**Industrial Policy and the Imperative of Manufacturing-led Growth**

India’s overall economic performance over the first decade of the 21st century has been outstanding, with the economy growing at an average of 7.5% p.a. However, India’s structural transformation during this period has been marked by a shift straight from agriculture to services, with the latteraccounting for over 60% of GDP growth. The role of the manufacturing sector, ordinarily considered to be an important engine of growth and job creation for low and middle income countries has been rather limited. Even after almost three decades of economic liberalization, the share of the manufacturing sector has remained stagnant at around 15% of GDP and 12% of employment.

At our present stage of development, the imperative of manufacturing led growth cannot beemphasized enough.Compared to any other sector in the economy, the manufacturing sector is likely to generate faster growth of employment for India’s largely low skilled and unskilled workforce. This will help address India’s challenge of productive job creation. Apart fromgenerating direct employment, rapid manufacturing growth is likely todrive growth of employment in other sectors such as construction and services that are required as inputs in manufacturing.Importantly, it willalso lead to a growth of non-traded services through the income effect. Apart from the fact that manufacturing is a critical engine of productive job creation, it also needs to be noted that services-led growth can no longer be rapid and sustainable.Growth in the past created a large imbalance between domestic absorption (requiring mainly goods) and domestic production (of mainly services) that led to unsustainably large trade deficits; services exports simply could not finance the required goods imports. Efforts to rein in trade deficits caused growth slowdown. If growth is to be rapid, it must correct this imbalance between domestic absorption and domestic production; and manufacturing-led growth can ensure this (Ghose, 2016).

The importance of the manufacturing sector has been recognized by successive governments. Both the ‘Make in India’ campaign of the incumbent regime and the National Manufacturing Policy of the previous regime set out with the objective of increasing the share of manufacturing in GDP to 25%. While, the latter was not even implemented, the former has failed to accelerate the growth of the manufacturing sector.Each of these policies highlighted the need for better infrastructure, appropriate labour laws, land for factories, and ‘ease’ of doing business to enable manufacturing to grow. While, these are permissive factors which would enable the manufacturing sector to thrive,they are not causal factors that can make it happen.

Given theexisting status-quo, India needs an industrial policy more than ever before.The Department of Industrial Policy and Promotion is in the process of preparing such a policy, and this is indeed a good beginning as it recognizesthat the time for such as policy is ripe[[1]](#footnote-2). Nevertheless, significant challenges lie ahead in outlining and identifying the specifics of such a policy such that these objectives can be converted into actionable policies with suitable instruments. It is important to identify what elements underlie and entail industrial policy. Understanding these fundamentals is essential for the policy debate to rest on strong conceptual foundations. The availability of firm/establishment level data in the manufacturing sector over the last fifteen years  provides a very rich dataset for understanding the broad conceptual framework of an industrial policy. In this study, we attempt to identify and summariz key micro trends in the growth of the manufacturing sector in a modest attempt to understand the dynamics behind the aggregate outcomes. This would enable us to understand the drivers of employment and output growth in a way that informs industrial policy.

We propose to begin our analysis, by examining employment trends in the manufacturing sector, across industry groups (based on the three/four digit National Industrial Classification). Industry specific analysis within the manufacturing sector will help understand which industries have driven employment growth. Given the strong case for sectoral level industrial policy, it is not only important to identify the employment creating potential across industries but also what factors have held back the growth of industries which have significant employment creating potential.Additionally, given that the challenge is not just of job creation butof productive job creation, we need to examine sectoral performancethrough the lens of productivity and wages.The heterogeneity in value-added per worker across industries suggests that national income and labour productivity can be enhanced by reallocation of resources from industries having low value added per worker to those havinghigh value-added per worker. Further, there is a special payoff to investment in ‘linkage’ industries, whose outputs are used as inputs by other industries. This assumes significance given the high degree of imported input intensity in Indian manufacturing.

While sectoral policies are a key element of industrial policy, an effective industrial policy needs to go beyond this and also focus on enterprises/firms.Typically, industrial policy has targeted sectors andthe discussion of “picking winners” is based on some variant of comparative advantage. The sectoral focus is partly a consequence of the lack of detailed firm-level data in developing countries. However, the availability of establishment data over the past fifteen years in the Indian manufacturing sector shows us that there is great deal of heterogeneity among establishments within a sector. Thus, we propose to examine the characteristics of successful firms and explore the possibility that industrial policy would be more effective if it targeted these characteristics rather than all firms in a sector. Further, certain policies may have a differential effect within a sector, enabling some ‘stars’ to emerge, while others close down.

Additionally, given the increasing recognition of the fact that industrial policy must complement and align with trade policy, we attempt to relate the performance of industries and firms to their imported input intensity and export intensity. This assumes importance given thattrade and industry policy in India have worked at cross purposes and undermined each other’s objectives. Import intensity of Indian manufacturing production has increased sharply over the last two decades and the inverted duty structure has undermined the competitiveness of manufacturing.

Finally several economists who have delved deeply into the histories of industrially advanced countries have noted that industrialization is a process of rapid learning (Joseph Stiglitz, Dani Rodrik, Ricardo Hausmann and Ha Joon-Chang). And good industrial policy is the process by which producers and policymakers consult and collaborate and learn together.With rapid changes in technology, industry boundaries are blurring, and new industries are emerging. Even within established industries, sources of competitive advantage will shift in dynamic and often unpredictable ways. The only source of an enterprise’s and a nation’s sustainable competitive advantage will be its ability to learn and change faster than any potential competition from other industries and other countries.Thus, while it is important to provide shields to enterprises and firms within the overarching framework of industrial policy, these shields must be temporary. The process of building enterprise capabilities behind the shields must happen concomitantly.A policy for building competitive enterprise capabilities, which is essential for India to grow more income-generating opportunities for its youth, must focus on interwoven processes for growth of enterprises and growth of people’s skills.

1. As of October 2018, a draft of the policy has been prepared by DIPP and is awaiting approval of the Union Cabinet. [↑](#footnote-ref-2)