Underperformance of Manufacturing Sectors in India

Why in news?

India has been under-performing in labour-intensive manufacturing sector for past two decades.

What is the status of manufacturing sector in India?

- **GDP Contribution** – The manufacturing sector remains a significant contributor to Indian economy contributing ***17% of India's GDP.***
- **Employment Generation** – The sector continues to be a major source of employment, *over 27.3 million workers*.
- **Global Competitiveness** – India has strengthened its position as a *global manufacturing hub*, attracting investments and exporting a wide range of products.
- *The manufacturing sector's growth rate averaged 7% per year* between 2014-15 and 2019-20.
- Merchandise exports for the period April-February 2023-24 were 394.99 Billion USD.
- **Emerging Sectors** – Sectors such as electronics, electric vehicles, renewable energy, and pharmaceuticals in manufacturing are experiencing rapid growth, driven by government support and market demand.

India's targets in manufacturing sector
• To increase the share of manufacturing to *25% in GDP by 2025*. • To create 100 million additional industrial jobs (from about 60 million) by 2025. • Achieve *USD 1 trillion merchandise exports target by 2030*.

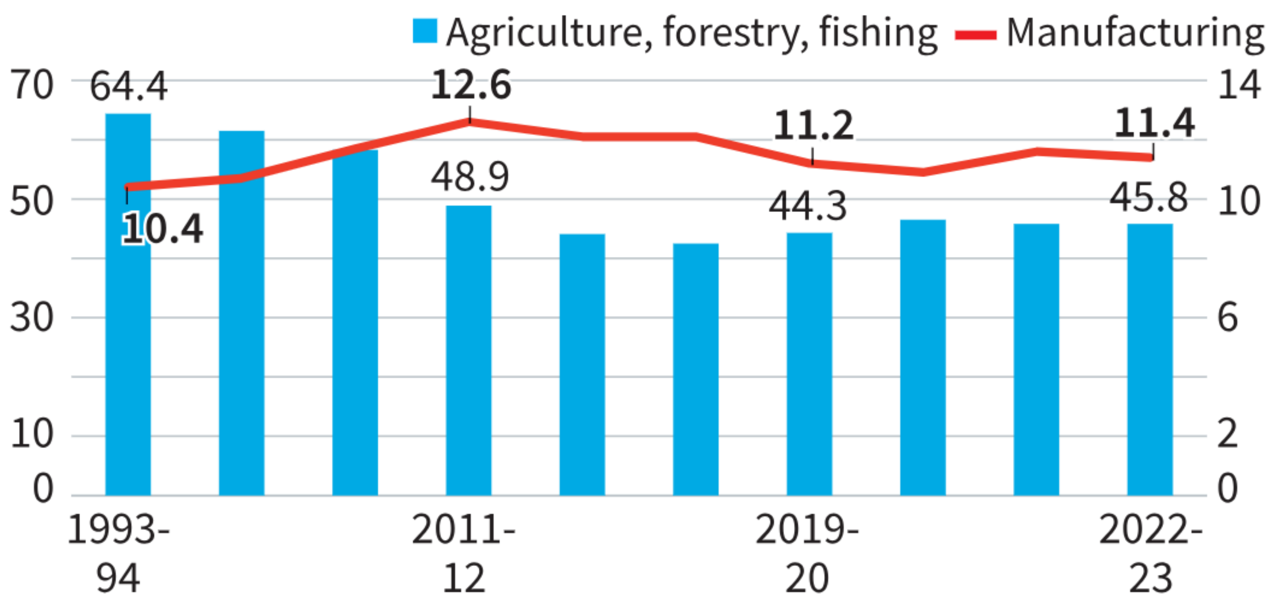
What are the challenges for the growth of manufacturing sector?

- **Stagnation of large plants** – Large plants in India have not grown over time despite a number of favorable developments such as policy liberalization and contractualisation of labour.
- **Rise in multi-plants** – In the last 20 years, there has been rise in multi-plants where it operates with multiple production facilities within a state.
- The share of multi-plants rose from *15% in 2001 to 30%* of total plants in 2022.
- **Stagnating of employment growth** – Employments in manufacturing has declined from 12.6% in 2011-12 to 11.4% in 2022-23.
- **Strategic Plant Proliferation –** Firms choose to increase the number of plants (extensive margin) rather than expanding the size of existing plants (intensive margin).

- **Split in big investments** – Investments in manufacturing have been split across a number of factories.

NSSO sample surveys, manufacturing employment has declined from 12.6% in 2011-12 to 11.4% in 2022-23.

Chart 3 | *The chart shows the shares of agriculture and manufacturing in total employment (1994-2023)*



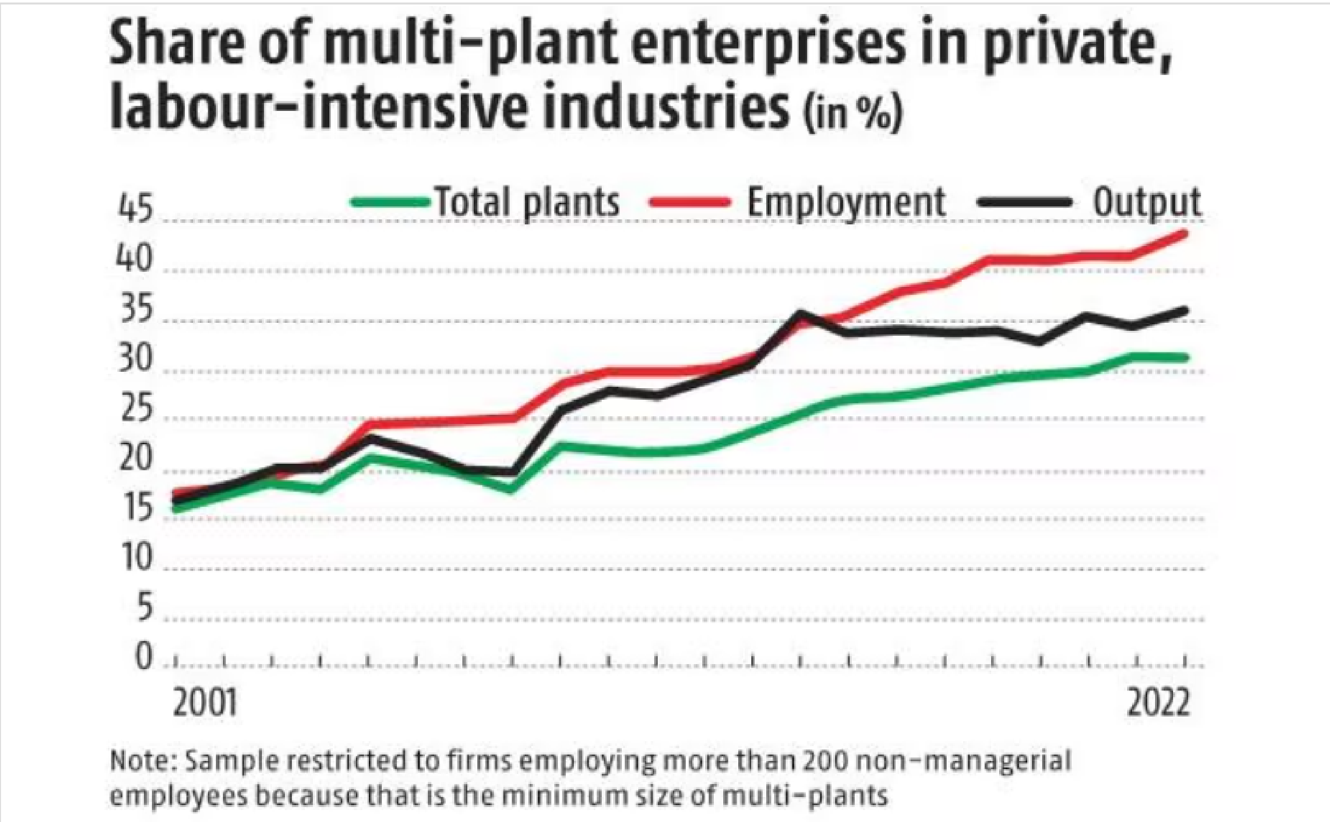
Why firms opting for multi plants?

- **Legal risks** – A dispute in a big plant would entail greater risks relative to that in a smaller plant.
- In an extreme situation shutting down a plant with 500 employees is less costly than

one with 5,000 employees.

- **Diversifying policy** – A drop in orders from one client that affects one plant.
- **Policy regulations** – Indian plants are kept too small by regulations, especially labour laws.
- The risks of broader political environment in which the firm feels that large plants is be vulnerable to the whims of the Centre and state governments.
- **Geographical advantage** – Smaller plants can be closer to dispersed labour pools, especially of women.
- **Flexibility in hiring** – In multi-plant units, there is a flexibility in hiring and firing labour as it helps the firms to shuffle based on demand.
- **Difficulty in land acquisition** – Land is difficult to acquire in contiguous parcels to sustain large plants.
- **Contract Labor** – Firms may find it more cost-effective or efficient to replace some of full time employees with contract labor.
- This could be due to factors such as flexibility, reduced labor costs, or avoiding certain labor regulations.
- The share of contract labour in total employment has increased from 22% in 2001 to 41% by 2022.

The Industrial Disputes Act, 1947 mandates a threshold of 100 employees for establishments to lay off employees or shut down without having to seek government approval.



Why small units undermining manufacturing growth?

- **Lower productivity** – 500 workers are more productive if they work in one plant than if they are split into two plants of 250 workers each.
- This pattern of large firms not becoming larger and remaining low productive is the root cause for *India's stagnating export performance*.
- For example, Bangladesh's market share in global apparel exports skyrocketed from 2.5% to 8% over two decades, while India's share stagnated at around 3%.
- **Overestimation of the size of plants** – The Annual Survey of Industries (ASI) suggest that India's largest manufacturing plants are bigger than they actually are.
- This leads to an *overestimation of the size of plants.*
- **Fragmented supply chain –** It leads to inefficiencies and higher cost in logistics.
- **Limited market reach** – It restricts growth potential by confining businesses to local or niche markets.

The Annual Survey of Industries (ASI) is the principal source of industrial statistics in India. The Annual Survey of Industries (ASI) is being conducted since 1959 under ministry of labour and employment.

What lies ahead?

- Changes in the law and implementation for expansion of manufacturing units.
- Reforms in industrial policy to align trade and industrial policies to promote domestic value addition.
- The special economic zones needs to be increased so that small firms expand to large unit.
- Creation of land banks to attract large firms like to establish larger units in India.

References

1. Business Standard| India's manufacturing performance Part 1
2. Business Standard| India's manufacturing performance Part 2