5 Economic growth without employment
The story of Indian manufacturing

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In the early 1950s, India launched an ambitious programme of state-led industrialisation. For a newly independent country that had suffered almost two centuries of colonial domination, this was an audacious move. At this time, India’s efforts to build scientific and technological capabilities despite the poverty of its population generated much hope, not only within India itself but also among other newly independent countries of the mid-twentieth century. Today, almost seven decades later, India’s record with respect to economic growth and development is mixed. Its gross domestic product (GDP), when measured at purchasing power parity (PPP), is the third largest in the world. Also, according to the latest statistics, the Indian economy is the fastest growing of the world’s large economies. Yet, it might appear paradoxical that the Human Development Report 2014 ranks India only 135 out of 187 countries with respect to achievements in human development. Why has India failed to convert its relatively good performance in economic growth into even modest improvements in conditions of living for millions of its poor citizens? Part of the reason lies in the nature of India’s economic growth, which has largely been driven by the services sector. At the same time, the performance of the manufacturing and agricultural sectors has been far from impressive. In 2010, manufacturing accounted for only 15 per cent of India’s GDP, compared to 30 per cent in China. In 2009–12, the manufacturing sector employed only 53.3 million – less than 12 per cent of India’s total workforce of 462 million (Thomas 2012).

At the root of India’s developmental challenges is the slow pace of employment generation. Thomas (2014) found that, given the rate of increase in India’s working-age population, the workforce employed in industry and services could potentially have grown at the rate of 15 million a year between 2004–05 and 2011–12. But the actual growth during this period was far slower, around 7 million jobs annually. Almost half of the net increase in non-agricultural employment occurred in construction, a relatively low-wage sector. The contribution of the manufacturing sector to the employment growth during these years was particularly slow, less than a million jobs a year (Thomas 2014; Thomas 2015a).
India’s inability to build a manufacturing sector large enough to absorb a substantial part of the country’s labour reserves is striking. The problem has its origins in the heady days of Indian planning, when manufacturing was the sector accorded the highest priority in economic development. As is well known, Indian development shifted decisively from a state-led to a market-led path from 1991 onwards. One of the early promises of the market-led economic reforms was that they would stimulate manufacturing employment, as it was thought that India’s labour intensive industries stood to gain from exposure to global markets. But the creation of employment opportunities, promised first by India’s planners and then in later years by its market-led reformers, failed to eventuate. Given this context, this chapter aims to examine the challenges faced by Indian manufacturing over the years, especially in regard to employment creation.

Indian manufacturing is made up of organised and unorganised (or registered and unregistered) sectors. The organised sector comprises factories that employ more than 10 workers and operate with the aid of electric power, as well as factories that employ more than 20 workers without the aid of electric power. In 2009–10, manufacturing workers belonging to the factory sector numbered 11.3 million and made up 21 per cent of all manufacturing workers. The rest of the manufacturing workforce, 42.2 million, were engaged in small, informal enterprises in the unorganised sector. It is notable that despite its low share of employment, the organised sector contributed 67.6 per cent of India’s total manufacturing GDP in 2010–11 (GOI, 2016).

This chapter begins with an examination of the early phase of state-led industrialisation in India. Discussion then moves to an evaluation of “jobless growth” in Indian manufacturing during the 1980s and the impact of the 1991 economic reforms on Indian industry. This is followed by an examination of the major constraints currently facing Indian manufacturing.

**Indian planning and capital-intensive industrialisation**

When India became independent in 1947, there were steep challenges facing the new nation on the economic front. During the first half of the eighteenth century, before the country was colonised by the European powers, India had been a major manufacturer of handicrafts. However, as the country came under the dominance of British imperialism over the century that followed, Indian handicrafts, unable to compete with factory-produced cloth from Britain, faced annihilation in both the export and domestic markets. Bagchi (1976) points to the steep decline in the share of the workforce engaged in industry in Gangetic Bihar during the nineteenth century as a result of this massive process of deindustrialisation.

Factory-based manufacturing had begun in India in the 1850s, with the setting up of cotton- and jute-textile factories in Bombay and Calcutta respectively. Despite this early start, India’s modern industries stagnated under the discriminatory trade, tariff and industrial policies of the British colonial regime.
The growth of agriculture, and especially food grain production, was extremely sluggish during the first half of the twentieth century. One of the driving factors behind the nationalist struggle for Indian independence was the setback faced by the country’s economy during the colonial period. It was these economic circumstances that led India to inaugurate state-directed efforts to promote modern industrialisation immediately after independence. Planning for industrialisation was carried out under the leadership of Jawaharlal Nehru, India’s first Prime Minister. The Second Five-Year Plan, which, according to Chakravarty, “reflected a major watershed in India’s economic thinking” (1987, 8), provided the blueprint for the industrialisation strategy. It emphasised the building of “heavy” or capital-intensive industries that were capable of substituting imports with domestically produced machinery.

Given its relative abundance of labour reserves and relative deficiency of capital, India’s choice of capital-intensive techniques for its industrialisation strategy went against the theory of comparative advantage. The economic justification for this strategy had its roots in the development debates of the 1950s, which identified low rates of savings as the biggest constraint facing post-colonial countries in their early stages of development. Low rates of savings translate into shortage of capital stock in relation to the availability of employable persons, which prevents the introduction of new technologies in the economy (Chakravarty 1987, 9–10). As a result, India’s Second Five-Year Plan envisaged the allocation of larger shares of investment to capital-goods-producing industries or to the building of machines that produce other machines. According to the model, this would result in a higher savings rate on the margin and a higher rate of growth in output.

India’s industrial policies during the early years of planning (1950s and 1960s) accorded primary importance to the public sector in many areas, especially in infrastructure building. Trade and tariff barriers were introduced to protect domestic industries from foreign competition. Investments by the private sector were subject to a wide range of regulations, such as controls on the creation of production capacities, on prices, and on the import of machinery. At the same time, private entrepreneurs received financial assistance through public-sector financial institutions (Chandrasekhar 1988). But even as India’s policy makers envisaged revolutionary changes in the sphere of industry, the country’s agrarian base and social settings remained largely untouched by the planning process. For example, attempts at land reform met with little success in most parts of India, making rural inequality a persistent feature of the Indian political economy. The unfinished agrarian transformation was in many respects responsible for the slow growth of Indian agriculture during the post-independence period.\(^3\) In this context, India’s planned industrialisation was only partially successful. Drawing on Keynesian, Kaleckian and Marxian theories, a number of scholars at this time attributed India’s industrial stagnation from the mid-1960s mainly to the slow expansion of domestic demand arguing that the slow growth of demand was a consequence of the unequal distribution of incomes and the sluggish growth of agricultural incomes in the country (Patnaik 1972; Mitra 1977; Chakravarty 1979).
There are many ways in which a slow growing agricultural sector can become a barrier to industrial growth. To begin with, as agriculture employs the bulk of India’s working population, slow agricultural growth depresses the incomes of the majority. Slow progress in agricultural production, especially of food-grains, leads to a rise in inflation, which affects urban workers and landless agricultural workers in particular (Patnaik 1972; Mitra 1977). Furthermore, a slowdown in agriculture reduces the production of raw materials for industries such as textiles and food-processing. Skewed distribution of incomes also adversely affects industrial growth, mainly by preventing firms from exploiting economies of scale. In a situation of high inequality, the demand for consumer durables and luxury goods consumed by a few may grow fast, while the demand for mass-consumption goods, such as textiles, may not (Chakravarty 1979). Patnaik and Chandrasekhar (2007) argue that the inability of the Indian state to impose some measure of “discipline” on capital weakened the state’s intervention in industrial development.

At the same time, an equally important alternative explanation for India’s industrial growth stagnation, which is based on neoclassical theories, focused on the supply constraints in the economy (Bhagwati and Desai 1970; Ahluwalia 1985). Bhagwati and Desai advanced several criticisms of the country’s industrial policy framework. In their view, the licensing regime in particular was ill-designed and concerned itself with excessive detail, slowing down industrial growth (1970).

**Growth during the 1980s**

After a long phase of stagnation between the mid-1960s and late 1970s, India’s industrial growth revived during the 1980s. This revival has been attributed to several factors, including the improvement in public sector investment from the mid-1970s on. Public investment in infrastructure had a positive impact on general productivity and reflected a more pro-business attitude in government (Sen 2007; Kohli 2006; Rodrik and Subramanian 2004). Even so, India’s industrial growth during the 1980s has been described as “jobless” growth. That is, despite the acceleration in the growth of factory sector output, factory sector employment during this decade remained stagnant (see Table 5.1 and Figure 5.1). This was because the output-growth acceleration during the 1980s was accompanied by important changes in the structure of the factory sector. On the one hand, capital-intensive industries such as chemicals, petroleum and plastics underwent significant growth. On the other, the factory-based production of cotton and jute textiles suffered a steep decline and thousands of mill workers lost their jobs in Mumbai, Kolkata, Ahmedabad, and other industrial centres. Total organised manufacturing employment in India increased only marginally, by 0.4 million, between 1980–81 and 1991–92. In comparison, an additional 2.6 million factory jobs were created in the country between 1969–70 and 1979–80 (Thomas 2013).
In spite of the slow growth of factory or organised manufacturing employment, overall manufacturing employment in India increased by a substantial 7.6 million during the 1980s (Table 5.1). This was largely the result of job creation in the unorganised sector. The major generators of employment during this period were food products, tobacco, wood products, furniture, and also chemical products (Thomas 2012; Thomas 2013). Overall, the growth of non-agricultural employment during the 1980s was relatively fast, especially in the rural areas. This, along with government financed poverty-reduction programmes such as the Integrated Rural Development Programme (IRDP) contributed to a substantial reduction in poverty during this decade (Sen 1996).
Studies of labour rigidity: A critical review

A widespread view in academic and policy circles is that the slow growth of factory employment in India during the 1980s and in later decades was due to rigidity in the country’s labour market (Fallon and Lucas 1993; Besley and Burgess 2004; GOI 2013, 42–49). Most academic studies attribute labour market rigidity in India to the Industrial Disputes Act (IDA) of 1947 and its amendments in 1972, 1976 and 1982. With the 1976 amendment, industrial establishments in India employing 300 workers or more were required to obtain government permission to retrench workers or close factories. The 1982 amendment made this requirement applicable to establishments employing 100 or more workers. However, there are grounds to contest this assessment. To begin with, academic studies of labour rigidity have been based almost entirely on the IDA, which is only one of many labour regulations in India. Moreover, the IDA is applicable to only a small segment of India’s workforce: 5.5 per cent of all workers and 12 per cent of all hired workers in 1999–2000, according to Pais (2008). It is also well known that more than 90 per cent of India’s working population who are in the unorganised sector are not protected by any labour regulations nor covered by social security benefits.

Scholars have also questioned the methodologies used in studies that see labour regulations as responsible for jobless growth (Bhattacharjea 2009). As an example, it is worth examining some of the methodological issues in the study by Besley and Burgess (2004), which is widely quoted and has influenced later academic and policy thinking in this area. Besley and Burgess focused on the amendments made to the IDA – which is a central (or national) piece of legislation – in various Indian states. Besley and Burgess categorised Indian states as “pro-worker”, “pro-employer” or “neutral”, using an index based on their reading of the various state-level amendments to the IDA. Their econometric investigations revealed that during the 1958–92 period, the “pro-worker” states experienced a relative slowdown in output and employment growth in the organised manufacturing sector. A number of later studies, which were greatly influenced by this methodology, also argued that the IDA was the main factor responsible for the slowdown in industrial growth across the country. However, according to Bhattacharjea,

Besley and Burgess misinterpreted several of the state-level IDA amendments; assigned identical scores to minor procedural amendments and major changes in job security rules; aggregated incommensurable pro-worker and pro-employer amendments occurring in the same year to give a summary score of +1 or −1 to a state for that year; used a misleading summation of these scores over time (so that a state that passed amendments in different years was assigned a higher score than one that passed the same amendments simultaneously); and ignored hundreds of other labour laws, including some whose provisions overlap with the IDA (2009, 55).
Besley and Burgess (2004), Fallon and Lucas (1993) and other studies that attributed jobless growth to labour rigidity conveniently overlooked the slow pace of employment growth during the 1980s; in fact, joblessness was restricted to few industries and regions. In absolute numbers, factory employment declined sharply during this decade, in the jute textile industry in West Bengal, and in the cotton textile industries in the states of Maharashtra and Gujarat. However, rather than labour regulations, it was actually a number of structural factors affecting the industry (some of which will be discussed below) that were responsible for the decline of the organised textile-mill industry in India. At the same time, new jobs were added in fairly large numbers during the 1980s in industries such as chemicals and machinery, and in several states, notably Tamil Nadu and Punjab (172,000 and 142,000 respectively) (Thomas 2002). The argument that the IDA discouraged employers from hiring more factory workers flies in the face of such evidence.

Analyses of industrial relations in Maharashtra and Gujarat indicate that the governments in these states were largely unsympathetic to the concerns of workers. It is well documented that in the 18-month long strike in the Mumbai cotton textile industry during 1982–83, mill workers ended up losing their jobs and livelihoods (Chandavarkar 2004; Breman 2004). Nevertheless, in their 2004 study, Besley and Burgess questionably classified Maharashtra and Gujarat along with West Bengal and Orissa as “pro-worker” states, based on the criteria they evolved in their study. In fact, Besley and Burgess’ eventual conclusion, that employment growth slowed in the pro-worker states, hinges crucially on the “pro-worker” labels attached to Maharashtra and Gujarat (as they are two of the three states that suffered significant job losses in the factory sector during the period covered by the study). Several later studies analysed industrial growth in India during the post-1990 period using the Besley and Burgess index or following most aspects of the methodology. Bhattacharjea argues that these later studies suffer from the same methodological issues that affect the Besley and Burgess study. In particular, they were “analysing [industrial] performance in the 1990s with reference to a classification of States based on their labour laws as they evolved before 1990” (Bhattacharjea 2007, 23). It is perplexing that despite its many problems, the argument that labour rigidity and tough labour laws constrain India’s industrial growth continues to be heard even today.

**Industrial growth after the 1990s**

India introduced far-reaching economic reform measures from 1991–92 onwards. These reforms virtually eliminated licensing, reduced other regulatory barriers, and deepened the country’s trade and financial relations with the rest of the world. External reforms have accelerated during the 2000s, especially since the middle of the present decade. The impact of these reforms on the growth of manufacturing output and employment has been mixed.
India’s organised manufacturing sector experienced a sharp acceleration in output and employment growth during the early years of economic reform, from 1991–92 to 1995–96. Nevertheless, the country’s organised manufacturing sector, as well as its overall GDP, decelerated between 1996–97 and 2001–02 (see Figure 5.1 and Thomas 2013). The fast growth recorded by manufacturing during the first half of the 1990s was led by a sharp revival in private-sector investment (see Figure 5.2). At the same time, however, as part of the structural adjustment programme, India tried to decrease its public expenditure and fiscal deficit. As a result, public investment as a share of GDP remained at a relatively low level during the whole of the 1990s. Private investment also began to decline from the middle of the 1990s, leading to an overall slowdown in the country’s industrial growth (see Figure 5.2).

India’s overall GDP growth, and the growth of the organised manufacturing sector in particular, recovered impressively during the early 2000s (see Figure 5.1). And as Figure 5.2 indicates, this growth was led by private corporate investment and exports. Capital- and skill-intensive industries, such as metals, machinery, automobiles and chemicals, recorded extremely fast rates of growth. During this period, segments of Indian manufacturing, such as the pharmaceuticals industry and the design and manufacture of low-cost vehicles, began to make a mark internationally for their specialized skills and capabilities.

With the onset of worldwide economic crisis in 2008, India’s manufacturing sector was hit by a slowdown in demand from export markets. In response to the crisis, the authorities launched expansionary monetary and fiscal policies. Banks were encouraged to lend more, especially in the form of housing and automobile loans. These measures had some success in reducing the impact of

![Figure 5.2](image)

*Figure 5.2* Gross fixed capital formation by public and private corporate sectors, as % GDP in India, 1970–71 to 2011–12.

Source: National Accounts Statistics, various years.
the global slowdown. However, from 2011–12 onwards, private investment in India slowed, and with this downturn, the country’s manufacturing sector entered yet another phase of stagnation from which it is yet to recover (see Figure 5.2). The impact of this industrial growth slowdown has been more adverse in the unorganised sector. As will be discussed below, the growth of employment in India’s unorganised manufacturing has been particularly slow since the mid-2000s.

The growth of organised manufacturing employment in India remained stagnant until the middle of the 2000s: only 1.2 million jobs were generated in this sector between 1982–83 and 2004–05. However, since the mid-2000s, there has been a notable turnaround in the growth of employment in India’s organised manufacturing, with a rise of 4 million between 2004–05 and 2010–11 (see Table 5.1). At the same time contract workers comprised an overwhelming proportion of the incremental employment in the country’s organised manufacturing sector during the 2000s. In other words, employment in India’s formal sector manufacturing has increased substantially since the mid-2000s, but this has occurred along with growing informalisation of the manufacturing sector.

The employment growth record of the unorganised sector has been particularly noteworthy. During the first half of the 2000s (1999–2000 to 2004–05), total manufacturing employment in India increased by 9.8 million, the bulk of it in the unorganised sector. Labour-intensive and export-oriented industries such as textiles, garments, leather, footwear, furniture, jewellery and gem cutting accounted for 7.2 million, or more than 70 per cent of the manufacturing employment growth during the first half of the 2000s (Thomas 2012). However, it was these very industries that suffered significant job losses during the late 2000s, particularly in the wake of a slowdown in export demand. Between 2004–05 and 2011–12, overall manufacturing employment in India rose by only 5.1 million, or just 10.6 per cent of the 48 million net addition to non-agricultural employment during the same period. Of the total increase in manufacturing jobs of 5.1 million, an increase of 4 million occurred in the organised sector. This implies that the increase in unorganised sector manufacturing employment in India since the mid-2000s was only 1.1 million, a sharp decline from the growth recorded by this sector during the previous decade (see Table 5.1). In the following paragraphs, I examine the reasons for the particularly poor growth record of India’s unregistered manufacturing in recent years.

Not constrained by labour laws

The argument that labour laws have hindered India’s industrial growth has become almost irrelevant in the light of recent evidence. As shown above, there has been a recent spurt in employment growth in organised manufacturing, the sector in which labour laws could have potentially discouraged employers from investing. In fact, contract workers or other employees (including employees
designated as supervisory staff) who are outside the purview of the labour laws have accounted for 69 per cent of the employment growth in India’s organised manufacturing during the 2000s. Contract workers as a proportion of all workers in India’s factory sector rose from 19.8 per cent in 1999–2000 to 32.8 per cent in 2009–10. Annavajhula and Pratap (2012) found that contract workers were employed in almost every aspect of production operations and formed 70–80 per cent of all workers in Maruti Suzuki’s plants in Gurgaon and Manesar.

The rising share of informal employment, even within the formal organised sector, makes the argument that India’s labour markets lack flexibility seem quite unconvincing. In fact, trade union activism has been declining in India since the early 1990s, and labour’s bargaining strengths relative to capital have been substantially reduced. With the central and the various state governments in India trying to attract investment, there has also been a growing laxity in the implementation of labour regulations. The number of days lost due to industrial disputes have declined markedly since the mid-1980s. In recent years, lockouts – which are enforced on workers by their employers – have become a far more important source of industrial disputes than strikes, which are work stoppages by employees. It is also worth noting that since the beginning of the 2000s, growth in the real wages of India’s factory workers has increasingly been falling behind the growth of labour productivity (Thomas 2013).

It is also notable that between 1999–2000 and 2004–05 women workers accounted for a substantial part of the net increase in manufacturing employment in India (3.9 million out of 9.8 million). The share of women in incremental employment was particularly high in textiles, garments, and gem cutting. On the other hand, 2.9 million out of the 3 million who lost jobs in Indian manufacturing during the second half of the 2000s were also women (Thomas 2012). The sharp rise and the subsequent fall in the number of women manufacturing workers indicates that women form an increasingly substantial proportion of the flexible component of India’s manufacturing labour force.

Many of the regulations concerning industry and labour that exist in India today have their origins in laws that were first enacted during the British colonial period (Pais 2008). As such, it is undeniable that these regulations are in urgent need of updating. At the same time, however, there is little evidence to support the argument that labour regulations represent the main constraint on the growth of manufacturing employment in India.

**Constraints on Indian manufacturing**

In India, the growth of the infrastructure sectors such as electricity, roads, and ports has failed to catch up with the overall pace of economic growth. This has resulted in severe supply-side bottlenecks adversely affecting the growth of the country’s manufacturing sector.
Supply-side constraints on Indian manufacturing and the role of public investment

Estimates by the Ministry of Power, for example, show that the energy availability in India during 2011–12 was 857.9 billion units (or kilowatt hours), which was 8.5 per cent less than the energy requirement for the year. Power demand and supply shortages have been reported from every region of India and from a majority of Indian states. In 2011–12, this deficit was 10.5 per cent in Tamil Nadu, 16.7 per cent in Maharashtra, 3.1 per cent in Punjab, and 21.3 per cent in Bihar (CEA, 2012, Annex II). Field research in Coimbatore in Tamil Nadu between 2008 and 2014 also revealed that power shortages have been the most serious constraint on growth in this industrial town since October 2007 (Thomas 2009). As a result of severe restrictions on the use of electricity imposed by the Tamil Nadu state government, several textile and engineering firms in Coimbatore and in other regions of Tamil Nadu were operating at 50 per cent or even less of their production capacities. Supply constraints such as power shortages affect micro and small industries much more than large industries. In Coimbatore, micro and small entrepreneurs were paying Rs. 4.30 or more per unit (or per kilowatt hour) of electricity, but were still experiencing production losses due to power interruptions. At the same time, multinational companies such as Hyundai in Chennai were being offered uninterrupted power supply at cheaper rates as part of agreements signed with the state government (Thomas 2009).

The huge deficit that India faces today in the infrastructure areas is, to a large extent, a result of the sharp fall in public investment in the Indian economy since the 1990s (Rao and Dutt 2006). Gross fixed capital formation (GFCF) in the public sector as a proportion of India’s GDP actually declined from 12.3 per cent in 1986–87 to 6.6 per cent in 2002–03. It subsequently increased to 8.5 per cent in 2008–09, before falling again in recent years (see Figure 5.2).

Industrial policies

India’s industrial policies in recent years – with respect to bank credit, prices and tariffs, to name just the three important ones – have not been helpful to the growth of the country’s manufacturing sector.

Availability and cost of credit

During the pre-1990 years, the targeting of bank credit at agriculture and small-scale industry was an important aspect of India’s banking policies. The availability of subsidized credit made sizeable contributions to the growth of small-scale industries, such as, for instance, the garment industry in Tiruppur (Chari 2000). However, the share of agriculture and industry in the total allocation of credit by scheduled commercial banks in India declined during the 1990s. As a proportion of non-food gross bank credit, advances to small-scale industries (SSIs)
fell from 15.1 per cent in 1990 to just 6.5 per cent in 2005. The number of SSI sector loan accounts in commercial banks declined from 219 million in 1992 to 93 million in 2005. On the other hand, the share of personal loans and professional services as a proportion of total outstanding bank credit increased from 9.4 per cent in 1990 to 27 per cent in 2005 (RBI 2006, 132–139). Since the mid-2000s, there has been a boom in the allocation of bank credit to large-scale industries, especially in sectors such as power and telecommunications (Nagaraj 2013, 44). Nevertheless, during the second half of the 2000s, the share of small and micro industries as a proportion of total credit disbursed in India remained unchanged, at around 6 per cent (RBI 2012, 76).

Small and micro enterprises have been hit hard by inadequate access to bank credit. According to an NSSO survey of unorganised manufacturing enterprises in 2005–06, 42 per cent of all enterprises identified shortage of capital as a major constraint on growth; 92.2 per cent did not receive any financial assistance, and only 3.6 per cent received loans from institutional sources (NSSO 2007, 30–32). In Coimbatore, access to cheap, institutional credit was extremely difficult for micro enterprises, which had to depend on private banks and private finance companies. The interest rates charged by these private banks were often high; interest rates between 28 per cent and 36 per cent were common (Thomas 2009).

Exchange rates, price fluctuations and their links to capital flows

The gradual liberalisation of India’s capital account during the 2000s and the accompanying increase in the inflow of foreign portfolio investments (FPI) have created problems for the country’s manufacturing sector. The volatility in FPI flows since the 2000s has led to wide fluctuations in exchange rates, as well as in the prices of several commodities.

The Rupee–Dollar exchange rate appreciated sharply between May 2007 and April 2008. This resulted in a steep decline in the revenues and profits of export-oriented industries such as textiles, garments, leather, and engineering. At the same time, there have also been equally sharp depreciations of the Indian Rupee, such as those that occurred during the second half of 2008 and again during the period from May 2011 to August 2013. During these periods of currency depreciation, imports of machinery and raw materials became costlier. More importantly, many Indian firms, which had availed themselves of foreign-currency loans, incurred heavy losses when they were required to repay their loans in the depreciated rupee. It may also be noted that the volatility in availability and generally high prices of key raw materials such as cotton and steel were major obstacles to the growth prospects of Indian industry during the late 2000s.

Trade liberalization and rising import intensity of manufacturing

During the 2000s, India reduced the tariffs on the import of several manufactured goods. These reductions mostly came about as a result of the country’s
commitments to international trade agreements, but they have adversely affected the prospects of India’s manufacturing firms, which are already disadvantaged by many supply-side constraints, as noted above. Industrial growth in India since the 2000s has been accompanied by a marked rise in the level of imports, notably of capital goods.

It is significant that the industries that recorded fast rates of growth in imports during the 2000s were machine tools, electrical and non-electrical machinery, electronic and computer goods, and transport equipment. Imports as a share of domestic production have been rising rapidly in these industries, most likely as a result of the reduction in import tariffs. The weighted average of import tariffs in India on capital goods declined from 94.8 per cent in 1991–92 to 28.7 per cent in 1995–96, 23.1 per cent in 2001–02, 9.5 per cent in 2005–06, and just 5.6 per cent in 2009–10.\(^6\)

Industrial growth that is increasingly based on imported components reduces the growth opportunities for domestic industry and depresses the possibility of linkages between the large and the small-scale sectors. Typically, a substantial part of the production of ancillaries and components for the machinery and transport-equipment industries in India has occurred in the small-scale or unorganised sector. With the rise in the import of components, such opportunities for production in the small scale sector are reduced. Indeed, studies have pointed to the growing technological distance separating the organised and unorganised sectors, and to the absence of a complementary relationship between the two (Kathuria, Raj and Sen 2010; Uchikawa 2011).

**Demand-side constraints on industrial growth**

The slow growth of effective demand, which was the result of low per capita incomes and high inequality in income distribution, has been identified as a key factor behind the deceleration in India’s industrial growth since the mid-1960s (Chakravarty 1979). Amsden (1977) attributed the slow growth of the machine tool industry in Taiwan during its formative years to the nature of the demand, which originated from a “large number of low-income machine tool users”, in other words, the type of market rather than the market size (218).

Is the Indian industry still constrained by the type, if not the overall size, of the domestic market? The 2009–10 NSSO survey on consumption expenditures revealed extreme disparities in per-capita consumption expenditures between the richest 10 per cent of households and their poor counterparts. For instance, the monthly per capita expenditure on consumer durables in urban areas was Rs. 969 for the 10th decile of households, falling drastically to just Rs. 74 for the 9th decile, and to even smaller amounts for households belonging to the lower deciles.

It is likely that the demand for consumer durables (e.g. furniture) in India is segmented, with the demand from the richest decile of households being fulfilled mainly by the organised sector industries, and to some extent imports. On the other hand, the small scale and unorganised sector enterprises largely
cater to the demand from the vast majority of poor households. The market for the unorganised sector industries appears to be constrained by the low purchasing power of individual consumers. As a consequence, unorganised sector industries are likely to be trapped in a cycle of poor quality of production, outdated technologies, and low levels of profitability.

What happened to labour-intensive industries?

It is indeed perplexing that despite being a labour-surplus country, India’s labour-intensive industries have not fared well, even after the introduction of market-oriented economic reforms (Kochhar et al. 2006). India’s failure to emerge as a major player in textiles is noteworthy, especially given its relatively early start in this industry. In an attempt to understand the reasons behind this failure, this final section examines India’s policies towards labour-intensive industries.

According to India’s Second Five-Year Plan, the production of consumer goods such as textiles should ideally be carried out in the small scale sector. This, it was expected, would help to alleviate the problem of unemployment. The consumer goods sector was also expected to generate the savings required to sustain capital goods production (Mazumdar 1991). As a result, the government banned the creation of new textile-production capacity in mills from 1950 onwards, favouring instead small scale production in handlooms. There were restrictions on the use of synthetic fibres by mills, and excise duties were imposed on mill-made cloth. The government even discouraged the production of cloth in power looms. According to Mazumdar (1991), government regulations were the main reason for the stagnation in the growth of India’s textile industry during the planning era. Technological progress was particularly sluggish, as the expansion of the industry occurred largely through the growth of unlicensed power loom units. At the same time, the slow growth of India’s textile industry was mainly due to the low per capita domestic demand for textiles and the specific strategies adopted by the large business houses (Chandrasekhar 1984). As noted earlier, there were widespread closures of composite mills (engaged in both weaving and spinning) in India’s cotton textile industry during the 1980s. In subsequent years, while the weaving industry shifted largely to power looms in the decentralised or unorganised sector, the spinning industry producing cotton yarn remained part of the organised sector. The share of the decentralised sector in total cloth production in India rose from 62 per cent in 1980–81 to 97 per cent by 2010–11 (GOI 2013, A-32).

Since the 1990s, there has been a degree of revival in the growth of India’s textile and garment industries as a result of the removal of many of the earlier restrictions on the industry and the greater opportunities for export growth. In 2011, India was second only to China in the export of textile yarn. However, with respect to the export of cotton fabrics, India was ranked in fifth position, behind countries such as Pakistan and Hong Kong. Some other labour-intensive industries in India, such as food products, beverages and tobacco,
experienced a slowdown in the growth of both output and employment during most of the 1990s and the 2000s. In fact, this amounted to a reversal of the fast growth experienced by these industries during the 1970s and 1980s (Thomas 2012). Most of India’s labour-intensive industries operate as small and micro enterprises. The supply, demand and policy-related factors discussed above, which constrain small firms in particular, are further major hurdles to the expansion of labour-intensive industries in India.

Conclusion

This chapter has attempted to explain why the manufacturing sector in India has had only a limited impact on the country’s development, especially in regard to employment creation. Indian manufacturing provided employment for 53.3 million people in 2009–10, which was less than 12 per cent of the country’s total workforce. Of all manufacturing workers in India, only around 21 per cent were engaged in the organized sector, while the rest of the workforce was attached to small, informal enterprises in the unregistered sector.

The growth of employment in India’s unorganised manufacturing has decelerated sharply since the middle of the 2000s. The generation of jobs within organised manufacturing revived during the same period, but most of the incremental employment was informal in nature. A number of factors have constrained the growth of Indian manufacturing during the 2000s, and their effect has been more intense in micro enterprises and small scale industries in the unorganised sector. Foremost among these factors is the slowdown in the growth of investment, especially public investment. This has led to supply-side bottlenecks, mainly in infrastructure and power generation. Insufficient availability of bank credit and fluctuations in exchange rates and the price of raw materials have also been important constraints. There has been an unhealthy rise in import intensity in several areas of Indian manufacturing, particularly in machinery industries. Another issue is the low levels of demand for industrial goods from a vast majority of the country’s population. In addition, the fast growth of high-paying sectors such as information technology and finance has increased the shortage of skilled workers facing Indian manufacturing.

India’s labour laws have often been singled out as being the cause of most of the problems affecting the country’s manufacturing sector. However, the argument that labour laws have hindered manufacturing growth is increasingly becoming irrelevant, as an overwhelming proportion of new employment in the country’s organised sector falls outside the purview of those laws. As this chapter has argued, the slow growth of India’s manufacturing sector has been largely due to a combination of external factors and inadequate policy responses on the part of the Indian government. For example, foreign direct investment (FDI) as a proportion of gross fixed capital formation (GFCF) was on average only 5.9 per cent during the period from 2001 to 2011 (Jadhav and Reddy 2013). Estimates by Rao and Dhar (2011) show that of the total FDI equity
inflows into India during 2005–08, only 20.6 per cent went to manufacturing. Also large shares of FDI flows – 40.3 per cent in 2006–07 – have gone into the acquisition of shares in domestic enterprises and do not therefore represent the building of new facilities (Rao and Dhar 2011, 25–27).

In recent times, the Indian government has unveiled new programmes for the promotion of domestic manufacturing. The previous government, led by the United Progressive Alliance (UPA), launched a National Manufacturing Policy in 2011. The current government, led by the National Democratic Alliance (NDA), has launched a “Make in India” initiative. The thrust of both these initiatives has been to attract private investment, especially foreign investment. In both these initiatives, the government’s role is confined to the creation of a facilitating environment for private investors. Foreign markets and foreign investors are themselves going through a tumultuous phase, with the global economy moving from one crisis to another. For this reason, it would be a mistake at this stage to rely too much on foreign investment or exports as drivers of growth in the Indian economy. Since 2011–12, India’s domestic private firms have been reducing their levels of investment, partly because of the slowdown in demand at home and abroad, and the unutilized capacities they had built during the previous years. Many of them are also heavily indebted.

Given the current circumstances, there is a critical need for a rise in public expenditure as part of efforts to promote economic growth in India. The country has huge investment needs in irrigation, electricity, rural and urban infrastructure, as well as in many areas of basic research. Furthermore, the revival of traditional, labour-intensive and agro-based industries as a way of generating decent jobs in the rural areas requires funding for new areas of knowledge and technology. The long lead time associated with these projects has made private investors wary about investing in them, making these areas suitable for public investment. Only in this way will it be possible to remove some of the long-standing barriers to Indian development.

Notes
1 Data obtained from the World Bank’s World Development Indicators. Available at http://data.worldbank.org/indicator.
2 See also Thomas (2015b) for regional aspects of employment growth in India.
3 See the set of articles in Byres (1998) and Nayyar (1994), which engage with various aspects of this argument.
4 It should be noted here that the Besley and Burgess index was based on amendments to the IDA up to 1989.
5 See, for instance, Hiraway and Shah (2011), which notes that in Gujarat the State Labour Department’s ability to enforce labour regulations has been substantially reduced over the last two decades.
6 Data obtained from http://planningcommission.nic.in/data/datatable/1705/final_76.pdf.
7 Data obtained from UN Comtrade. Available at http://comtrade.un.org/pb/.
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References


