De-industrialisation has set in

Governance deficit's behind the worst-ever manufacturing performance since 1982-83

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Amidst the talk of governance deficit and policy paralysis, the slippage of the third quarter GDP growth rate to 6.1% from 6.9% over the first nine months of the current fiscal year is not unexpected. Nor should it be surprising that the manufacturing sector has come almost to a standstill in Q3 2011-12, with a growth rate of 0.4%. If we take the first nine months of 2011-12, YoY growth in manufacturing has been at a record low of 3.4%. Apparently, the projection of 3.9% growth in manufacturing for the whole year as made by the Prime Minister's Economic Advisory Council in its 'review of the economy 2010-11' released last week is optimistic.

But, even if achieved, it will be the worst ever performance of manufacturing since 1982-83. Manufacturing has anyway been expanding at an unimpressive average annual rate of around 7.4%, against the service sector growth of over 8.5%, since the early 1990s. This has led to its near-stagnant share in total GDP at 15-16%. The 66th NSS round of employment shows that between 2004-05 and 2009-10, the share of manufacturing in total employment has actually declined from almost 8% to 7% in rural areas and from 24.6% to 23% in urban areas. This is a warning signal that the process of de-industrialisation has already set in, which is a cause of serious concern (hope the government is listening).

Belying the belief in service-led growth, recent research by eminent development economists has shown that manufacturing is central to the vigour not only of a nation's economy but also its democracy. A weak manufacturing sector may ultimately threaten the sustainability of a country's growth process. Concerned about the stagnant and low share of manufacturing, the government has launched several initiatives for promoting manufacturing clusters since the late 1990s. These include growth centres, food parks, textile parks, SEZs, industrial parks and so on. This is quite in line with a global trend towards the adoption of industry clustering as a key component in industrial development. However, what is unfortunate is that all of them are languishing due to indecision, delays and policy reversals.

SEZs are the only clusters that have attracted substantial investment despite several roadblocks and adverse public opinion. However, due to serious differences persisting between the ministries of commerce and finance, which have led to crucial policy reversals, their prospects also look bleak now. Developers and units have been running from pillar to post in the hope that the government will ultimately honour the contract evolved in the SEZ Act and stabilise the policy regime. Similar has been the fate of investors in other initiatives. The latest in the series is the national manufacturing policy, which proposes to set up National Investment and Manufacturing Zones as integrated industrial townships with highly ambitious objectives to enhance the share of manufacturing in the GDP to 25% within a decade and create 100 million jobs in manufacturing. These zones would offer, in addition to tax sops, certain relaxations in labour and environmental laws to promote manufacturing. The policy got cabinet approval on 25 October, 2011. It has been six months now and the policy still remains on paper due to inter-ministerial differences once again.

Both labour and environment ministries have locked horns with the department of industry over labour and environment relaxations and are sitting on the required notifications for liberalising the rules. It is a sad reflection of the leadership's inability, lack of political will and weak commitment. Within a democratic framework, transitions from agrarian to industrial societies almost always involve difficult, perplexing and nerve-racking decisions. It requires a skillful, well-informed and strongly committed government to implement key decisions to defend upcoming opportunities and protect the processes of capital accumulation. One must note that investment is irreversible and costly. It cannot be forthcoming in the presence of uncertainty as to future policies.

Dani Rodrik, in one of his papers, has shown that even moderate amounts of policy uncertainty can act as a hefty tax on investment. In India, indecision (or delays in decision-making) has become a hallmark of policymaking and implementation. These delays have perpetuated uncertainty, which has entailed huge economic costs by reducing efficiency and distorting choices. One of the most controversial and contentious components of policy initiatives is the package of economic rents that is normally offered by the government to encourage capital accumulation. The government keeps dragging its feet on the implementation of these packages.

The economic history of developed and other industrially successful countries indicates that their governments intervened directly and indirectly to create the right kind of economic rents to promote industrial entrepreneurship and managed them strategically to assist capital accumulation, institutional development and infrastructural build-up. The countries that concentrate on the input costs of economic rents with far less attention devoted to the rent-outcome have little chance to succeed. With increased mobility of capital and labour, changes in firms' organisational structure in production and distribution methods, and proliferation of regional agreements, investment decisions have become highly sensitive to these economic rents.

If crafted carefully and monitored sincerely, these rents can have very significant implications for efficiency and growth and their net effect can be highly positive. This requires imaginative policymaking informed by a strategic medium- to long-run vision and commitment. Once in place, indecision, uncertainty and instability in their implementation can lead to severe damage to investment prospects. Dani Rodrik cautions that rational behaviour by the private sector calls for withholding investment until much of the uncertainty regarding these benefits is eliminated.

The government must, therefore, ensure stability, certainty and sustainability in these benefits attached with various policy initiatives to facilitate the flow of investment and immediately curb the decelerating trends in manufacturing growth. This is likely to bring greater payoffs in terms of investment and growth than the content of the policy itself.

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