

Industrial Policy - 2017

A Discussion Paper

Department of Industrial Policy and Promotion, Ministry of Commerce and Industry

This discussion paper reviews the progress made in the last quarter century since the 1991 Industrial Policy and provides thoughts to facilitate discussions for formulation of a new Industrial Policy aimed at building a globally competitive Indian industry equipped with skill and scale and technology.

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1. INDUSTRIAL POLICY 1991

1.1 Industrial policy 1991 set out directions for industrialisation in an economy that began its journey in liberalisation. It dealt with liberalising licensing and measures to encourage foreign investments. A policy for public sector enterprises and the Monopolies and Restrictive Trade Practices Act were introduced.

Elements of Industrial Policy, 1991

1.2 The Government decided to take series of initiatives in key areas:

- (a) Industrial Licensing
- (b) Foreign Investment
- (c) Foreign Technology Agreements
- (d) Public Sector Policy
- (e) MRTP Act

1.3 The first key reform was abolition of industrial licensing except those included in a small specified negative list.

1.4 In order to attract foreign investment in high priority industries requiring large capital and advanced technology, approval for direct foreign investment upto 51% of equity in high priority sectors known as Appendix I industries was provided.

1.5 Access to advanced technology was enabled, by providing for automatic approval of technology agreement related to high priority industries within specified parameters. Indian companies were made free to negotiate the terms of technology transfer with their foreign counterparts according to their commercial judgement.

1.6 It was acknowledged in the policy that public sector enterprises demonstrated insufficient growth in productivity, lack of technology upgradation, inadequate attention to R&D and human resource

development and a very low rate of return on the capital invested. Government, therefore, decided to adopt a new approach for public enterprises, which inter-alia indicated priority areas for growth of public enterprises in:

- (i) Essential infrastructure goods and services
- (ii) Exploration and expansion of oil and mineral resources
- (iii) Technology development and building of management capabilities in areas crucial for long term development of the economy where private sector investment is inadequate
- (iv) Manufacture products where strategic consideration predominates

1.7 It was decided that MRTP Act will be amended to remove threshold limits of assets in respect of MRTP companies and dominant undertakings. It also abolished the requirement of prior approval of the Central Government for establishing new undertakings.

2. PROGRESS MADE

2.1 During the last quarter century, India has made significant progress on various initiatives listed in the 1991 industrial policy and much more. The list of industries in respect of which industrial licensing was compulsory was 18. This list has progressively shrunk and currently license is required only in four areas, namely, cigars and cigarette on the tobacco, industrial explosives, electronic, aerospace and defence equipment, industrial explosives and hazardous chemicals.

2.2 Giant strides have been made in liberalising the Foreign Direct Investment policy. Foreign investment in most sectors is allowed upto 100% under automatic route. Around 90% of total FDI inflows are now through the automatic route. Only few sectors such as publishing and printing, satellite, food product training, mining and mineral exploration, titanium based minerals and ores require Government approval. Path breaking

reforms have been made in the last three years; new sectors such as defence and food retail were opened, investment limits have been reduced progressively and conditionalities have been eased.

2.3 Total FDI inflow was USD 156.53 bn since April 2014 (USD 45.15 bn in 2014-15, USD 55.56 bn in 2015-16 and USD 60.08 in 2016-17). Highest ever annual inflow (US\$ 60.08 bn) was received in 2016-17. FDI equity inflows increased by 52% during 2014-16 and 62% since the launch of Make in India. India is now ranked amongst top 3 FDI destinations (World Investment Report 2016, UNCTAD) and 9th in the FDI Confidence Index in 2016, up 2 places from 2015 (AT Kearney)

2.4 The change in public sector policy led to private sector participation in sectors of iron and steel, electricity, air transport, ship building, heavy machinery, telecommunication cables and instruments. Growth of private sector in terms of number of enterprises and paid-up capital has been much faster than that of public sector in the last three decades.

2.5 India was among the first developing countries to have a competition law in the form of the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 with the aim to enhance competition in the market. It however had the flipside of restricting the size of enterprises. The removal of the requirement for pre-entry scrutiny and the clearance of the industrial projects of big business houses by the MRTP Commission removed the barrier for growth of businesses. The Competition Act 2002 by bringing all public sector enterprises and departments of the governments at the Centre and State, barring a few which perform sovereign functions, under the Act, has obliterated the distinction between public and private enterprises and contributed to creating a level playing field in the market place.

3. CONSTRAINTS TO INDUSTRIAL GROWTH

The major challenges that have restricted industrial growth inter-alia include the following:

3.1 Inadequate infrastructure: Physical infrastructure in India suffers from substantial deficit in terms of capacities as well as efficiencies. Rapid growth of the economy has put further stress on infrastructure. Lack of quality industrial infrastructure has resulted in high logistics cost and has in turn affected cost competitiveness of Indian goods in global markets.

3.2 Restrictive labour laws: The tenor of labour laws has been overly protective of labour force in the formal sector. Though labour protection and security are required, the flipside is that it discourages employers from hiring workers on a regular basis. It has probably also led to entrepreneurs choosing to stay away from labour intensive sectors and opt for highly capital or skilled-labour intensive technologies sectors.

3.3 Complicated business environment: Complex and time taking business processes and clearances have been a disincentive for businesses. India also suffered from a complex multi-layered tax system, which with its high compliance costs and its cascading effects adversely affects competitiveness of manufacturing.

3.4 Slow technology adoption: Indian industry has been a slow adopter of new and advanced technologies. Inefficient technologies led to low productivity and higher costs adding to the disadvantage of Indian products in international markets.

3.5 Low productivity: Productivity as measured by value added per worker and average wages in manufacturing in India are only one-third of that in China. Differences in productivities across sectors and across firms within the same sector make matters worse. Workers in India are overwhelmingly employed in low productivity and low wage activities.

3.6 Challenges for trade: Manufacturing sector especially exporters are facing challenges of stagnant/shrinking global demand and rising protectionist tendencies around the world. Indian MSME sector is

particularly facing tough competition from cheap imports from China and FTA countries.

3.7 Inadequate expenditure on R&D and Innovation: Investments in these areas is essential to ensure growth in industry. Public investments have been constrained by the demands from other public service demands and private investment is not forthcoming as these involve long gestation periods and uncertain returns.

3.8 It is also to be understood that these factors work in tandem to increase costs of goods and services. They are strongly entwined, one feeds into another thereby exacerbating the disadvantages. The nexus needs to be broken at more than one link to ensure that the spin-off is in the positive direction.

4. INDIA AT AN INFLECTION POINT

4.1 India today, as it was in 1991 is at an inflection point. In 1991 the country rose to change from the brink of a financial crisis with foreign exchange reserves at the lowest, exports at the lowest, growing current account and trade deficit. In 1991 it was a country trying to break the conservatism in enterprise but today it is a resurgent India aspiring for its rightful place on the world stage.

4.2 The economic fundamentals including GDP, inflation, fiscal deficit, current account deficit and foreign investment inflows are stable and strong. Forecasts for India from World Bank, IMF etc., are all optimistic over the next two years and the country's long run potential growth rate is estimated to be around 8-10 per cent. India is showing improvement on every important metric and several internationally reputed indices such as the Global Competitiveness Index, Logistic Performance Index and the Global Innovation Index. India holds large untapped potential. India is rated first among 100 countries on the growth, innovation and leadership index (Frost & Sullivan: 2015). The economy has all the right conditions to take-off and

is expected to do so over the next decade. The decisive reforms undertaken by the Government stand to validate the same.

4.3 The implementation of Goods and Services Tax is considered the first major taxation reform since independence. Leveraging competitive federalism, there is strong focus on enhancing ease of doing business in the country. Launch of Make in India programme to boost manufacturing in India, further liberalisation of the FDI policy and transformative initiatives like Digital India, Start up India and Skill India, in addition to the audacious demonetisation of select high denomination currency are only a few initiatives that have prepared the ground for a higher growth trajectory for the economy.

4.4 It is time to shift from a policy of continuity with change in 1991 to radical and accelerated reforms for greater strategic engagement with the world. As often summed up- it is time to Reform, Perform and Transform. A comprehensive, actionable, outcome oriented industrial policy will enable Industry to deliver a larger role in the economy; to fulfil its role as the engine of growth and to shoulder the responsibility of adding more value and jobs.

5. A FUTURE READY INDUSTRIAL POLICY

5.1 Clear vision, strategic objectives and intent

The policy aims to set a clear vision for the role of industry and industrial growth in the growth and development of the economy. A shared vision to develop a globally competitive Indian industry with skill and scale, which leverages technology, will be developed through engagement with stakeholders. Strategic objectives have to be delineated with measurable outcomes. The policy has to also ensure that it embeds into itself sectoral objectives and provides an overarching umbrella policy framework. The timeframe for implementation of the policy needs to be decided taking into consideration the changing economic and business cycles of the world and the Indian economy, geo-political trends and broad policy directions in the

country. To begin with, the following strategic objectives are set forth for the policy, to enable commencement of work. They have been developed to provide a picture of the policy intent. Illustrative outcomes and questions that trigger the search for solutions have also been spelt out.

5.2 Establishing global linkages

5.2.1 India needs to strengthen global strategic linkages by - creating global brands out of India, strengthening linkages between Indian and global SMEs and intensifying FDI. Concerns have been raised about the brand value of Indian products, significantly low value addition done in India and the minimal positive externalities from FDI.

5.2.2 Brand building should gain importance alongside achieving quality and scale. The quantum of value addition has to be increased at all levels. Larger the value addition, greater the positive externalities from economic activity. Creating complete value chains domestically and globally or integrating into existing chains is vital to ensure that the world market is accessed at the right time.

5.2.3 FDI policy has largely aimed at attracting investment. Benefits of retaining investments and accessing technology have not been harnessed to the extent possible. FDI policy requires a review to ensure that it facilitates greater technology transfer, leverages strategic linkages and innovation.

5.2.4 Illustrative outcomes and trigger questions

Long-term

- Increasing the number of global-Indian firms to those in the Fortune-500 category
- Establish complete value chains, within India or across countries, in select sunrise sectors like renewable energy, food processing, electronics etc.
- An FDI regime that balances the short term and long term benefits of inward and outward investments.

Medium-term

- Attract \$100 bn inward FDI annually and support outward FDI to assert Indian presence in world markets
- Increase the share of India in sourcing of top brands in sectors where India enjoys a distinct comparative advantage such as apparel and footwear

MSME

- How can Indian MSMEs be plugged into the global value chain?
- How can MSMEs be equipped to market themselves globally?

Investment policy

- How can the FDI Policy channelise investments into the potential sectors to increase domestic value addition, strengthen linkages and enable brand building?

5.3 Enhancing industrial competitiveness

5.3.1 Competitiveness of Indian industry, or the lack of it, has been a concern that has been discussed for a long time now. Competitiveness can be improved by reducing the cost of infrastructure such as power, logistics, easing regulatory/compliance burden, reducing the cost of capital and improving labour productivity.

5.3.2 Industrial infrastructure in India suffers from lack of funds and inefficiencies. Infrastructure financing relies heavily on banks due to the lack of developed debt and bond markets. Increased pressure on infrastructure from rapid urbanisation exacerbates inefficiencies leading to high cost of logistics. Similarly the cost of power in India is higher than in most countries. Despite efforts as part of the Ease of Doing Business initiative, business environment in India still remains cumbersome. At present our labour productivity is roughly half of China and a fraction (one eighth to one tenth) of Western Europe and United States.

5.3.3 Advances in technology are leading to emergence of new activities, major changes in existing systems and obsolescence at a rate faster than ever before. The Industry 4.0 bouquet of technologies has blurred the line

between manufacturing and services and is predicted to impact all industries. The central role of technology in next generation business has to be acknowledged and appropriated to ensure greater productivity and competitiveness.

5.3.4 In an open world, domestic tax structure and duty rates are an important factor in deciding the direction of flow of raw materials and final products. High direct tax rates and a duty structure that favours import of final products can act as disincentives for domestic manufacturers. It has increasingly common occurrence with goods being traded under regional or preferential trading agreements.

5.3.5 **Illustrative outcomes and trigger questions**

Long-term

- Harness existing strengths in sectors like automobiles and auto-components, electronics, new & renewable energy, banking, software, tourism. Create globally scaled-up and commercially viable sectors to achieve competitiveness.
- Focus on identified industry, manufacturing and services, with potential for sale and expansion for support. Eg Waste management, medical devices, renewable energy, green technologies, financial services etc.
- Leverage presence of a large public sector in core sectors and the forward and backward linkages created over the decades provides for captive source for investments and efficiency improvements.

Medium-term

- Targeted measures to improve labour productivity in select sectors
- Creating a robust and safe digital infrastructure to support next gen digital technologies
- Improve business environment by reducing compliance cost and transaction time

Labour Reforms

- What key reforms can enhance labour market flexibility? How can fixed-term employment contribute towards flexibility in hiring as well as retrenchment?

- How can the problem of low job creation in the formal sector be addressed?

Access to Capital for MSMEs

- What alternatives to banks, can be developed improve access to capital for MSMEs – Peer to Peer Lending, Crowd funding etc.
- Can a credit rating mechanism for MSMEs be looked upon to provide them easier access to funds?

Taxation

- How can the problem of inverted-duty structure be addressed and also be balanced against obligations under multilateral or bilateral trade agreements?
- How can incentives be linked to reforms and performance?

Industry Standard

- Can industry-wide mandatory technical regulations be developed to address this gap? How can enterprises be encouraged to set up testing labs in India?

5.4 Employing gainfully, a growing workforce

5.4.1 India is now in the mid-point of the demographic dividend phenomenon which is expected to continue for another 20-25 years. While debate on whether India will successfully harness the demographic dividend, it has been a part of mainstream planning and policy making process in the last decade.

5.4.2 There are several related concerns, to name a few, include the following

- Some states would move out of the phenomenon earlier than others adding yet another dimension to existing inequalities
- Projected upward trends in automation leading to job losses
- Disproportionately slower growth in creation of jobs as compared to growth in output
- Poor outcomes in education, skill and health leading to an inability to harness the demographic dividend

5.4.3 Illustrative outcomes and trigger questions

Long term

- Gainful employment of the millions of aspirants who join the workforce over the next two decades

Medium term

- Creation of jobs at the bottom of the pyramid
- Jobs to employ the large number of unskilled and semi-skilled labour moving out of the primary sector
- What would be the impact of automation on jobs and employment?
- What measures are to be taken to ensure that the employability of the new workforce?
- Measures to be taken by industry to complement efforts of the government?

5.5 Ensuring sustainability and responsible industrialisation

5.5.1 Industry is a major contributor to carbon emission and also has substantial resource footprint. It is also irrefutable that energy is a significant contributor to industrial growth as well as industrial emissions. Clean energy and cleaner industrial technologies have to be taken together.

5.5.2 Policies on utilisation of natural resources, including energy sources have to be aligned to support industrial growth. Sustainability has to be treated as integral to growth in all sectors and industry as a whole. A fine balance between industrial growth and improvement in environment and sustainability has to be achieved. Sectors that contribute to the latter should be given equal or more attention given that they also contribute to the former.

5.5.3 Illustrative outcomes and trigger questions

Long-term

- A global leader in green energy, green manufacturing and green technologies
- A dynamic renewables sector that contributes substantially to the energy mix

- Establishment of a circular economy

Medium term

- Improvements in energy use efficiency through large scale adoption of smarter technologies

Sustainability

- What are the measures to ensure minimal/zero waste from industrial activities?
- Which sectors need to be targeted to radically cut emissions?

5.6 Enabling ecosystem for technology adoption and innovation

5.6.1 India has the potential to diversify its strengths in the field of information technology. It is not just the largest software service provider, but can provide products and solutions and also become the 'Digital factory of the world', by becoming the vanguard of digital revolution. Education and R & D systems work in silos and often do not align with industry needs. In-house research in industry is straight jacketed and has limited collaborative efforts with the education/R&D system. Despite foreign investments being received in the country over the last three decades transfer of technology has largely remained at assembly level. Component manufacturing, design and R&D activities have to be strengthened.

5.6.2 Right models of technology transfer need adopted to ensure that the transferred technology is enhanced and customized for Indian conditions. The issue of academia - research institutions – industry linkages needs to be addressed. Across the board, innovation should be promoted helping Indian firms increase their R&D spends and file high-quality patents that can be commercialized. Start-up ecosystem that plays a key role in this effort needs to be encouraged.

5.6.3 Illustrative outcomes and trigger questions

Long-term

- Establish an ecosystem supportive of advanced and smart manufacturing
- Thriving innovation ecosystem that provides appropriate support at the right stage of innovation

Medium-term

- Strengthen and diversify information technology industry
- Focus on commercialisation of innovation – incubation and acceleration.
- Enable adoption of smart technologies by SMEs in select sectors

Technology Upgradation

- What specific action points can enable MSMEs to adopt and upgrade technology, considering the world is moving towards Smart Manufacturing?
- What can be done to enable adoption of Industry 4.0 technologies?

Innovation

- How can commercialisation of innovation be encouraged?
- How can institutes of higher learning collaborate with industries for Research & Development?
- How can industries be triggered to innovate themselves and adopt smart technology?

Technology Transfer

- What are measures that can facilitate technology transfer from foreign enterprises to domestic industries?

6. NEXT STEPS

The result of the exercise is to formulate an outcome oriented actionable industrial policy that provides direction and charts a course of action for a globally competitive Indian industry which leverages skill, scale and technology. Consultations will be held with industry bodies, industry captains, central government departments, state governments, think tanks, academia and R&D institutes to understand perspectives of all stakeholders.