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# **MSMEs and Industrial Policies in India: A Critical Evaluation**

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## ***Abstract***

*Starting with the industry policy resolution of 1956, MSMEs have been given considerable attention in the industrial policies announced in India. Although the Mahalanobis model adopted for the Second Five Year plan emphasized the growth of heavy industries, the small scale and consumer goods industries had been given due consideration. The industrial policy statement of 1977 gave an explicit support to the development of MSMEs in India. The industrial policy of 1980s and the new industrial policy of 1991 had nothing to offer newly to the progress of MSMEs. Nevertheless, in recent times a number of measures have been initiated to boost the MSME sector, and the results of which have been reflected on its growing contribution to India's GDP, employment generation and exports.*

***Keywords:*** *MSMEs, Industrial Policy, Five Year Plans, Big Push, Manufacturing, Liberalization*

## **I. Introduction**

The indisputable importance that Micro Small and Medium Enterprises (MSMEs) play in an economy's growth and development has long been recognized in development literature. Recognizing how MSMEs can make visible and direct transformation in the life and livelihood of people at large besides contributing to the economy's overall growth via its enormous and unquestionable linkage effect, governments across the world have been busy with framing industrial policies that cater to the specific emerging needs of MSMEs. It is quite interesting to note that although MSMEs have been regarded as vital in giving a 'big push' to the development endeavours of third world economies, its importance has not declined even in the advanced economies of the world. India too has been a testing ground for the development of MSMEs as its planners as back as in 1950s unearthed the unimaginable potential of MSMEs in revitalizing the development process of the economy. In recent times, India has envisaged a number of supportive and strategic policy interventions

with the aim of rejuvenating the MSME sector in the country particularly to counter the adverse economic impacts that have been spawned on account of the Covid-19 pandemic. Against this background, the paper intends to look into the rationale of MSMEs in Indian context by tracing out how policy makers have incorporated MSMEs as a vital component of industrial policy input.

### **MSMEs in Indian Policy Making in 1950s**

Indeed, it is clear that one has to trace out the development and problems of small scale and medium enterprises in the larger context of industrial policy framework (Sandesara, 1988). Starting with the Second Five Year Plan, India has been making strenuous efforts to transform the industrial sector by raising its contribution to GDP and employment generation. Taking inspiration from the industrial journey of the erstwhile Soviet Union, in 1956, the Government of India embarked on a Heavy Industrialization strategy in view of the long term industrial and infrastructural requirements of the country (Purohit & Joshi, 2011). Heavy industries being more capital intensive in nature were not expected to produce sufficient employment opportunities for the growing labour force in India. Considering the failure of Heavy Industry strategy in addressing the short term and immediate needs of poverty amelioration and employment generation, the Wage-Goods model, prepared by C.N. Vakil and P.R. Brahmanada, two eminent economists of that time, was suggested as an alternative to heavy industry (Balakrishnan, 2007). Contrary to the heavy industry model, which gave priority to the development of capital goods industries, the Wage Good model envisaged a growth strategy by giving prominence to the setting up of small scale and cottage industries in India fuelled by the agriculture sector growth, which would result in the reduction of poverty by way of producing things that people normally buy, besides creating gainful employment opportunities to the masses. But, no wonder, this model was rejected by the Planning Commission, suggesting that this would not lay any foundation for the long term industrial development of the country. Perhaps, it could be well said that the Wage Good Model actually paved the way of envisioning MSME development by placing it in the larger context of Indian industrial policy making particularly in the post-independent India. It is worthwhile to mention at this juncture that in order to counter the growing opposition to the heavy industry model as it put much pressure on India's precious financial resources without tackling the basic issues like poverty and employment generation, the proponents of Heavy industry model were forced to incorporate provisions for small scale industrial development in their original plan of heavy industrialisation. It underlines the fact that even in the Second

Five Year Plan, which was said to be stressing heavy industrialization, the government had to recognise and incorporate the space for industrial policy decisions aiming at fostering small scale and cottage industries in the face of growing discontent with the heavy industrialisation strategy. These developments may sound well the fact that Indian realities and the public sentiment for that matter have always been in favour of supporting the small scale and medium enterprises. Critics of the heavy industrialization went to the extent of saying that the build up towards the heavy and unprecedented balance of crisis that India had to undergo in later years was the offshoot of spending in excess of what the domestic saving and other resources would warrant. Hence, it boils down to the point that India has had to pay a lot because of its policy of neglecting the serious development of small scale and cottage industries. Perhaps on account of this criticism that Mahalanobis himself, the much celebrated architect of the Heavy Industrialization Model, had to come out with a four sector model, in addition to the two sector model that he had earlier developed, giving specific importance to the growth of small scale and medium industries in India.

### **Industrial Policy Statement-1977, The Janata Government and the Small Scale Industries**

It is true that the Industrial Policy Resolution that came in 1956 on the prescriptions of what has later been described as the “Heavy Industry Strategy of Development’ or the ‘Mahalanobis Model’ to name after its ardent supporter and architect, P.C. Mahalanobis, a lot of harsh and sharp criticisms were levelled against the rationale of adopting such a policy particularly in a country that was literally ravaged by the problems of poverty, unemployment, lack of financial resources, and growing divide between the rural and urban regions. The growing discontentment among the people had its political repercussions in the form of declining popularity of the dispensation at the centre. The Janata Government that came into power, in December 1977, announced a sea change in the orientation towards industrialisation. It lamented that the 1956 industrial policy, ‘despite desirable elements, had resulted in certain distortions’ (Datt & Mahajan, 2018). It restated the industrial policy resolution according importance to the development of small scale and cottage industries to tackle the immediate economic and social issues that were plaguing the Indian economy in those days. Thus, perhaps, for the first time, the concerns of small and medium industries received due attention in the policy arena; a series of concessional programmes were announced which aimed at creating a conducive environment for starting small scale industries in India. The low capital-output ratio and capital-labour ratio which are the

attractive features of small scale industries lured many budding entrepreneurs into the field of small scale sector. This coupled with concessional offers of various kinds resulted in reducing the entry barriers for the small scale sector, and the result was the mushrooming of small scale business entities in India.

It needs to be mentioned here that the policy prescriptions for the small scale sector in India had little influence on determining the growth of the sector. A study on the growth of the small scale sector in India during the period 1961 to 1991 clearly pointed out that the growth of the small scale sector was conditioned more by the general growth trend of the aggregate economy than any specific policy level interventions of the governments (Williams, 1998).

### **Industrial Policy-1980, and the Small Scale and Medium Sector**

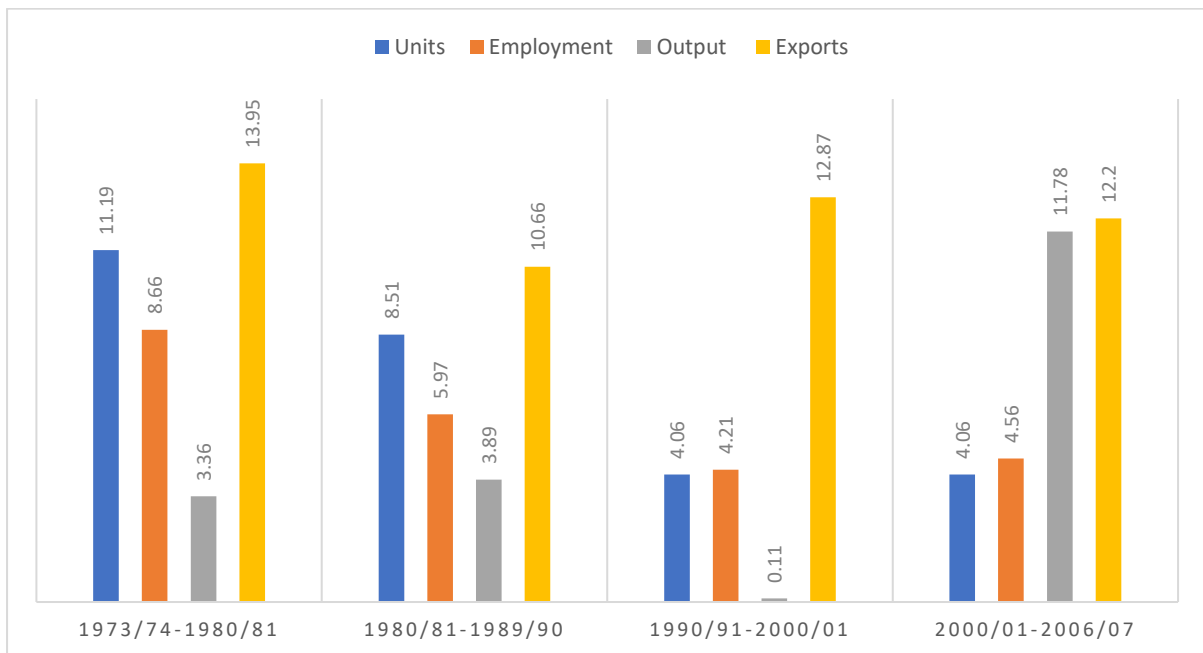
Roughly speaking Industrial policy 1980 had nothing to offer remarkably different from the Industrial Policy Resolution of 1956 for the development of small and medium enterprises. Indeed, it could be articulated that the Industrial policy-1980 affirmed strongly the importance of heavy and large industries. Driven by the sole objective of realizing 'growth' over 'distribution' and regional development, the 1980 policy sought to bury the difference between small scale and large scale industries, and intended to promote the latter at the cost of the former (Datt & Mahajan, 2018). Putting it differently, the importance of small scale was neglected, leading to the selection of capital-intensive ways of industrialization, downplaying the objectives of equity and employment generation. To sum up, the industrial policies in 1980s were more heavy industry and public sector centric, giving no visible and specially designed efforts for the growth the small scale and medium industries. The sole aim of 1980s, as far as the industrial sector is concerned, was to enhance the efficiency of the public sector enterprises with huge capital outlay.

### **MSMEs in the liberalized regime in India**

The transition of Indian industrial sector from an era of inward-looking oriented policies and regulated framework to more liberalized and outward-looking strategy has in fact led to an impressive growth of the Indian manufacturing sector which is reflected in an upward jump in the contribution and growth of industrial sector in India's Gross Domestic Product (Kaplinsky, 1997). It is quite undeniable that Chinese perpetual and envious growth rate of GDP as has been witnessed in the liberalized period is attributed partly to the overwhelming growth of the SME sector (Kapila, 2017). Contrary to this, if one examines the

growth of SMEs in India in terms of its contribution to the output and employment generation and exports, it could be inferred that the liberalized regime does not seem to have produced a commendable accomplishment at least in the immediate post-reform period (Figure 1). The reason for this dismal performance are twofold viz. the increasing competition from the outside due to intensive globalization pursued by the government and the loosening of the protective environment that they had enjoyed under the regulated regime before 1991. The paradigm shifts from a policy protection to promotion as enshrined in the latest policy enunciations have made sweeping changes insofar as the small scale sector is concerned in India.

**Figure 1 Growth Performance of Small Scale Industries Pre Liberalization vs. Liberalization**



Source: Compiled from Uma Kapila, Indian Economy, 17<sup>th</sup> Edition

The enunciation of four-sector model in Mahalanabis strategy and the coming up of Janata government with its pro-poor centric development approach had given a fillip to the growth of SMEs in 1970 which is evident from the fact that growth performance of units, employment and output during this period was respectively 11.19 per cent, 8.66 per cent, and 3.36 percent (Figure 1). In the post-reform period of 1990s and 2000s, barring exports, in all other indicators the performance of MSME was very discouraging.

## **MSME Policy in recent times**

Considering the redistributive and employment effects of MSMEs, governments both at the Central and States have been making concerted efforts to convert MSMEs as a complementary sector for ensuring inclusive growth in India. During the Covid induced pandemic days, the government implemented a number of measures to enhance investment in MSMEs by allowing more concessions for the young entrepreneurs to embark on new fields including manufacturing and service areas. MSME Development Act has been made as a tool to effect these changes. In order to pursue start-ups to invest in MSMEs, the definition of MSMEs has also been changed. These measures have yielded visible evidence of success which can be gauged from increase in the number of units, investments and employment created by the MSMEs in recent times. It is a matter of great gratitude that MSMEs today contribute roughly 30 per cent of India's GDP, providing employment to 11 crore people. The Union Budget 2022-23 envisages to introduce a lot of schemes aiming at bringing in an environment of ease of doing business for the MSMEs.

## **II. Concluding Remarks**

Thus, it is obvious that MSMEs have always had a particular place in the industrial policies announced in India so far. The Industrial policy resolution of 1956, although explicitly supported large scale industries, accorded priority to small scale industries. Interestingly, 1970s industrial policy gave a big thrust to the small scale industries which reflected in the historical performance of small scale industries in that period. However, the growing rate of subsidization of inputs, relaxing of licence rules, and comparative ease of availing loans at concessional interest rates have resulted in the overcrowding of MSMEs and the consequent increase in the rate failures of enterprises.

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