A troubling snapshot of Indian manufacturing

There are a handful of accepted truths about Indian manufacturing. Enterprises in this sector have a growth problem, often turning out to be “dwarfs” rather than “babies”. These dwarfs dominate the sector numbers-wise. They suffer from low productivity given that their small size prevents them from achieving economies of scale, among other disadvantages. However, they employ a huge chunk of the labour force. The recently released *Ease Of Doing Business* report by NITI Aayog and the IDFC Institute, based on an enterprise survey carried out in 2016, lends some welcome empirical heft to these truths, and delineates the problems sharply.

According to the sixth economic census conducted during 2013 and the first quarter of 2014, 131.29 million people are employed in 58.5 million establishments in industry and services. Given these numbers, it’s par for the course that only 21% of the enterprises employ 10 or more workers. Own account enterprises, meanwhile, which were managed entirely by their owners and didn’t employ any other workers, constituted almost 45% of the enterprises.

The enterprises surveyed by the report—in the manufacturing sector, and registered under the Factories Act, 1948—make up a small subset of these numbers. But they are consistent with broader trends. Small firms dominate. Unsurprisingly, the jobs they create are low-paying ones. The wage spread between small and large enterprises is a disquieting 80%. Compare this to China, where the spread is just about half that.

Factor in the trends in young enterprises—described by the report as having been set up 10 years ago or less—and the contours of the problem become clearer. The report finds that “the largest share of young enterprises is in other non-metallic mineral products (15%), food (12%), and textiles (10%)”. These are all labour-intensive sectors. So far, so good. India needs such enterprises to mop up the growing labour force. But those sectors are among the ones where the share of small enterprises is the largest. Non-metallic mineral products heads the table when it comes to small enterprises, while food products come in third. Little wonder 75% of all young enterprises can be classified as small. In short, new enterprises in the manufacturing sector are creating jobs—but low-paying, low-productivity ones.

The solutions are not rocket science. Improving physical infrastructure is essential. This ranges from transport systems to the power sector. The report also mentions the need to improve access to finance for smaller enterprises and making firm entry and exit easier, among other measures. This newspaper has also been a votary of enhancing the flexibility of labour regulations. The report shows that there are two reasons for this. One, of course, is that large firms with larger workforces face a greater regulatory burden in this area. This diminishes their efficiency and provides an incentive for smaller firms to cap their workforce below the point where onerous regulations kick in, feeding into the size problem, or employ workers in an informal capacity.

The second reason is more indirect. The lower wage spread in China goes along with the domination of medium and large enterprises, which together account for over 75% of the workers. The report speculates that this domination of larger enterprises creates an ecosystem where small firms must perforce improve productivity—whether to compete or take advantage of the downstream opportunities created by larger firms. High productivity goes with higher wages.

Out of the box measures might be of some use as well. The report throws up some interesting facts. Most of the young enterprises are located in Maharashtra, Gujarat, Tamil Nadu, Andhra Pradesh and Telangana. Concurrently, unlike in other states, older manufacturing firms in Andhra Pradesh, Telangana, Maharashtra and Gujarat face a lower regulatory burden than younger firms. The latter are thus disadvantaged in the states where they are highly concentrated, creating a

barrier to growth and productivity—perhaps a legacy of crony capitalism in states that have traditionally been more enterprise-oriented, with larger firms more effectively able to utilize these networks.

How to address this? For one, it’s time the government stopped treating lobbying like a four-letter word. It is a widely accepted practice in developed economies—and bringing in a law to legitimize it and regulate it in a transparent fashion could reduce corruption and give smaller enterprises that band together for advocacy and lobbying a means to have policy inputs.

Political compulsions have often been offered up as an excuse for going slow on such reforms. This is not entirely unreasonable, but it cannot be an answer in perpetuity. At some point, the government of the day will have to bite the bullet.

How can the government remove barriers to growth in the manufacturing sector? Tell us at views@livemint.com

END