, reservation of products exclusively for production in the small-scale and cottage industries was 500. Even though this number is now 16 but this led to **small scale informality** which had gotten entrenched in Indian manufacturing. *[Majority of Indian manufacturers are therefore still small scale]*
  - This phenomenon created an absence of middle level companies among Indian enterprises;
  - This has also led to India being practically left out of Global Value Addition (GVA) chains;

## What should be the salient feature of India's industrial policy?

- Clearly India should not roll back to pre-1991 of a 'command and control' economy, but:
  - The state can play the role of an organizer of domestic firms;
  - The state can protect local firms from foreign industrial giants;
  - The state can follow to a certain extent, China's industrial policies, which has led to the development of huge firms like Lenovo, Haier etc.
- Industrial policy for India must also seek not only the prevention of 'coordination failures' but seek to avoid giving birth to competing investments in today's capital-scarce environment.
  - For example: the state can control predatory price wars that lead to companies like Jet Airways going bankrupt; or stop the misuse of capital investments which have led to the rise of NPA'S in the Telecom sector.
  - Doing this is important socially as well, because the poor Telecom sector performance eventually hampered investment in telecom infrastructure in rural areas thereby widening the digital divide.
- **Industrial policy also must be such that manufacturing will create jobs;** as its share in total employment fell from 12.8% to 11.5% over 2012 to 2016.
- Increasing the export capacity and capabilities of manufactures will need to be another rationale for India's industrial policy.
  - Between 2014 to 2018 there has been an absolute fall in dollar terms in merchandise exports which any industrial policy will have to address.
  - India can also look at the export-oriented manufacturing on which The East Asian miracle was based upon - *which led to employment of surplus labour released by agriculture in manufacturing, thus raising wages and reducing poverty rapidly.*
  - **For an exports led economy, economies of scale are critical:**
    - But the unorganized sector accounts for a massive 45% of India's exports - *which could be problematic for any new industrial policy to into account;*
    - Therefore, India's industrial policy must also seek the formalization of the Indian economy (*especially the MSME sector*).
- Lastly, any industrial policy for India must seek to boost the MSME sector towards efficient and sustainable economies of scale. MSME's growth and development is very important for turning India into a manufacturing powerhouse.

## Conclusion

- India must take lessons from the evolution of the IT sector and try to have it replicated in the manufacturing sector.
  - The success story of India's IT industry can be attributed to:
    - The government invested in creating high-speed Internet connectivity enabling integration of the Indian IT industry with the world. [Example of the state providing infrastructure]

- The government allowed the IT industry to import duty-free both hardware and software. [Example of the state facilitating enterprises through policy-making]
- The IT industry was also able to function under the Shops and Establishment Act and hence were not subject to the burdening labour laws. [Labour laws of India as such, needs a much needed relook]
- The IT sector benefited from low-cost, high-value human capital created by public investments earlier in technical education. [Example of success of state investments in human capital]

Thus, one can observe that without all of these facilitative factors, the IT success story would not have occurred in India. The country now must replicate this success story in the manufacturing sector and lay down the roadmap for a future of inclusive and sustained growth.

***Drishti Input:***

Give an account of the state of manufacturing sector in India. What lessons can be implemented from the IT sector?

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