



The Ascent and Decline of Reservation in Indian Small Scale Industries: Evolution of the Policy Environment¹

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Small Scale sector has occupied the centre stage in Indian industries right after independence. While in the classical Gandhian thinking small scale industries plays a

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I Introduction

Small Scale sector has occupied the centre stage in Indian industries. The justification for such a strategy came from varied sources – from the Gandhian emphasis on small scale industries to a perceived socialist notion of small industries being more employment intensive and perhaps efficient. These considerations prompted the Indian policy makers to reserve a number of items

imperfections. *The factor market distortion argument* ... might suggest that the correct inference to be drawn from the discussion is that the problem of less than optimal size of SSI is best tackled by confronting it at its source – enacting policies to remove capital market distortions. This is indeed that first best solution, but it will emerge from the discussion in this section that the reasons for capital market segmentation are such that they are hard to remove through direct interventions. Hence, there is the need to adopt supportive policies for SSI development as a second best solution".

What has been the dimension of such changes of reservation policy of small scale industries? What prompted the policy makers to increase / reduce the number of reserved items under small scale sector on the one hand and to extend the definitional perimeter from SSI to SME to MSME, on the other? The present paper seeks to understand these issues and in this process narrates the story of this evolution of reservation of small scale sector and various definitional changes.

The rest of the paper is organized as follows. Section II is devoted to small industries in the early days of Planning and covers roughly the period 1950 – 1966. The hey day of reservation of small sector since 1967 till early 1990s is dealt with in section III. Policies towards small scale and progressive de reservation are covered in Section IV. Section V concludes the paper.

II. Small Industries in the early days of Planning²

In some sense, the term “small scale industries” is misleading this term has been used, “to indicate small sized industrial units and not small sized industries” (Bhati, 2002). The legal framework is provided by the Industries Development and Regulation Act, 1951, Section 11 B(1) of which defined SSI, “as an industrial undertaking which may be held on ownership terms, lease or hire purchase basis and the original investment in plant and machinery in that undertaking does not exceed the specified limit in force at the time.”

² We have consciously used the term small industries. The semantics of the official discourse has undergone quite an evolution in this regard. The group “Small Scale Industries” (SSI) graduated to “small and medium scale (SME) industries” sometime in mid 1980s and more recently to “micro, small and medium scale industries” (MSME).

Intellectual Foundation

Small industries in India have a long intellectual history. Interestingly the intellectual foundation for emphasizing small industries came from two diverse and diametrically opposing sources. First, Gandhi's notion of economic development was heavily tilted in favor of "cottage industries". Mostly these got manifested in terms of Gandhi's emphasis on *Khadi*. Writing in 1934, in an issue of the *Harijan*, he commented:

"Khadi is the sun of the village solar system. The planets are the various industries which can support khadi in return for the heat and the sustenance they derive from it. Without it other industries cannot grow. But during my last tour I discovered that, without the revival of other industries, khadi could not make further progress. For villagers to be able to occupy their spare time profitably, the village must be touched at all points."³

Does this echo the sentiment of "balanced growth"? Later commentators on Gandhi's economic philosophy favoring small scale industry got a number of key traits in Gandhi. For example, Rivett (1959) pointed out that Gandhian economic philosophy was not necessarily un-western and that his emphasis on village industrialization can be rationalized in terms of employment generation and seasonal occupation and "are identical in substance with some of those used, e.g., in the Report of the Village and Small Scale Industries Committee" (popularly called the Karve Committee Report) during the mid 1950s (Rivett, 1959; p.6). However, Gandhi's intellectual foundation of skepticism of market forces seemed to have emanated was

philosophy, viz., Mahalanobis Model. Mahalanobis's four sector model comprises the following sector: (1) investment goods industries; (2) factory type (or large scale) consumer goods industries; (3) hand type (or small scale) consumer goods industries including agriculture; and (4) all types of services (Table 1; Mahalanobis,

Government Policies

The special role of the small industries finds a mention in the Industrial Policy Resolution of 1948 as they are suited for better utilization of local resources (both human and physical) and for achieving local self sufficiency in respect of certain types of essential) consumer goods (like food, cloth and agricultural implements). Noting that, "cottage and small scale industries have a very important role in the national economy", the 1948 Industrial Policy Resolution went on to say,

"The healthy expansion of cottage and small scale industries depends upon a number of factors like the provision of raw materials, cheap power, technical advice, organised marketing of their produce, and where necessary, safeguards against intensive competition by large scale manufacture.... Most of these fall in the Provincial sphere and are receiving the attention of the Governments of the Provinces and the States. The Resolution of Industries Conference has requested the Central Government to investigate how far and in what manner these industries can be co ordinated and integrated with large scale industries. The Government of India accepted this recommendation. It will be examined, for example, how the textile mill industry can be made complementary to, rather than competitive with the handloom industry, which is the country's largest and best organised cottage industry."⁴

The First Five Year Plan Document (1951 1956) too devoted two specific chapters on village industries (Chapter 24) and small industries and handicrafts (chapter 25). Insofar as the definition of small scale industries is concerned, the First Five Year Plan Document noted:

"It is customary to refer to industries which are not required to be registered under the Factory Act as cottage and small scale industries. There is no accepted line of distinction between cottage and small scale industries and different definitions are adopted according to the object in view. The distinction frequently made between establishments which employ power and those which do not become less useful as electricity becomes more generally available. The number of workers employed in an establishment has only a limited value as a criterion for distinguishing large scale and small scale establishments. In addition to the test of numbers employed and the use of power, a further test may be whether a unit which may otherwise be regarded as small is owned by the worker himself or by a co operative group" (emphasis added).⁵

Around the mid 1950s, small scale industrial sector was almost synonymous with cottage and village industries. To promote different segments of SSI, the Central Government

⁴ Available at <http://www.dcmsme.gov.in/policies/iip.htm>

⁵Chapter 25, para 1; available at <http://planningcommission.nic.in/plans/planrel/fiveyr/index1.html>

decided to set up six exclusive boards, viz., Khadi and Village Industries Board; Handloom Board; Handicrafts Board; Coir Board; Sericulture Board; and Small Scale Industries Board (SSIB) (Subrahmanya, 1995).

The main policy thrust to this sector came in 1956 with the second industrial Policy resolution. The government had been supporting the SSIs by restricting production of large scale industries by differential taxation but the policy resolution of 1956 put stress on reducing regional disparities by supplying raw materials in locations lacking raw materials needed for SSIs. Thus a scheme for setting up industrial estates in various important centers in the country was implemented. A National Small Industries Corporation was also set up in 1956.

Adequate financial support was also lent to this sector. To ensure adequate flow of credit to this sector, the government in consultation with RBI introduced the Credit Guarantee Scheme in 1960 and RBI was designated as the Credit Guarantee Organization (CGO) for guaranteeing the advances granted by banks and other credit Institutions to small scale industries. Small industries were exempted from the scope of taxation except in 1960, when excise duty was imposed on a few footwear manufacturers as some large units producing footwear were deliberately adopting decentralization to evade taxation.

The Government of India in 1954 constituted an advisory board, namely the Small Industries Development Board, to render advice on all issues pertaining to the development of small scale sector and to coordinate and facilitate the inter institutional linkages. The board in 1955 defined small scale units as a unit employing less than 50 employees if using power and less than 100 employees if not using power and with a capital asset not exceeding Rs. 5 lakhs. The Ministry of Commerce, on the recommendation of Small Scale Industries Board and industries modified this definition in 1960. According to the modification, the condition of number of employees was dropped without any change in the investment limit. Thus, the modification widened the scope of employment in the small scale sector.

III Hey Day of Reservation for Small Industries:

| Table 2: Progressive Reservation of Small Scale Sector: 1967 1991 | | | |
|---|----------------------|--------------------------|--------------------------------------|
| Date of Notification | No.of Items Reserved | No. of items de reserved | Cumulative net no. of items reserved |
| Phase 1 | | | |
| 1 Apr 67 | 47 | | 47 |
| 19 Apr 70 | 8 | | 55 |
| 24 Feb 71 | 73 | | 128 |
| 11 Nov 71 | | 4 | 124 |
| 26 Feb 74 | 53 | | 177 |
| 5 Jun 76 | 3 | | 180 |
| 26 Apr 78 | 324 | | 504 |
| Phase 2 | | | |
| 26 Apr 78 | 807 | | 807 |
| 30 Dec 78 | | 1 | 806 |
| 12 May 80 | 27 | | 833 |
| 19 Feb 81 | 1 | 1 | 833 |
| 3 Aug 81 | 9 | | 842 |
| 23 Dec 81 | 2 | 13 | 831 |
| 14 Oct 82 | | 3 | 828 |
| 19 Oct 82 | 9 | | 837 |
| 3 Sep 83 | 35 | | 872 |
| 18 Oct 84 | 1 | 1 | 872 |
| 30 May 84 | 7 | 14 | 869 |
| 30 Oct 86 | 1 | 7 | 863 |
| 13 Feb | | | |

Industrial policy of 1977

The Industrial policy of 1977 placed huge importance on the small scale sector. Ignoring all aspects of economy and commerce, it emphasized "whatever can be produced by the small scale sector must only be so produced." Reservation of items to be produced by the small scale sector was increased to include 504 items increase in such numbers was proposed to provide

adequate support to the SSIs. Special attention in the form of making available margin money was given to the tiny sector. IPR 1977 decided to take the focal point of development of small scale from big cities to district headquarters. A District Industries Centre was proposed to be set up in each district which would provide the required support and services to the small industries. It stated that assistance towards technological up gradation of SSIs would be an integral part of Government policies henceforth. Marketing of goods was identified as a bottleneck for the growth of this sector, hence measures such as purchase preference and reservation for exclusive purchase by Government Departments and PSU's were initiated.

The Committee for drafting legislation for small scale industries, constituted in 1972 suggested that small scale industries be classified into Tiny, Small and Ancillary Industries.

Tiny Industries would be those whose investment in fixed assets was less than Rs.1 Lakh or Rs. 4000 per worker and whose annual turnover does not exceed Rs. 5 lakhs. Small Industries would be those whose capital investment in fixed assets does not exceed Rs. 7.5 lakh irrespective of the number of persons hired.

Ancillary industries defined as such industries providing services to other units for production of other goods would be such whose investment in fixed assets would not be more than 10 lakh.

In order to remove the tendency of falsification of accounts, resort to 'benami' units and understating of the value of plants and machinery to circumvent the existing investment limit, the investment ceiling of tiny, small and medium industries were revised upwards in Industrial policy resolution of 1980 as follows:

- x Increase in limit of investment in the case of tiny units from Rs.1 lakh to Rs.2 lakhs;
- x Increase in limit of investment in the case of small scale units from Rs. 10

Rs.Rs. (10)Tj/TT11Tf
Increa

Industrial policy of 1980

This policy reversed the previous trend of creating division among the industrial sector based on size and focused on promoting SSIs on the basis of integrated industrial development. It proposed setting up 'nucleus plants', which would concentrate on assembling products of the ancillary units falling within its orbit, on producing inputs needed by large number of smaller units and making adequate marketing arrangements. The plan was to generate sufficient forward and backward linkages so that adequate number of small units grows in industry starved areas. Availability of credit to growing units was continued. To assist in the growth of small units, a scheme of building buffer stock of essential materials utilizing Small Industries Development Corporations (SIDC) was introduced.

The Industrial policy Statement of 1985 took into account the impact of inflation and decided to again make incremental changes in the investment limit. Hence investment limit of small scale was increased to Rs. 35 lakh and that of ancillary units was increased to Rs. 45 lakh.

In 1986, in order to coordinate the financial assistance to small units a separate special fund called the Small Scale Development Fund (SIDF) was set up with IDBI. In 1988, the Small Industries Development Bank (SIDBI) was proposed to be set up which would administer both SIDF, set up in 1986 and National Equity Fund to provide equity support to tiny and small scale sector Projects.

IV Small Industries since the economic reforms

Continuation of protectionist attitude

As far as the SME sector is concerned, the initial years of the 1990's witnessed continuation of protectionist attitude which was reflected in the Industrial Policy Resolution of 1990. Reservation of items to be manufactured by SSI's was increased to 836. Investment ceiling in plant and machinery was increased for SSI's. Technology up gradation was stressed on to improve the competitiveness of the SSI's. Central Investment Subsidy was created for this

sector in the rural and backward areas. To ensure adequate flow of credit to this sector Small Industries Development Bank(SIDBI) was created.

In order to reorient industrial growth to provide more industrial employment, disperse industries in rural areas and to enhance the contribution of small scale industries, the Industrial policy resolution of 1990 permitted such ancillary units which undertook to export 30 percent of their produce to increase their investment limit to Rs. 75 lakh. Investment ceiling for tiny industries was revised upwards to Rs. 5 lakh and that for small industries was revised upwards to Rs. 60 lakh.

In 1997, on the recommendation of Abid Hussain Committee, the government defined small scale enterprises to replace small scale industries. Enterprises would cover all business enterprises including the service sector which provide services to industrial enterprises. Taking into account these factors investment

facilities these years also saw various exemptions on excise duties to SSI's. Encouraging the SSI's to seek ISO 9000 certification of quality was another focal point.

From Protection to Promotion

The Abid Hussain Committee report, 1997 served as an important reference in shaping future policy initiatives for

The comprehensive Policy Package for SSI's launched in 2000 increased the excise duty limit from 50 lakh to one crore in order to increase their competitiveness. A Governing & Technology Approval Board with inter ministerial Committee of Experts was set up to define

opportunities generated by trade liberalization, the Government in the NCMP declared that a major promotional package" will be announced for this

machinery is more than Rs. 1 crore but less than Rs. 10 crore. The small scale industries would hence be known as Small and Medium Enterprises.

There was a long standing demand from entrepreneurs and small scale associations for a single comprehensive legislation. The Micro, Small and Medium enterprise Development Act came into existence in 2006. This act defined 'medium' enterprises for the first time in India and 'micro' enterprises for the first time. Industries were classified as manufacturing and services with their respective set of investment limits (Table 3).

| Table 3: Definitions of Small, Medium and Micro Enterprises | | |
|--|--------------------|---|
| | Enterprises | Investment in plant & machinery |
| Manufacturing Sector | Micro Enterprises | Does not exceed twenty five lakh rupees |
| | Small Enterprises | More than twenty five lakh rupees but does not exceed five crore rupees |
| | Medium Enterprises | More than five crore rupees but does not exceed ten crore rupees |
| Services Sector | Micro Enterprises | Does not exceed ten lakh rupees: |
| | Small Enterprises | More than ten lakh rupees but does not exceed two crore rupees |

of the NCAER subsequently has argued for complete abolition of reservation for SSI sector. More recently, Debroy and others (2006) in a detailed study arrived at the following broad characteristics of the reserved sector under the small scale industries: (a) units that produced reserved items are barely a fifth of the total SSI sector; (b) they account for about a sixth of the total employment; (c) but only one eighth of the output of the sector; and (d) their exports are only a twentieth of the total SSI exports.

However, with the general economic liberalization, progressive de reservation of a number of items reserved for exclusive manufacture by the micro and small scale sector have taken place. The objective of progressive de reservation was, "to provide for opportunities for technological upgradation, promotion of exports and economies of scale, in order to encourage modernization and enhance the competitiveness of MSEs in view of the liberalisation and globalisation of the economy" (Government of India, 2009).

In accordance with Section 29(B) of the IDR Act, 1951, Items were reserved /de reserved. Procedurally, this is done by an Advisory Committee under the chairmanship of the Secretary (MSME). The Advisory Committee makes its recommendations on the basis of the laid down procedure in the IDR Act, 1951 which relates to, "the economies of scale, the level of employment, the possibility of encouraging and diffusing entrepreneurship in industry, the prevention of concentration of economic power to the detriment of the common interest and any other issue which the Committee may think fit" (Government of India, 2009). Illustratively, 125 items were de reserved on 13 March 2007 and 79 more on 8th February 2008 and the total number of items reserved for exclusive ~~AE-DA~~ and may

| Table 4: Progressive De Reservation of Small Scale Sector: 1992 2011 | |
|---|-------------------------|
| Year | Items under reservation |
| 1993 | 842 |
| 1994 | 836 |
| 1995 | 836 |
| 1996 | 836 |
| 1997 | 836 |
| 1998 | 836 |
| 1999 | 821 |
| 2000 | 812 |
| 2001 | 812 |
| 2002 | 748 |
| 2003 | 675 |
| 2004 | 605 |
| 2005 | 506 |
| 2006 | 398 |
| 2007 | 239 |
| 2008 | 35 |
| 2009 | 21 |
| 2010 | 21 |
| 2011 | 20 |

Government of India, Ministry of Micro, Small &

V Concluding Observations

Small Scale industries have come a long way from the toddler stage of the 1950s to its current position. While their contribution to Indian industries has not been uniform, given the higher employment intensity of the small scale sector, their importance can hardly be underestimated. However, given the technological configuration and optimal firm size, tinkering with the scale of operations from a bureaucratic angle may be counter productive. Thus, from this standpoint, extension of the small scale industries to SME and finally to MSME has been an effort in the right direction. Moreover, given the factor market imperfections,

protecting the small scale sector as a second best solution need not continue forever. In fact, over the years, the evolutionary story presented in the paper seems to indicate that a two pronged strategy has been adopted. On the one hand, there has been a progressive

Annex 1: Evolution of the Definition of Micro, Small and Medium Scale Industries

Note : Micro ,Small and Medium industries have always been defined on the basis of their investment limits in their fixed assets

| YEAR | Ministry, Committee, Commission or Policies involved | SMALL SCALE INDUSTRY DEFINITION | Reasons and Comments |
|------|---|---|--|
| 1955 | Small Scale Industries Board | " Small scale industry as a unit employing less than 50 employees if using power and less than 100 employees if not using power and with a capital asset not exceeding Rs. 5 lakhs". | |
| 1960 | Ministry of Commerce and Industries | Small scale industry will include all industrial units with a capital investment of not more than Rs. 5 lakhs, irrespective of the number of persons employed" | |
| 1972 | Committee for drafting legislation for small scale industries | <p>Tiny industry – investment <= 1 lakh or Rs.4000 per worker ,and annual turnover <= Rs.5 lakh</p> <p>Small industry – investment strictly <= Rs. 7.5 lakh</p> <p>Ancillary industry – investment <= Rs. 10 lakh</p> <p>Tiny industries are those whose investment is not more than Rs. 2 lakhs</p> <p>Small industries are those whose investment limit is</p> | <p>Small Scale industries were classified under 3 categories such as Tiny, Small, Ancillary Industries.</p> <p>The term Small Scale Industries to be replaced by Small Enterprises</p> |
| 1980 | The Industrial Policy of 1980 | | |

| YEAR | Ministry, Committee, Commission or Policies involved | SMALL SCALE INDUSTRY DEFINITION | Reasons and Comments |
|------|--|------------------------------------|----------------------|
|------|--|------------------------------------|----------------------|

| YEAR | Ministry, Committee, Commission or Policies involved | SMALL SCALE INDUSTRY DEFINITION | Reasons and Comments |
|------|--|---|---|
| | | | <p>However, with regard to their location, the population limit of 50,000 as per the 1981 census would continue to apply. Steps will be taken to ensure better inflow of credit and other vital inputs and to improve the infrastructure support to the constituents of the Tiny Sector. "</p> <p>INDUSTRIAL POLICY 1990</p> <p>POLICY MEASURES FOR THE PROMOTION OF SMALL SCALE AND AGRO BASED INDUSTRIES AND CHANGES IN PROCEDURES FOR INDUSTRIAL APPROVALS</p> <p>http://dcmsme.gov.in/policies/iip.htm#lndus5</p> |
| 1997 | The Government on recommendation of Abid Hussain Committee | <p>"Tiny " enterprises Investment not more than Rs.25 lakh</p> <p>Small and Ancillary industries – Investment in plant and machinery not more than Rs.3 Crores.</p> | <p>"First, the definition of the small scale enterprises (SSEs). Incentives, credit facilities, and promotional facilities should then be available to all small scale enterprises. To begin with, the concept of the SSE sector, should include all business enterprises in the service sector which provide services to industrial enterprises. Taking into account all these factors, an investment limit provides services to industrial enterprises. Taking into account all these factors, an investment limit of Rs. 25 lakh for tiny units is adjudged to be most appropriate. For small scale enterprises, the level should be immediately raised to Rs. 3 crore for the same reasons. "</p> <p>AbidHussain Committee Report</p> |

| YEAR | Ministry, Committee, Commission or Policies involved | SMALL SCALE INDUSTRY DEFINITION | Reasons and Comments |
|------|--|---------------------------------|---|
| | | | http://dcmsme.gov.in/publications/committerep/abid.htm |

1999

new Policy Initiatives in 1999 2000

Small industry
 a unit engage in manufacturing, repairing, processing and preservation of goods having investment in plant and machinery at an original cost not exceeding Rs. 1 crore

Investmentos0Tc0003T41Tf.225TD.0002Tc(and)

| YEAR | Ministry, Committee, Commission or Policies involved | SMALL SCALE INDUSTRY DEFINITION |
|------|--|------------------------------------|
|------|--|------------------------------------|

| YEAR | Ministry, Committee, Commission or Policies involved | SMALLSCALE INDUSTRY DEFINITION | Reasons and Comments |
|------|--|--|--|
| | | | <p>operationalised by SIDBI.</p> <p>Thus, it is felt that having a definition for industries falling under the medium and small scale sector would enable the Government and other authorities to work out definite plans for funding and promoting the industries falling under the category and nurturing them to grow into stronger and larger entities in the long run. “</p> <p>(http://www.thehindubusinessline.in/business/2004/06/08/stories/2004060801210500.htm)]</p> <p>SSI (small scale industries) sector will henceforth be known as SME sector (small and medium enterprises)</p> |
| 2006 | Micro, Small and Medium Enterprise Development (MSMED) Act, 2006 | <p><u>Manufacturing:</u></p> <p>Micro Does not exceed Rs.25 Lakh.</p> <p>Small More than Rs.25 lakh but does not exceed Rs.5 crore.</p> <p>Medium More than Rs.5 crore but does not exceed Rs.10 crore</p> <p><u>Service</u></p> <p>Micro Does not exceed Rs.10 Lakh</p> | <p>Enterprises were broadly classified into (1) Manufacturing enterprises and (2) Service enterprises. Both these were further categorized into Micro, Small and Medium Enterprises</p> <p>[“There was a long standing demand from entrepreneurs, small industry associations and related stakeholders for a single comprehensive legislation. The “Micro, Small and Medium Enterprises Development (MSMED) Act, 2006” is the first Act for micro, small and medium enterprises which inter alia, provides for establishment of a statutory National Board for Micro, Small and Medium Enterprises filing of</p> |

| YEAR | Ministry, Committee, Commission or Policies involved | SMALL SCALE INDUSTRY DEFINITION | Reasons and Comments |
|------|--|---|---|
| | | <p>Small More than Rs. 10 lakh but does not exceed Rs.2 crore.</p> <p>Medium More than Rs. 2 crore but does not exceed Rs. 5 crores</p> | <p>memoranda, measures for promotion, development and enhancement of competitiveness of micro, small and medium enterprises, credit facilities, procurement preference and provisions related to delayed payments to micro and small enterprises. The</p> |

| YEAR | Ministry, Committee, Commission or Policies involved | SMALL SCALE INDUSTRY DEFINITION | Reasons and Comments |
|------|--|---------------------------------|---|
| | | | <p data-bbox="894 384 1446 430">6 07 MajorInitiatives.pdf</p> <p data-bbox="894 504 1446 777">Note: Investment ceiling differences in manufacturing and service sectors are due to differences in fixed costs. Fixed costs incurred by the manufacturing sector is higher than that of the services sector</p> |

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