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Indian Manufacturing: A Volatile Sector

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Abstract

The government of India launched an ambitious manufacturing development programme named “Make in India” during September 2014 to make India as a global manufacturing hub. Major target of this initiative is to increase the contribution of manufacturing output to 25 per cent of Gross Domestic Product (GDP) by 2025, from 16 per cent currently. The million dollar question here is “whether this target is achievable and does Indian manufacturing sector has the potential to grow consistently and create more employment opportunities”? Based on the latest available data this paper is an attempt to analyse this question and to investigate the growth record of Indian manufacturing sector since the initiation of economic reforms in 1991.

Keywords: Manufacturing, reforms, volatility, G.D.P., performance.

Introduction

Manufacturing sector is the core of overall industrial sector is regarded as backbone for any economy. The role of this sector becomes even more important when it comes for a transitional economy since it is expected to be an engine for the growth and major absorber of labour force. Additionally with increasing returns to scale and as a major source of income and employment it would be expected to eliminate the poverty levels rapidly. This has been the strategy of our early planned economic development since second five year plan when the policy of industrialisation was started and it was clearly stated that it is essential for rapid growth in income levels and removal of poverty. This strategy was quite successful for the Nehruvian period (1950-64) as the secondary

sector recorded a high growth rate of 6.8 percent per annum.* However, this momentum could not be sustained afterwards initially due to natural factors like drought conditions (during mid sixties) in the country and border conflicts and later on due to forced imposition of socialism and more restrictions on production and output especially for the private corporate sector. Production and expansion was curtailed by imposing limits to capacity utilization, branch restrictions for firms, investment and industrial licensing, quantitative and tariff restrictions on imported inputs, regulation of monopolies and trade practices, foreign exchange regulation, nationalisation of commercial banks, price controls, etc. These factors led the industrial sector to a long term recession until it was revived in 1980s with the introduction of partial reform measures. According to Ahluwalia (1991), it is no surprise that the regulatory framework of the pre-1980s, inter alia, has been held responsible for low growth rate of output and productivity of India's manufacturing sector.

A wide ranging and comprehensive economic reforms have been initiated in India since 1991-92 which covered almost every important sphere of the economy including capital market, external sector, banking sector and the industrial sector. These reform measures constituted deregulation (specifically abolition of licensing permit quota raj), liberalization of the external trade and payment system and partial privatization of some of the state sector enterprises. "Dereservation and delicensing" of major industries have been introduced to create more opportunities for private sector and abolition of monopoly and restrictive trade practices (MRTP) act led more optimism regarding expansion benefits for firms.

Financial sector reforms initiated since 1992 systematically reduced government dominance regarding investment and financing. Deregulation of administered interest rate system and liberalisation of financial markets, especially banking sector, has resulted into more financing opportunities for the private corporate sector. According to Ahluwalia (1995), the changes that the reforms after 1991 brought in were "fundamental" in nature compared to the "marginal" changes only in the previous decade.

Performance Analysis

This section analyses the performance Indian manufacturing sector during last 25 years (1991-2016). A simple statistical analysis based on various issues of Central Statistical Organisation (CSO) data and other government agencies reports has been presented here for broad readership.

Although it is true that process of industrialisation in the early planning period created a fundamental base for further industrial development, the performance of this sector has not been up to the mark. Many economic theories predicted that over the period of time, for a transitional economy, the contribution of manufacturing sector to gross domestic product and employment will increase. This does not seem to be true in the case of Indian manufacturing sector, as its share in total GDP increased only marginally from around 9% (1950-51) to 15% (2014)*[†]. In accordance with development theories the share of primary sector in GDP declined rapidly after independence

*PulapreBalakrishnan, The Recovery of India: Economic Growth in the Nehru Era.

[†]Manufacturing contribution in the Indian economy is nearly 17 per cent to Gross Value Added (GVA- Economic Survey 2015-16)

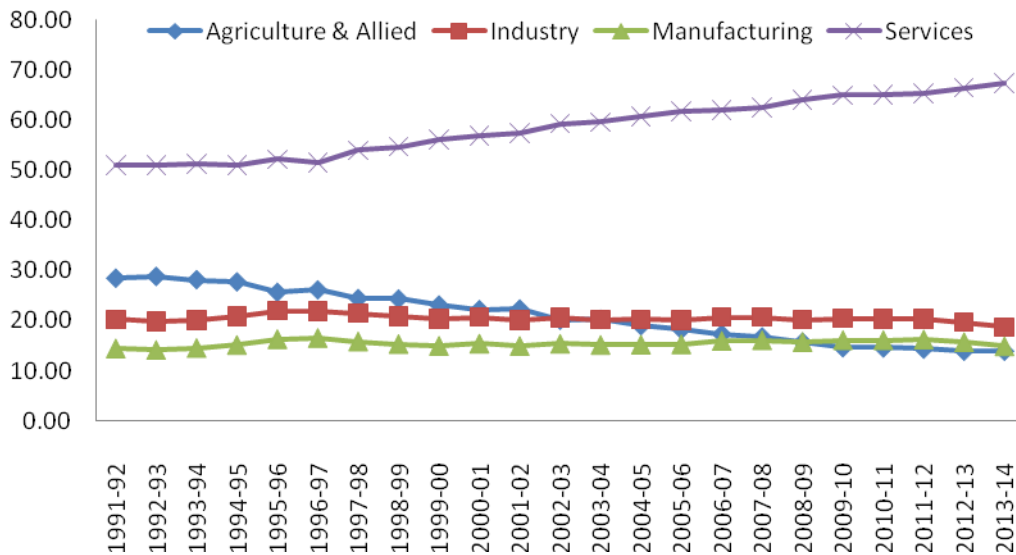
but shockingly manufacturing sector's contribution is almost constant from 1980-81. Its share in the labour absorption is also low as presently only 12% of India's labour force is employed in this sector.

Table - 1, Sectoral Contribution to GDP

Year	Agriculture & Allied	Industry	Manufacturing)	Services
1950-51	51.88	11.10	(8.98)	34.63
1980-81	35.69	18.64	(13.95)	45.26
1991-92	28.54	20.22	(14.51)	51.02
2000-01	22.26	20.64	(15.46)	56.86
2010-11	14.59	20.30	(16.17)	65.10
2013-14	13.94	18.70	(14.94)	67.36

*At 2004-05 Prices (Source CSO)

Figure-1, Sectoral Contribution to GDP



Although, performance of manufacturing sector on labour absorption and its contribution to GDP has been lower as compared to services, the growth in this sector registered a strong pace in overall GDP growth over the past 25 years. For example, while real GDP expanded at an average growth rate of 5.9 percent per annum during 1990s and 7.3 percent per annum during 2001-2012 decade, average growth in the manufacturing sector was marginally higher at around 6.0 per cent per annum and 8.1 percent per annum over the same period. Starting from year 1993-94, the manufacturing sector registered a strong growth consecutively for four years. In fact this sector witnessed a record growth of more than 15% during 1995-96 and proponents of economic reforms firmly argued that industrial sector is now adjusting to its optimal level due to unshackling and removal of domestic restrictions which favoured production and expansion. This hypothesis proved wrong in next few years as manufacturing sector collapsed to near zero growth during 1997-98 and

very dismal growth in subsequent years. The performance of this sector could not be revived till 2002-03 due to unfavourable domestic and international conditions. Recovery in growth started after 2002-03 and nearly after a decade the manufacturing sector again stood high in terms of growth and achieved remarkable double digit growth continuously for three years up to 2007-08. National income also experienced a robust growth and India became the second fastest growing economy in world by approaching near a double digit growth level. The average growth for manufacturing sector (8.1%) during 2000-01 to 2011-12 was higher than the average GDP growth rate (7.3%) which represents a quite satisfactory pace. This is indeed a remarkable achievement because global economy was in the troubled trajectory since 2008 sub-prime crisis of the United States.

Table – 2, Annual Growth Rates

Year	GDP at factor cost	Manufacturing	Industry
1991-92	1.4	-2.4	-0.2
1992-93	5.4	3.1	3.1
1993-94	5.7	8.6	7.2
1994-95	6.4	10.8	10.4
1995-96	7.3	15.5	13.0
1996-97	8.0	9.5	7.7
1997-98	4.3	0.1	2.2
1998-99	6.7	3.1	3.5
1999-00	8.0	5.4	5.2
2000-01	4.1	7.3	6.0

*At 2004-05 Prices (Source CSO)

Year	GDP at factor cost	Manufacturing	Industry
2001-02	5.4	2.3	2.2
2002-03	3.9	6.9	6.9
2003-04	8.0	6.3	5.6
2004-05	7.1	7.4	7.5
2005-06	9.5	10.1	8.5
2006-07	9.6	14.3	12.9
2007-08	9.3	10.3	9.2
2008-09	6.7	4.3	4.1
2009-10	8.6	11.3	10.2
2010-11	8.9	8.9	8.3
2011-12	6.7	7.4	6.7

*At 2004-05 Prices (Source CSO)

Year	GDP at factor cost	Manufacturing	Industry
2012-13	5.4	6.0	4.8
2013-14	6.3	5.6	5.2
2014-15	7.1	5.5	6.5
2015-16	7.2	9.3	8.8

*GVA at Basic Prices (Base Year: 2011-12)

Data for 2011-12, 2012-13 & 2013-14 are Second Revised Estimates (New Series).

Data for 2014-15 are First Revised Estimates.

Data for 2015-16 are Provisional Estimates.

Source: Handbook of statistics on Indian Economy, 2015-16

Figure 2, Annual Growth Rate of G.D.P. and Manufacturing Sector

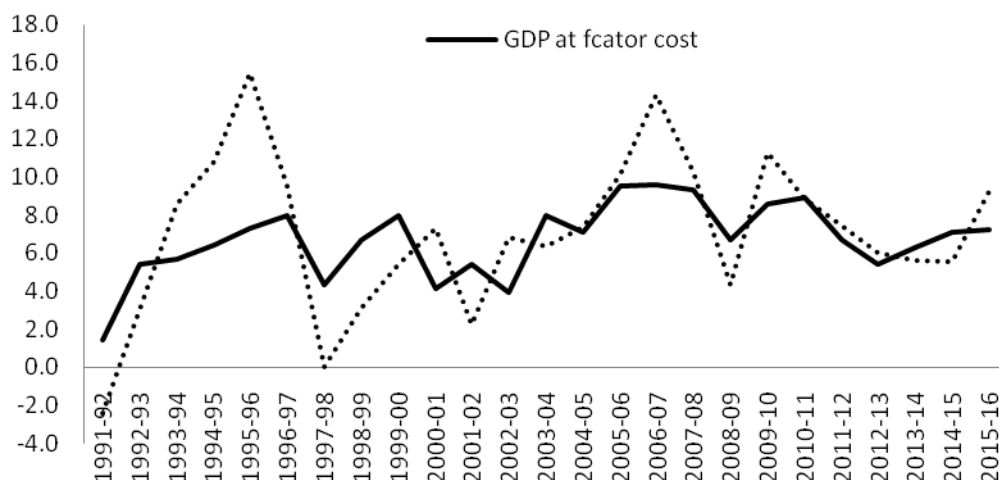


Table – 3, High and Low Growth Rate

Period	Manufacturing		Services		GDP	
	High	Low	High	Low	High	Low
I- (1991-92)-(1999-00)*	15.5	-2.4	10.9	4.3	8.0	1.4
II- (2001-02)-(2011-12)*	14.3	2.3	11.1	5.5	9.6	3.9
III- (2012-13)-(2015-16)**	9.3	5.5	9.4	6.9	7.2	5.4

*At 2004-05 Prices (Source CSO),

** At 2011-12 Prices, Gross Value Added at Basic Prices, (Source C.S.O.)

Although averages represent a quite satisfactory picture of manufacturing sector growth, the annual growth rate has been very volatile. To be specific the figure indicates that, while the growth in real GDP was somewhat stable during the ten year period (2003-2012), the manufacturing sector growth has been the subject of wide fluctuations. In fact after achieving the peak growth rate of 14.3% during 2006-07, manufacturing growth slumped down to 4.3% in 2008-09. A comparison of manufacturing sector with that of real GDP and services has been produced in the figure-1.1 below. From the table it can be seen that there is a wide divergence between high growth and low growth achieved during each period for this sector. In fact during first period this high-low differential is as high as 17.9 as compared to 6.6 in GDP and services. Subsequent period witnessed a decline in this difference particularly for GDP (5.7) and services (5.6) while this was quite high for manufacturing (12). This high volatility in the manufacturing sector growth is a matter of great concern as manufacturing sector is treated as an engine of growth for any transitional economy. The third period growth estimates are based on a new methodology (Gross Value Addition at basic prices) and at new price level (2011-12) and thus are not directly comparable with earlier period. But surely this period is also indicating a further reduction in the high-low growth difference within each sector. Please refer table 3 for detail.

From the above analysis it is clearly visible that Indian Manufacturing sector growth has not been consistent and it has been subject to large yearly variation. Its contribution to GDP has been constant since very long time and it has failed to absorb labour force liberated from agriculture sector. India's share in world manufacturing is only 1.8%. This is in stark contrast to China; where manufacturing contributes 34% to the GDP and is 13.7% of world manufacturing – up from 2.9% in 1991. India's growth has been on the back of a booming services sector which contributes 62.5% of the GDP.

Conclusion

These statistics clearly indicate that while manufacturing has not been the engine of growth for the Indian economy, it now needs to grow at a much faster rate. In fact it has the potential to grow faster and consistently as this sector has already touched a dream growth of more than 15% during 1990s. India's long touted demographic dividend can only then be sufficiently exploited through the systematic growth of this sector.[‡]A number of constraints faced by the various manufacturing sub-sectors are common, and include stiff competition from other emerging market economies, especially China, high cost of funds, low technology intensity, inadequate infrastructure, scarcity of skilled and semi-skilled manpower, high input costs, high transaction costs and the slowing down of world demand.[§] Therefore, efforts should be made to eliminate all these hurdles in order to make India as a global manufacturing hub and increasing manufacturing contribution to 25% by 2025 as stated in "Make in India" programme. The stable and systematic growth is possible by bringing some fundamental reforms in this sector which includes: labour market reforms, capital market reforms, infrastructural reforms, technological reforms.

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[§]Report of the working group on "Boosting India's manufacturing exports" Twelfth five year plan -2012-17).

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