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# Competitive Manufacturing as a Growth Driver: Some Policy Lessons for India

**Mr R C Bhargava**, Chairman, Maruti Suzuki India Ltd has been associated with the development of the car and component industry in India for the last 40 years. He has been a part of the journey that has propelled this sector to become one of the most competitive and successful manufacturing chapters in India. Mr Bhargava shares his views on what ails the manufacturing sector in India and what can make the sector competitive.

*This brief is based on his e-lecture on May 1, 2021 delivered to mark the 34th Foundation Day of ISID.*

Evidence from populous countries that have witnessed rapid growth in gross domestic product (GDP) show that manufacturing has been the prime driver of growth and employment in the initial stages of their development. The share of manufacturing in their GDP has been 30-40 percent. As times progressed, and other sectors grew, the contribution of manufacturing slowly came down. This has been the experience of China, as well as Japan and Korea that were rebuilding their economies after the Second World War. This has also been the history of developed countries such as United Kingdom, United States, and Germany, where growth was driven by industrialisation. A populous country like India cannot be expected to provide growth and employment to its population without a developed manufacturing sector.

## What Failed Indian Manufacturing?

A robust manufacturing sector has been our policy objective since the 1950s, where a rapidly growing industrial sector was envisaged to create wealth and eradicate poverty. However, we did not succeed in this and manufacturing share in GDP has remains stagnant at 14-16 percent till date. The fatal weakness in the policies pursued in India was the failure to understand the importance of competitiveness and what constitutes competitiveness. The policies pursued in fact added to the cost of the manufacturer and resulted in a loss of competitiveness. The size of the market remained small with an unencouraged export regime, which anyway could not take off without products being competitive. The imposition of high taxes and treating manufactured products as luxury goods kept the domestic market size small and limited the ability to exploit economies of scale. The business environment was not conducive for investments in technology and better systems of manufacturing. As a result, industrial development remained stagnant.

Industrial development in India was based on the premise that competition was wasteful. In the pre-1991 era, policy making was based on centralized planning and protectionist policies. There was an absence of any efficiency criteria for public sector enterprises (PSEs). The PSEs were not profit-oriented and did not focus on aspects of keeping manufacturing costs

*Low cost of manufacturing and quality products are key to competitiveness*

low to build competitiveness. This limited their growth and resulted in a misuse of resources. Control over private enterprises through licensing that designated the nature as well as the quantity of goods to be produced, restrictions on free entry into the market, and other controls formed a part of restrictive policies that did not allow private enterprises to grow in size, generate or retain profits. Domestic firms were not expected to compete in the international markets and were protected. Restrictions on imports of cheaper inputs from abroad further tied their hands with regard to investment in technology and design development. At the same time, consumers had to pay more for most of the manufactured goods as they had limited choice in terms of costs as well as quality. Stagnation of technology led the private sector goods to become obsolete gradually over time, and therefore, less competitive. Without the generation of any surplus due to slow growth, the resources of the government remained constrained, and this further led to the reduction in the investments in infrastructure and social sectors such as health and education, which further hampered competitiveness for the future.

The ensuing economic crisis in late 1980s compelled the government to liberalise the economy. Economic reforms in 1991 brought in a wave of reforms such as the liberalisation of international trade, abolition of licenses, and privatisation. Foreign investment was welcomed, even if with some riders.

However, the policy makers did not lose the ingrained suspicion of the private sector and no element of trust developed between the two. The importance of making manufacturing competitive was still not understood or accepted. Many of the conditions and policies that led to manufacturing in India being costly remain unchanged till today. Domestic growth of manufactured products is still restricted by high taxes, and export growth remains slow due to lack of competitiveness. Importantly, the value of time and timely decision-making is still not appreciated in government quarters. Delays add to the cost of manufacturing and restrain competitiveness. Successive reforms have still not succeeded in generating ease of doing business. And thus, share of manufacturing remains stagnant at 14-16 percent and competitiveness still eludes the sector.

## The Way Forward

While there are many elements that constitute competitiveness, the key aspects accrue to the costs of manufacturing and quality of products. There is an ever-evolving dynamism to both that change with time, patterns of demand, and technology. There are however, certain important aspects that can be developed in India to achieve competitiveness. Four key elements stand out.

*Re-investment of profits essential for enterprises to scale-up*

The first element is trust. It is imperative that the relationship between the private sector and government stakeholders is based on trust. The State needs to recognise the private sector as an engine of growth, a partner in development, instead of viewing profit-making with suspicion. This trust will allow the private sector to flourish.

*Labour is not just a factor of production and cost, but a partner in growth and productivity*

The second element is about profit itself. It is important for the private sector to realise that re-investment of profit into the company is of vital importance. Unless enterprises have the ability to generate adequate internal resources each year, investments in technology development cannot take place. This is also an enabling factor for enterprises to gain access to the financial markets. Frugal management including capping salaries of top management, ensuring that the profits are not siphoned away from the company but re-invested into it are of critical importance to scale up. To achieve low cost of production, frugal management and cutting costs at the upper tiers is essential. Small scale enterprises too need to re-invest their profits. While private enterprises should be encouraged to generate profits, government policies should ensure necessary controls on the use of such profits.

The third element is labour partnership. Labour is not just a factor of production and cost. The relationship between labour and capital need not be one of conflict. A motivated labour force can boost the productivity of other factors of production. Labour is the biggest contributor to the firm's competitiveness. Labour, thus, needs to be seen as a partner in the competitive spirits of an enterprise rather than as a cost centre.

The fourth and crucial element is the critical role of the government. The government can help keep the costs of production low. Costs include that of land, raw materials, infrastructure, transport and logistics, electricity, compliances to tax laws, costs of labour, and finance. However, this is not a sufficient condition to achieve competitiveness as quality is equally important. While consumers look for lower costs and acceptable quality, that itself is an evolving and continuous process. The government has to induce conditions to nudge the private sector to meet quality standards.

Timely decision making and bureaucracy that is mindful and aware of the ground realities of the businesses can help create competitive environment for enterprises. Another critical role of the government is to create demand and enable businesses to reap economies of scale through expansion. Without adequate demand conditions, manufacturing will not flourish.

*Commensurate growth of domestic demand essential to ensure manufacturing growth*

In order to achieve the target of 25 percent of share in GDP, an annual growth rate of 12-15 percent will need to be attained in manufacturing sector with commensurate growth of domestic demand. These objectives can be achieved by realizing the need for attaining manufacturing competitiveness facilitated by right mix of government policies.

ISID Institute for Studies in Industrial Development
*A Sponsored Institution of Indian Council of Social Science Research*
4, Vasant Kunj Institutional Area, New Delhi - 110070, India
*E-mail*: info@isid.org.in; *Website*: http://isid.org.in