Indian Institute of Management Calcutta

Working Paper Series

WPS No. 759
February 2015

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

Anindya Sen
Professor, Indian Institute of Management Calcutta
D. H. Road, Joka, P.O. Kolkata 700 104

Partha Ray
Professor, Indian Institute of Management Calcutta
D. H. Road, Joka, P.O. Kolkata 700 104
http://facultylive.iimcal.ac.in/workingpapers

The Ascent and Decline of Reservation in Indian Small Scale Industries: Evolution of the Policy Environment[1]

AnindyaSen
Professor
Economics Group
IIM Calcutta
e-mail: asen@iimcal.ac.in

Partha Ray
Professor
Economics Group
IIM Calcutta
e-mail: pray@iimcal.ac.in

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 key role, in planning paradigm too, there was an emphasis on small scale industries that can be traced to its perceived higher employment intensity. Interestingly, the increasing emphasis on small scale industries in India has been accompanied by an increase in the number of reserved items under small scale industries (SSI). It started with 47 items in 1967 and came to cover 836 categories in 1998! With the initiation of economic liberalization during the 1990s, the list of reserved categories of SSI dwindled to around 20 by end of 2010. The present paper is a narrative account of this policy evolution. We find that while the number of reserved categories under small scale industries has come down the domain of small industries got extended to SME and finally to MSME. Besides, various preferential routes to factor market have been extended to the small industries sector. As an example, bank finance to the small scale sector is counted for the stipulated lending under priority sector. While these twin policy measures of de-reservation and preferential treatment seem to be in the right direction at the current juncture, it remains to be seen to be seen how long such preferential treatment should continue.

[1] Research assistance of Jayati Halder is gratefully acknowledged.

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

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 under exclusive production rights of small scale industries. The list of reserved items under small scale industries (SSI) was progressively extended – thus, what started with 47 items in 1967 came to cover 836 categories in 1998! With the dismantling of industrial licensing regime and initiation of economic liberalization during the 1990s, the process moved inthe opposite direction and the list of reserved categories of SSI dwindled to around 20 by end of 2010. In a parallel track there were huge definitional changes – the earlier notion of SSI came to be extended to small and medium enterprises (SME) and further to micro, medium and small enterprises (MSME). The philosophy of protecting and promoting small industries has been succinctly put in the following statement from the Report of the Expert Committee on Small Enterprises (1997; Chairman: Abid Hussain):

> "The arguments advanced in the literature for promotion of small-scale enterprises (SSE) involve both certain desirable characteristics of such enterprises (e.g. their labour intensity and related positive distribution effects, their flexibility, their potential contribution to decentralization, their promotion of entrepreneurship etc,) and a common belief that that under normal market conditions either too few, or the wrong combination of resources will be employed in such enterprises it is important to distinguish between the reasons why one hopes to see a flourishing small scale industry (SSI) sector (having to do with its positive features) and the need for sector specific support programs. Such programs are necessary if and when market imperfections may impede the sector's full flowering in the sense that the size of the sector is below the 'optimum' which might be reached in the absence of such imperfections. If markets and more general policies worked adequately, SSI might live up to its potential without any special support programs.The basic imperfection which might lead to a less than optimal size of SSI lies in the area of factor markets – of both labour and capital. It is argued below that in most economics – and in developing countries in particular – capital market imperfections are more basic to the non-optimal size of the SSI than labour market

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 Planning[2]

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 not from standard neo-classical economics (e.g., those being talked of at that time, like Marshall and Pigou) but from John Ruskin. Later, based on the data obtained from the Report of the Ambar Charkha Enquiry Committee (1956), Sen (1957) showed that, "The Ambar Charkha programme must have inflationary effects and will affect capital accumulation adversely …far from creating any flow of surplus, it produces a flow of output whose value is less than even the recurring- costs" (p. 1957).In other words, in terms of cost consideration viability of Gandhiankhadi programme could be seriously questioned.

Surprisingly, the other intellectual impetus for emphasizing small scale industries came from something which in popular parlance is often seen as an antithesis of Gandhian

[3]Available at http://www.gandhi-manibhavan.org/gandhiphilosophy

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, 1955). This model, unlike his two-sector model, in some sense, is more of an allocation –type planning model rather than a growth model.

Table 1: Mahalanobis Four Sector Model

	Sector Index	New Employment	Capital needed per worker	Total Capital Needed	Income Coefficient on Capital	Income generated
1. Investment Goods Industries	1	N_1	θ_1	$N_1\,\theta_1$	β_1	$N_1\theta_1\beta_1$
2. Consumer Goods Industries						
2.1 Factory type	2	N_2	θ_2	$N_2\,\theta_2$	β_2	$N_2\theta_2\beta_2$
2.2 Hand-type (inclAgri)	3	N_3	θ_3	$N_3\,\theta_3$	β_3	$N_3\theta_3\beta_3$
3. Services	4	N_4	θ_4	$N_4\,\theta_4$	β_4	$N_4\theta_4\beta_4$
Source: Mahalanobis, 1955						

Thus, essentially the four sector Mahalanobis model was to take care of the employment objective of the planning process. In the current scenario of "jobless growth", the growth of manufacturing sectors is viewed as an answer to the problem of increasing employment. But the earlier thinkers were not too sure of this solution. In fact, Singh (2008) in this context rightly noted:

> "An important drawback of the heavy-industry-biased industrial strategy is that itconflicts with the employment objectives embodied in the five-year plans. Theplans sought to square this circle by providing external (against foreigncompetition) and internal (against domestic competition) protection to a numberof small-scale and cottage enterprises for which the capital-labour ratio was very low. Thus, for instance, domestic modern textile factories were limited inhow much they could expand their output so that they would not compete withthe high-cost products of the cottage industries (p. 5).

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
[5] Chapter 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: Policy Initiatives since 1967

Beginning of Reservation

The most important policy towards the SSIs undertaken in this era was the reservation policy of 1967. Interestingly, Mohan (2001) observed:

> "A curious feature of this reservation policy introduced in 1967 was that it had no legal backing until 1984. It is a remarkable comment on the heavily regulated economy of the time that a draconian regulation such as this was not legally challenged. In was only in 1984 that the government plugged this legal inadequacy and put this policy on a statutory footing in the IDR Act".

In the 1967 policy, the professed objective was focused on "improving the competitiveness" of this sector. From the present vantage point, it is an example of an unthinking jargon by the bureaucracy. Increase in competition could not be achieved by reserving items for exclusive manufacturer and thereby restricting competition. The rationale was clearly some version of infant industry argument. To achieve this, the policy of reservation for exclusive manufacture in SSIs was initiated with 47 items reserved. The numbers gradually increased and by the end of 1970 the number of reserved items stood at 55.

The period from 1970 to 1990 can be considered as the golden era of reservation in favour of small scale sector (Table 2). The government decided to encourage small enterprises to build up managerial and entrepreneurial skills in the country .The focus of the government had shifted from agriculture to industry in the earlier years and finally moved to the social indicators. Small scale sector emerged as the hope of removal of not only the prevalent unemployment but also the widespread poverty. Throughout the period of 1970 – 90, almost every year this sector was subject to increased exemptions and concessions from various duties and taxes. The Jha committee report of 1980,New Scheme of Excise Concessions of 1986, Scheme of concession under MODVAT Scheme 1986 all these added to the duty exemptions already present. Allocation to this sector was revised upwards almost every year. Assistance to the small scale sector was extended even at the cost of huge loss in revenue. In short, in these years this sector was given every support and protection it needed to grow into the vibrant industry that the government had hoped for.

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-87			850
20-Jul-87		13	847
18-Mar-88		3	846
3-Mar-89	3	1	835
31-Jul-89	1	14	836
1990			836
1991			842
Source: Mohan (2002)			

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:

- Increase in limit of investment in the case of tiny units from Rs.1 lakh to Rs.2 lakhs;
- Increase in limit of investment in the case of small scale units from Rs. 10 lakhs to Rs. 20 lakhs; and
- Increase in limit of investment in case of ancillaries from Rs. 15 lakhs to Rs. 25 lakhs.

The change in investment limit was hoped to facilitate long overdue modernization of many existing small scale units and to help genuine small scale units to come up.

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 limit for tiny sector was enhanced to Rs. 25 lakh and that for small sector it was enhanced to Rs. 3 crore.

Simplification of Regulations

Despite the government support, industry players often complained of facing too many regulations. In the Industrial Policy Act of 1991, main thrust was given to simplify regulations and procedures of licensing, regulations and controlling. SSI's were exempted from licensing for all articles of manufacture. Investment ceiling to the tiny enterprises was raised irrespective of location, also the tiny sector along with the small units were given priority in raw material allocation. Equity participation by other industrial undertakings was allowed to a limit of 24 percent in shareholding in SSI's. To ease the problem of delayed payments to SSI's, factoring services were launched.

The following years SSI's received due attention of the government focusing on easing of credit flow to this sector which was reflected in the announcement of Seven Point Plan in 1995 focusing on setting up specialized branches to serve the needs of small scale units in 85 identified districts, and establishment of a Technology Development and Modernization Fund in SIDBI to finance quality projects and strengthen export capability of SSI's. Apart from the credit

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 SME sector. The committee suggested that the policy of protection be replaced by a policy of promotion with adequate supply of credit, technology assistance and low transaction cost. For the first time the policy of cluster was suggested in an expert committee report although almost 300 clusters unaided by the state were already operational at that time. Also the focus on Small Scale Industries was widened to include all Small Scale Enterprises.

Probably the most important suggestion in this report was the gradual abolition or phasing out of Reservation policy which had become inconsistent with the trade reform policy. In order to facilitate the phasing out of reservation, transitional arrangements were made such as increasing the investment limit of Small Scale sector to 3 Crores and excise incentives for graduating tiny and small scale units. Several other financial support like restructuring SFCs and SIDCs, reducing credit costs for SSEs and support for technological development were also recommended in the report.

Policies to cope with competition

The ongoing programme of economic reforms and changes in the international front including the emergence of WTO had brought many new opportunities as well as challenges for the SME sector. The most important challenge was the competition faced by this sector both locally and globally. At the same the sector was facing some problems which related to credit, infrastructure, technology, marketing, delayed payment hassle on account of so many rules and regulations etc. .

Till then SIDBI was a subsidiary of IDBI and IDBI was a major share holder in State Finance Corporations. To equip SIDBI to play its apex role in SSI credit provision more effectively, SIDBI was delinked from IDBI in 1998.

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 the scope of technology up-gradation and sectoral priorities. The Third Census for SSI's sector was conducted which covered the sickness and its causes in SSI's. A scheme of granting Rs. 75,000 to SSI's for obtaining ISO 9000 certification was continued till the 10th plan. Initiative was taken to define the Medium sector for the first time in 2000.

Launching of Market Development Assistant Scheme exclusively for the SSI sector was announced in the Industrial Policy Package of 2001. 417 Specialized branches were made operational for SSI's, 60 clusters were identified for focused development, and a Small and Medium Enterprises Fund was setup under SIDBI to solve the problem of inadequate finance for SSI as per the Industrial Policy on SSI's, 2003 – 04. Policy Initiative on SSI on 2004 suggested setting up of National Commission on Enterprises to propose measures to improve productivity of these enterprises, employment generation, linkages etc. Promotional packages for SME'S were also initiated.

The Policy package for SME, 2005 – 06 laid emphasis on cluster development not only to promote manufacturing but also to renew industrial towns.Small and Medium Enterprises were identified in the service sector and were treated at par with the SSIs in manufacturing sector.

Recent Policy Initiatives

The MSME Act, 2006, was another major reference point while tracing the policy initiatives for the SME sector. Medium sector was defined for the first time in India and Micro sector was defined for the first time in this act. This Act provided for the establishment for the National Board for Micro, Small and Medium Enterprises.The Government with an objective to support the manufacturing sector enterprises (particularly the small and medium enterprises) in their endeavor to become competitive, announced in 2005-06 the formulation of "National Manufacturing Competitiveness Programme" (NMCP).In order to assist the micro and small enterprises in fully harnessing their potential by enhancing their competitiveness to face the challenges of stiff competition (both in the domestic and global market)and in availing

opportunities generated by trade liberalization, the Government in the NCMP declared that a major promotional package" will be announced for this segment to provide full support in the areas of credit, technological up-gradation, marketing and infrastructure up-gradation in major industrial infrastructure.

In 2009 export slowdown had affected this sector adversely. In order to support the sector the Government proposed to create a special fund out of RIDF to SIDBI. This fund would incentivize banks and SFCs to lend to Micro and Small Enterprises by refinancing 50 per cent of incremental lending to MSEs in the year 2009.

Measures for promotion and development

The Government has over the years formulated several policies to ensure vitality and competitiveness in the SSIs. Policy of reservation was one such policy. Under reservation policy some selected items were identified to be exclusively manufactured in the SSI sector. The reservation policy started in 1967 with just 47 items in the list which increased to 504 in 1978. After the introduction of National Industrial Classification (NIC) code the list was recast. As a result, the list of reserved items expanded from 504 to 807 in 1978 and was 836 in 1989.Throughout the 90's the number of reserved items had a general increasing trend. But in accordance with Abid Hussain Committee report, gradual phasing out of reservation started with de-reservation of few items every year since 2000.

Government Store Purchase Programme was initiated in order to aid small scale sector in marketing their products at remunerative prices. Under this policy items were reserved to be bought exclusively from SME units. According to New Policy Initiative of 1999 the investment ceiling for small scale industries was decreased from 3 crore to 1 crore.

Throughout these years the 'medium 'sector had been vaguely present but not officially defined. In 2001 there was a proposal to define 'medium' sector. The absence of such definition had led to a situation where funds allotted for the small and medium sector could not be utilized by small sectors who had graduated to 'medium' sector. In 2001, on the basis of SIDBI's proposal the medium sector was proposed to be such unit whose investment in plant and

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
	Medium Enterprises	More than two crore rupees but does not exceed five core rupees

Move towards De-reservation

Thus, by 1990s, it was clear that the policy of reservation had failed to deliver. This became clear both from academic literature as well as successive government reports. Illustratively, using second census data Sandesara (1993) found that capacity utilization in 1987-88 and aggregate change in production in 1987-88 were both lower for reserved than for unreserved items and suggested that major factor behind such a performance of reserved industries is excess entry of small firms into these protected sectors.[6]Morris et al (2001) surveyed around 1200 SSI units and demonstrated that production of reserved items grew at a retarded rate to that of other producers in the SSIs. Mohan (2002) in a well-documented study

[6]Shridharan (2002) found that only four industry groups account for two-thirds of reserved products, implying that reservations were decided on the basis of the most vocal campaigners rather than a sound analysis of items appropriate for small-scale production.

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 manufacture in micro and small enterprise sector now stands at 20 only (Table 4).

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 & Medium Enterprises, Annual Report, various Issues.	

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 de-reservation of the sectors under SSI / SME / MSME, and on the other, various routes of preferential treatment have been extended to the small industries sector. Illustratively, bank finance to the small scale sector is counted for the stipulated lending under priority sector. While these twin policy measures of de-reservation and preferential treatment seem to be in the right direction at the current juncture, it remains to be seen to be seen how long such preferential treatment should continue. But, such questions are beyond the scope of the present paper.

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	**Tiny industry** – investment <= 1 lakh or Rs.4000 per worker ,and annual turnover <= Rs.5 lakh **Small industry** – investment strictly <= Rs. 7.5 lakh **Ancillary industry** – investment <= Rs. 10 lakh	**Small Scale industries** were **classified** under 3 categories such as **Tiny, Small, Ancillary Industries.** The term **Small Scale Industries** to be replaced by **Small Enterprises**
1980	The Industrial Policy of 1980	**Tiny industries** are those whose investment is not more than Rs. 2 lakhs **Small industries** are those whose investment limit is of Rs.20 lakh	**"**This would eliminate the tendency to circumvent the present limit by understating the value of machinery and equipment, falsification of accounts or resort to 'benami' units. The enhancement of the limit in terms of

YEAR	Ministry, Committee, Commission or Policies involved	SMALL SCALE INDUSTRY DEFINITION	Reasons and Comments
		Small ancillaryindustries are those whose investment are not more than Rs.25 lakh	investment in plants and machinery will also help genuine small scale units particularly those being set up by young and technically qualified entrepreneurs, to come up. This measure will also facilitate long over due modernisation of many of the existing small scale units.**"** Industrial Policy Resolution 1980 http://dcmsme.gov.in/policies/iip.htm#Indus4
1985	The Industrial Policy Statement of 1985	**Small industries** - Investment ceiling for such industries was Rs.35 lakh **Small ancillary industries** – Investment ceiling was of Rs.45 lakh	**"The** Industrial Policy Statement of 1985 made incremental changes and took into account the impactof inflation. **"** GENERAL REVIEW STUDY OF SMALL & MEDIUM ENTERPRISE(SME) CLUSTERS IN INDIA www.unido.org/fileadmin/import/userfiles/russof/small.pdf
1990	Industrial Policy Resolution of 1990	**Small industries** - Investment ceiling for such industries was Rs.60 lakh **Small ancillary industries** – Investment ceiling was of Rs.75 lakh	**"**The investment ceiling in plant & machinery for small scale industries (fixed in 1985) would be raised from the present Rs. 35lakhto Rs. 60lakhand correspondingly, for ancillary units from Rs. 45lakhto Rs. 75 lakhs. In order to enable small scale industries to play an important role in the total export effort, such of the small scale units which undertake to export at least 30 per cent of the annual production by the third year will be permitted to step up their investment in plant & machinery to Rs. 75 lakhs. Investment ceiling in respect of tiny units would also be increased from the present Rs. 2lakhto Rs. 5 lakhs.

YEAR	Ministry, Committee, Commission or Policies involved	SMALL SCALE INDUSTRY DEFINITION	Reasons and Comments
			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. **"** INDUSTRIAL POLICY 1990 POLICY MEASURES FOR THE PROMOTION OF SMALL SCALE AND AGRO-BASED INDUSTRIES AND CHANGES IN PROCEDURES FOR INDUSTRIAL APPROVALS http://dcmsme.gov.in/policies/iip.htm#Indus5
1997	The Government on recommendation of Abid Hussain Committee	**"Tiny " enterprises -** Investment not more than Rs.25 lakh **Small and Ancillary industries –** Investment in plant and machinery not more than Rs.3 Crores.	**"**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. **"** AbidHussain Committee Report

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	**Investment limit** in plant and machinery for small scale units was **decreased from Rs. 3 crore to Rs.1 crore.** This decision has been notified vide Order No. S.O. 1288(E), dated 24th December, 1999. **"**The Central Government considers it necessary with a view to ascertain which ancillary and small scale industrial undertakings need supportive measures, exemption or other favourable treatment under the Industries (Development and Regulation) Act, 1951 (65 of 1951) (herein after referred to as the said Act) to enable them to maintain their viability and strength so as to be effective in- a. promoting in a harmonious manner

YEAR	Ministry, Committee, Commission or Policies involved	SMALL SCALE INDUSTRY DEFINITION	Reasons and Comments
			the industrial economy of the country and easing the problem of unemployment, and b. securing that the ownership and control of the material resources of the community are so distributed as best to sub serve the common good;…….In the said Order,- a. In the paragraph relating to Small Scale Industrial Undertaking, for the words "rupees three crores", the words "rupees one crore" shall be substituted; and b. In the paragraph relating to Ancillary industrial undertaking, for the words "rupees three crores", the words "rupees one crore" shall be substituted. **"**http://dcmsme.gov.in/publications/circulars/cirular1.htm
2001	On the basis of SIDBI 's proposal through the Finance Ministry	**Tiny industry** – investment limit remain unchanged at Rs. 25 lakh. **Small industry** – One with investment in plant and machinery not exceeding Rs 1 crore . **Medium industry-** one with investment in plant and machinery of Rs 1 crore to Rs 10 crore.	**Medium scale enterprise defined for the first time,** **[**"The absence of the definition had led to a situation where funds dedicated ostensibly for the SME sector, such as the Rs 10,000-crore SME fund announced by the NDA Government, could not be utilised for funding the companies that would now fall into the medium sector after the new definition comes into play. The SME fund is being

YEAR	Ministry, Committee, Commission or Policies involved	SMALL SCALE INDUSTRY DEFINITION	Reasons and Comments
			operationalised by SIDBI. Thus, it is felt that having a definition for industries falling under the medium-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. **"** (http://www.thehindubusinessline.in/bline/2004/06/08/stories/2004060801210500.htm)**]** **SSI** (small scale industries)sector will henceforth be known as **SME** sector(small and medium enterprises)
2006	Micro, Small and Medium Enterprise Development (MSMED) Act, 2006	***Manufacturing:*** **Micro** - Does not exceed Rs. 25 Lakh. **Small** - More than Rs.25 lakh but does not exceed Rs. 5 crore. **Medium** - More than Rs. 5 crore but does not exceed Rs. 10 crore ***Service :*** **Micro** - Does not exceed Rs. 10 Lakh	Enterprises were broadly classified into **(1) Manufacturing enterprises and (2) Service enterprises.** Both these were further categorized into **Micro , Small and Medium Enterprises** **["**There was a longstanding demand from entrepreneurs, small industry associations and related stakeholders for asingle comprehensive legislation. The"Micro, Small and Medium EnterprisesDevelopment (MSMED) Act, 2006" is the firstAct for micro, small and medium enterpriseswhich, inter alia, provides for establishmentof a statutory National Board for Micro, Smalland Medium Enterprises, filing of

YEAR	Ministry, Committee, Commission or Policies involved	SMALL SCALE INDUSTRY DEFINITION	Reasons and Comments
		Small - More than Rs. 10 lakh but does not exceed Rs.2 crore. **Medium** - More than Rs. 2 crore but does not exceed Rs. 5 crores	memoranda, measures for promotion, development and enhancement of competitiveness of micro, small and mediumenterprises, credit facilities, procurementpreference and provisions related to delayedpayments to micro and small enterprises. The medium sector has been defined for thefirst time in India and Micro enterprises havebeen defined for the first time in this Act. Under the MSMED Act 2006, the earlier, rather limited, concept of 'Industries' has been widened to that of 'Enterprises'. Enterprises have been classified broadly into two categories, namely enterprises engaged in the manufacture/production of goods pertaining to any industry; & enterprisesengaged in providing/rendering of services. Enterprises have been defined in terms ofinvestment in plant and machinery/ equipment (excluding land & building) **"** http://www.msme.gov.in/ssi-ar-eng-2006-07.pdf **"**In the changed economic scenario of liberalisation and globalisation and with a view to increasing the competitiveness of manufacturing small scale industries, the investment limit in respect of 71 products has been enhanced to Rs.5 crore to enable the units manufacturing these products to carry out technological upgradation and modernisation of their units.**"** www.msme.gov.in/OutcomeBudget200

YEAR	Ministry, Committee, Commission or Policies involved	SMALL SCALE INDUSTRY DEFINITION	Reasons and Comments
			6-07-MajorInitiatives.pdf] **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

References

Bhati, S. S. (2002): "India: The Role of Small-Scale Industries in An Emerging Economy", in C. Harvie& B. C. Lee (Eds.), *Sustaining SME Innovation, Competitiveness and Development in the Global Economy*, 12-13 July 2002 (pp. 1-18). University of Wollongong: Centre for SME Research & Development.

Debroy, Bibek, AmareshDubey, LaveeshBhandari, and MridusmitaBordoloi (2006): "Small Sector in India: Status, Growth and De-Reservation", AStudy Conducted by, Rajiv Gandhi Institute for ContemporaryStudies, available at http://dcmsme.gov.in/reports/SmallSectorInIndia08.pdf

Government of India, Ministry of Micro, Small & Medium Enterprises (2009): Annual Report 2007-2008.

Mohalanobis, P (1955): "The approach of Operational Research to Planning in India", *Sankhya,* Vol 16, Parts 1 & 2, pp 3-62.

Morris, S. et al., 2001.*The Growth and Transformation of Small Firms in India*. Oxford, New Delhi

Rivett, Kenneth (1959): "The Economic Thought of Mahatma Gandhi", *British Journal of Sociology*, Vol. 10, No. 1, pp. 1-15.

Sandesara, J C (1993): 'Modern Small Industry, 1972 and. 1987-88: Aspects of Growth and Structural Change', *Economic and Political Weekly*, February 6.

Sen, Amartya (1957): "A Short Note on the *Ambar* Charkha", *Economic Weekly*, October 19.

Singh, Ajit (2008): "The Past, Present and Future of Industrial Policy in India: Adapting to the Changing Domestic and International Environment", Working Paper No 376, Centre for Business Research, University of Cambridge.

Subrahmanya, M H Bala (1995): "Reservation Policy for Small-Scale Industry: Has It Delivered the Goods?",*Economic and Political Weekly*, May 27.

*****