INDUSTRIAL POLICY SINCE 1956

When India achieved Independence in 1947, the national consensus was in favour of rapid industrialization of the economy which was seen not only as the key to economic development but also to economic sovereignty. In the subsequent years, India's Industrial Policy evolved through successive Industrial Policy Resolutions and Industrial Policy Statements. Specific priorities for industrial development were also laid down in the successive Five Year Plans.

Building on the so-called "Bombay Plan"[1] in the pre-Independence era, the first Industrial Policy Resolution announced in 1948 laid down broad contours of the strategy of industrial development. At that time the Constitution of India had not taken final shape nor was the Planning Commission constituted. Moreover, the necessary legal framework was also not put in place. Not surprisingly therefore, the Resolution was somewhat broad in its scope and direction. Yet, an important distinction was made among industries to be kept under the exclusive ownership of Government, *i.e.*, the public sector, those reserved for private sector and the joint sector. Subsequently, the Indian Constitution was adopted in January 1950, the Planning Commission was constituted in March 1950 and the Industrial (Department and Regulation) Act (IDR Act) was enacted in 1951 with the objective of empowering the Government to take necessary steps to regulate the pattern of industrial development through licensing. This paved the way for the Industrial Policy Resolution of 1956, which was the first comprehensive statement on the strategy for industrial development in India.

Industrial Policy Resolution - 1956

The Industrial Policy Resolution - 1956 was shaped by the Mahalanobis Model of growth, which suggested that emphasis on heavy industries would lead the economy towards a long term higher growth path. The Resolution widened the scope of the public sector. The objective was to accelerate

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[1] Bombay Plan prepared by leading Indian industrialists in 1944-45 had recommended government support for industrialization, including a direct role in the production of capital goods.

economic growth and boost the process of industrialization as a means to achieving a socialistic pattern of society. Given the scarce capital and inadequate entrepreneurial base, the Resolution accorded a predominant role to the State to assume direct responsibility for industrial development. All industries of basic and strategic importance and those in the nature of public utility services besides those requiring large scale investment were reserved for the public sector.

The Industrial Policy Resolution - 1956 classified industries into three categories. The first category comprised 17 industries (included in Schedule A of the Resolution) exclusively under the domain of the Government. These included *inter alia*, railways, air transport, arms and ammunition, iron and steel and atomic energy. The second category comprised 12 industries (included in Schedule B of the Resolution), which were envisaged to be progressively State owned but private sector was expected to supplement the efforts of the State. The third category contained all the remaining industries and it was expected that private sector would initiate development of these industries but they would remain open for the State as well. It was envisaged that the State would facilitate and encourage development of these industries in the private sector, in accordance with the programmes formulated under the Five Year Plans, by appropriate fiscal measures and ensuring adequate infrastructure. Despite the demarcation of industries into separate categories, the Resolution was flexible enough to allow the required adjustments and modifications in the national interest.

Another objective spelt out in the Industrial Policy Resolution - 1956 was the removal of regional disparities through development of regions with low industrial base. Accordingly, adequate infrastructure for industrial development of such regions was duly emphasized. Given the potential to provide large-scale employment, the Resolution reiterated the Government's determination to provide all sorts of assistance to small and cottage industries for wider dispersal of the industrial base and more equitable distribution of income. The Resolution, in fact, reflected the prevalent value system of India in the early 1950s, which was centered around self sufficiency in industrial production. The Industrial Policy Resolution – 1956 was a landmark policy statement and it formed the basis of subsequent policy announcements.

Industrial Policy Measures in the 1960s and 1970s

Monopolies Inquiry Commission (MIC) was set up in 1964 to review various aspects pertaining to concentration of economic power and operations of industrial licensing under the IDR Act, 1951. While emphasizing that the planned economy contributed to the growth of industry, the Report by MIC concluded that the industrial licensing system enabled big business houses to obtain disproportionately large share of licenses which had led to pre-emption and foreclosure of capacity. Subsequently, the Industrial Licensing Policy Inquiry Committee (Dutt Committee), constituted in 1967, recommended that larger industrial houses should be given licenses only for setting up industry in core and heavy investment sectors, thereby necessitating reorientation of industrial licensing policy.

In 1969, the monopolies and restrictive Trade Practices (MRTP) Act was introduced to enable the Government to effectively control concentration of economic power. The Dutt Committee had defined large business houses as those with assets of more than Rs.350 million. The MRTP Act, 1969 defined large business houses as those with assets of Rs. 200 million and above. Large industries were designated as MRTP companies and were eligible to participate in industries that were not reserved for the Government or the Small scale sector.

The new Industrial Licensing Policy of 1970 classified industries into four categories. First category, termed as ‘Core Sector’, consisted of basic, critical and strategic industries. Second category termed as ‘Heavy Investment Sector’, comprised projects involving investment of more than Rs.50 million. The third category, the ‘Middle Sector’ consisted of projects with investment in the range of Rs.10 million to Rs.50 million. The fourth category was ‘De-licensed Sector’, in which investment was less than Rs.10 million and was exempted from licensing requirements. The industrial licensing policy of 1970 confined the role of large business houses and foreign companies to the core, heavy and export oriented sectors.

The Industrial Policy Statement - 1973

With a view to prevent excessive concentration of industrial activity in the large industrial houses, this Statement gave preference to small and medium entrepreneurs over the large houses and foreign companies in setting up of new capacity particularly in the production of mass consumption goods. New undertakings of up to Rs.10 million by way of fixed assets were exempted from licensing requirements for substantial expansion of assets. This exemption was not allowed to MRTP companies, foreign companies and existing licensed or registered undertakings having fixed assets of Rs.50 million and above.

The Industrial Policy Statement -1977

This Statement emphasized decentralization of industrial sector with increased role for small scale, tiny and cottage industries. It also provided for close interaction between industrial and agricultural sectors. Highest priority was accorded to power generation and transmission. It expanded the list of items reserved for exclusive production in the small scale sector from 180 to more than 500. For the first time, within the small scale sector, a tiny unit was defined as a unit with investment in machinery and equipment up to Rs.0.1 million and situated in towns or villages with a population of less than 50,000 (as per 1971 census). Basic goods, capital goods, high technology industries important for development of small scale and agriculture sectors were clearly delineated for large scale sector. It was also stated that foreign companies that diluted their foreign equity up to 40 per cent under Foreign Exchange Regulation Act (FERA) 1973 were to be treated at par with the Indian companies. The Policy Statement of 1977 also issued a list of industries where no foreign collaboration of financial or technical nature was allowed as indigenous technology was already available. Fully owned foreign companies were allowed only in highly export oriented sectors or sophisticated technology areas. For all approved foreign investments, companies were completely free to repatriate capital and remit profits, dividends, royalties, etc. Further, in order to ensure balanced regional development, it was decided not to issue fresh licenses for setting up new industrial units within certain limits of large metropolitan cities (more than 1 million population) and urban areas (more than 0.5 million population).

Industrial Policy Statement -1980

The industrial Policy Statement of 1980 placed accent on promotion of competition in the domestic market, technological upgradatrion and modernization of industries. Some of the socio-economic objectives spelt out in the Statement were i) optimum utilisation of installed capacity, ii) higher productivity, iii) higher employment levels, iv) removal of regional disparities, v) strengthening of agricultural base, vi) promotion of export oriented industries and vi) consumer protection against high prices and poor quality.

Policy measures were announced to revive the efficiency of public sector undertakings (PSUs) by developing the management cadres in functional fields *viz.*, operations, finance, marketing and information system. An automatic expansion of capacity up to five per cent per annum was allowed, particularly in the core sector and in industries with long-term export potential. Special incentives were granted to industrial units which were engaged in industrial processes and technologies aiming at optimum utilization of energy and the exploitation of alternative sources of energy. In order to boost the development of small scale industries, the investment limit was raised to Rs.2 million in small scale units and Rs.2.5 million in ancillary units. In the case of tiny units, investment limit was raised to Rs.0.2 million.

Industrial Policy Measures during the 1980s

Policy measures initiated in the first three decades since Independence facilitated the establishment of basic industries and building up of a broad-based infrastructure in the country. The Seventh Five Year Plan (1985-1900), recognized the need for consolidation of these strengths and initiating policy measures to prepare the Indian industry to respond effectively to emerging challenges. A number of measures were initiated towards technological and managerial modernization to improve productivity, quality and to reduce cost of production. The public sector was freed from a number of constraints and was provided with greater autonomy. There was some progress in the process of deregulation during the 1980s. In 1988, all industries, excepting 26 industries specified in the negative list, were exempted from licensing. The exemption was, however, subject to investment and locational limitations. The automotive industry, cement, cotton spinning, food processing and polyester filament yarn industries witnessed modernization and expanded scales of production during the 1980s.

With a view to promote industrialization of backward areas in the country, the Government of India announced in June, 1988 the Growth Centre Scheme under which 71 Growth Centers were proposed to be set up throughout the country. Growth centers were to be endowed with basic infrastructure facilities such as power, water, telecommunications and banking to enable them to attract industries.

Industrial Policy Statement- 1991

The Industrial Policy Statement of 1991 stated that "the Government will continue to pursue a sound policy framework encompassing encouragement of entrepreneurship, development of indigenous technology through investment in research and development, bringing in new technology, dismantling of the regulatory system, development of the capital markets and increased competitiveness for the benefit of common man". It further added that "the spread of industrialization to backward areas of the country will be actively promoted through appropriate incentives, institutions and infrastructure investments".

The objective of the Industrial Policy Statement - 1991 was to maintain sustained growth in productivity, enhance gainful employment and achieve optimal utilization of human resources, to attain international competitiveness, and to transform India into a major partner and player in the global arena. Quite clearly, the focus of the policy was to unshackle the Indian industry from bureaucratic controls. This called for a number of far-reaching reforms :

- A substantial modification of Industry Licencing Policy was deemed necessary with a view to ease restraints on capacity creation, respond to emerging domestic and global opportunities by improving productivity. Accordingly, the Policy Statement included abolition of industrial licensing for most industries, barring a handful of industries for reasons of security and strategic concerns, social and environmental issues. Compulsory licencing was required only in respect of 18 industries. These included, *inter alia,* coal and lignite, distillation and brewing of alcoholic drinks, cigars and cigarettes, drugs and pharmaceuticals, white goods, hazardous chemicals. The small scale sector continued to be reserved. Norms for setting up industries (except for industries subject to compulsory licensing) in cities with more than one million population were further liberalised.
- Recognising the complementarily of domestic and foreign investment, foreign direct investment was accorded a significant role in policy announcements of 1991. Foreign direct investment (FDI) up to 51 per cent foreign equity in high priority industries requiring large investments and advanced technology was permitted. Foreign equity up to 51 per cent was also allowed in trading companies primarily engaged in export activities. These important initiatives were expected to provide a boost to investment besides enabling access to high technology and marketing expertise of foreign companies.
- With a view to inject technological dynamism in the Indian industry, the Government provided automatic approval for technological agreements related to high priority industries and eased procedures for hiring of foreign technical expertise.
- Major initiatives towards restructuring of public sector units (PSUs) were initiated, in view of their low productivity, over staffing, lack of technological upgradation and low rate of return. In order to raise

resources and ensure wider public participation PSUs, it was decided to offer its shareholding stake to mutual funds, financial institutions, general public and workers. Similarly, in order to revive and rehabilitate chronically sick PSUs, it was decided to refer them to the Board for Industrial and Financial Reconstruction (BIFR). The Policy also provided for greater managerial autonomy to the Boards of PSUs.

- The Industrial Policy Statement of 1991 recognized that the Government's intervention in investment decisions of large companies through MRTP Act had proved to be deleterious for industrial growth. Accordingly, pre-entry scrutiny of investment decisions of MRTP companies was abolished. The thrust of policy was more on controlling unfair and restrictive trade practices. The provisions restricting mergers, amalgamations and takeovers were also repealed.

Industrial Policy Measures Since 1991

Since 1991, industrial policy measures and procedural simplifications have been reviewed on an ongoing basis. Presently, there are only six industries which require compulsory licensing. Similarly, there are only three industries reserved for the public sector. Some of important policy measures initiated since 1991 are set out below:

- Since 1991, promotion of foreign direct investment has been an integral part of India's economic policy. The Government has ensured a liberal and transparent foreign investment regime where most activities are opened to foreign investment on automatic route without any limit on the extent of foreign ownership. FDI up to 100 per cent has also been allowed under automatic route for most manufacturing activities in Special Economic Zones (SEZs). More recently, in 2004, the FDI limits were raised in the private banking sector (up to 74 per cent), oil exploration (up to 100 per cent), petroleum product marketing (up to 100 per cent), petroleum product pipelines (up to 100 per cent), natural gas and LNG pipelines (up to 100 per cent) and printing of scientific and technical magazines, periodicals and journals (up to 100 per cent). In

February 2005, the FDI ceiling in telecom sector in certain services was increased from 49 per cent to 74 per cent.

- Reservation of items of manufacture exclusively in the small scale sector has been an important tenet of industrial policy. Realizing the increased import competition with the removal of quantitative restrictions since April 2001, the Government has adopted a policy of dereservation and has pruned the list of items reserved for SSI sector gradually from 821 items as at end March 1999 to 506 items as on April 6, 2005. Further, the Union Budget 2005-06 has proposed to dereserve 108 items which were identified by Ministry of Small Scale Industries. The investment limit in plant and machinery of small scale units has been raised by the Government from time to time. To enable some of the small scale units to achieve required economies of scale, a differential investment limit has been adopted for them since October 2001. Presently, there are 41 reserved items which are allowed investment limit up to Rs.50 million instead of present limit of Rs.10 million applicable for other small scale units.
- Equity participation up to 24 per cent of the total shareholding in small scale units by other industrial undertakings has been allowed. The objective therein has been to enable the small sector to access the capital market and encourage modernization, technological upgradation, ancillarisation, sub-contracting, *etc*.
- Under the framework provided by the Competition Act 2002, the Competition Commission of India was set up in 2003 so as to prevent practices having adverse impact on competition in markets.
- In an effort to mitigate regional imbalances, the Government announced a new North-East Industrial Policy in December 1997 for promoting industrialization in the North-Eastern region. This policy is applicable for the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura. The Policy has provided various concessions to industrial units in the North Eastern Region, *e.g.,*

development of industrial infrastructure, subsidies under various schemes, excise and income-tax exemption for a period of 10 years, *etc*. North Eastern Development Finance Corporation Ltd. has been designated as the nodal disbursing agency under the Scheme.

- The focus of disinvestment process of PSUs has shifted from sale of minority stakes to strategic sales. Up to December 2004, PSUs have been divested to an extent of Rs.478 billion.
- Apart from general policy measures, some industry specific measures have also been initiated. For instance, Electricity Act 2003 has been enacted which envisaged to delicense power generation and permit captive power plants. It is also intended to facilitate private sector participation in transmission sector and provide open access to grid sector. Various policy measures have facilitated increased private sector participation in key infrastructure sectors such as, telecommunication, roads and ports. Foreign equity participation up to 100 per cent has been allowed in construction and maintenance of roads and bridges. MRTP provisions have been relaxed to encourage private sector financing by large firms in the highway sector.

Evidently, in the process of evolution of industrial policy in India, the Government's intervention has been extensive. Unlike many East Asian countries which used the State intervention to build strong private sector industries, India opted for the State control over key industries in the initial phase of development. In order to promote these industries the Government not only levied high tariffs and imposed import restrictions, but also subsidized the nationalized firms, directed investment funds to them, and controlled both land use and many prices.

In India, there has been a consensus for long on the role of government in providing infrastructure and maintaining stable macroeconomic policies. However, the path to be pursued toward industrial development has evolved over time. The form of government intervention in the development strategy needs to be chosen from the two alternatives: 'Outward-looking development policies' encourage not only free trade but also the free movement of capital, workers and enterprises. By contrast, 'inward-looking development policies' stress the need for one's own style of development. India initially adopted the latter strategy.

The advocates of import substitution in India believed that we should substitute imports with domestic production of both consumer goods and sophisticated manufactured items while ensuring imposition of high tariffs and quotas on imports. In the long run, these advocates cite the benefits of greater domestic industrial diversification and the ultimate ability to export previously protected manufactured goods, as economies of scale, low labour costs, and the positive externalities of learning by doing cause domestic prices to become more competitive than world prices. However, pursuit of such a policy forced the Indian industry to have low and inferior technology. It did not expose the industry to the rigours of competition and therefore it resulted in low efficiency. The inferior technology and inefficient production practices coupled with focus on traditional sectors choked further expansion of the India industry and thereby limited its ability to expand employment opportunities. Considering these inadequacies, the reforms currently underway aim at infusing the state of the art technology, increasing domestic and external competition and diversification of the industrial base so that it can expand and create additional employment opportunities.

In retrospect, the Industrial Policy Resolutions of 1948 and 1956 reflected the desire of the Indian State to achieve self sufficiency in industrial production. Huge investments by the State in heavy industries were designed to put the Indian industry on a higher long-term growth trajectory. With limited availability of foreign exchange, the effort of the Government was to encourage domestic production. This basic strategy guided industrialization until the mid-1980s. Till the onset of reform process in 1991, industrial licensing played a crucial role in channeling investments, controlling entry and expansion of capacity in the Indian industrial sector. As such industrialization occurred in a protected environment, which led to various distortions. Tariffs and quantitative controls largely kept foreign competition out of the domestic market, and most Indian manufacturers looked on exports only as a residual possibility. Little attention was paid to ensure product quality, undertaking R&D for technological development and achieving economies of scale. The industrial policy announced in 1991, however, substantially dispensed with industrial licensing and facilitated foreign investment and technology transfers, and threw open the areas hitherto reserved for the public sector. The policy focus in the recent years has been on deregulating the Indian industry, enabling industrial restructuring, allowing the industry freedom and flexibility in responding to market forces and providing a business environment that facilitates and fosters overall industrial growth. The future growth of the Indian industry as widely believed, is crucially dependent upon improving the overall productivity of the manufacturing sector, rationalisation of the duty structure, technological upgradation, the search for export markets through promotional efforts and trade agreements and creating an enabling legal environment.

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