

RESERVATION POLICY AND ITS INFLUENCE ON THE MSMEs IN INDIA DURING PRE AND POST GLOBALISATION ERA: A STUDY

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Abstract: Micro, Small and Medium Enterprises (MSMEs) have become a vital medium for economic development for the policy makers since independence. As the sector is highly sensitive in nature it was supported by a number of protection measures to safeguard the sector from stiff market competition. Reservation Policy introduced in 1967 is one of such policy measures under which a number of items were reserved for exclusive production/manufacture by the MSMEs. No other sectors can manufacture such reserved items unless they undertake 50 percent of export obligations of such items. This paper is a modest attempt to study the effects of Reservation Policy on the MSMEs during the pre and post liberalization and the rationale of gradual withdrawal of the policy during the post liberalization period. The period of study is from 1967 to 2015 i.e. from the year of introduction of the Reservation Policy to the year of withdrawal of the policy. The period from 1967 to 1990 has been termed as Reservation Period and the period from 1991 to 2015 as the De-Reservation Period. The study is based on secondary data collected from the Annual Reports published by the Ministry of MSMEs in different years. From 1967 to 1990 i.e. the pre-liberalisation period a significant number of items were included in the reserved list to protect the MSMEs from the imperfections in factor market, labour, capital and land. However, from 1997 onwards i.e. the post liberalization period the protection policies were replaced by promotional measures and a number of items were de-reserved to increase the competitiveness of the sector and enable the consumers to get the best quality of products at a competitive price. The policy was totally withdrawn by the Govt. in 2015 by de-reserving all the reserved items as the performance of the MSMEs during the reservation period has not been satisfactory and the policy adversely affected the manufacturing employment and export growth of the MSME sector. The Govt. is on the right direction by de-reserving a number of items in the reservation list in a phased manner and substituting the protection measures by the promotional measures.

Index Terms - Globalisation, Liberalisation, Micro, Small and Medium Enterprises (MSMEs), Protection, Promotion, Reservation Policy, Quantitative and qualitative Restrictions (QRs).

I. INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) have become a vital medium for economic development for the policy makers since independence. This sector has the capability to generate employment and remove uneven distribution of wealth by utilization of regional resources (Lahiri, Rajib 2014). As the sector is highly sensitive in nature, it requires careful policy initiatives by the policy makers. The initial thought just after independence was to protect and allow sufficient time to the sector to be self-reliant and various protective measures were followed by the Govt. The Reservation Policy introduced in 1967 is one of such protection measures. However, with the tide of globalization since 1991 the Reservation Policy lost its importance and withdrawn in 2015.

II. OBJECTIVE OF THE STUDY

- To present a brief account of Reservation Policy from 1967 to 2015
- To analyse the effect of reservation policy on the MSME sector during pre and post liberalization period

III. LITERATURE REVIEW

Sandesara, J.C (1993) compared the performance of the Small Scale Industries (SSIs) producing the reserved items and the SSIs producing non-reserved items. Surprisingly, the SSIs producing non-reserved items showed a better performance. Sandesara argued that the SSIs suffer from lack of competitiveness due to reservation policy.

Debroy et al (2006) observed that the reservation policy lost its importance in the era of liberalization as only one-fifth of the total SSIs produce reserved items. Such SSIs generate only one-sixth of the total employment and contribute in one-twentieth of total SSI export. Thus, the impact of the policy is significantly low on the SSI sector.

Sen & Ray (2015) studied the pattern of rise and fall of the items reserved from 1967 to 2011. The study showed that the number of reserved items increased from 1967 to 1990. From 1997 onwards de-reservation policy got more attention following the effect of globalization in Indian economy. They argued that reservation policy failed to deliver expected results and protection policies were replaced by promotional measures.

IV. METHODOLOGY AND DATA SOURCE

The period of study is from 1967 to 2015 as the Reservation Policy was introduced in 1967 and withdrawn in 2015. The entire study period is divided into two periods: Pre- liberalization i.e. Reservation Period and Post Liberalisation i.e. De-Reservation Period. 1967 to 1990 has been termed as the Reservation Period and 1992 to 2015 as the De-Reservation Period. The study is based on secondary data and collected from the Annual Reports of MSMEs (relevant years) and information supplied by various authors in different books, articles and working papers.

V. RESULTS AND DISCUSSION

5.1 Concept of Micro, Small and Medium Enterprises (MSMEs)

The Small Scale Industries (SSIs) have undergone many changes in definition. In 2001, on the basis of SIDBI's proposal the medium sector with the value plant and machinery more than Rs. 1 crore but less than Rs. 10 crore has been included in small scale sector and the sector was renamed as Small and Medium Enterprises (SMEs). However, in 2006 a more comprehensive definition of the sector was introduced and the sector was renamed as Micro, Small and Medium Enterprises (MSMEs) as per the following levels of investment:

Table 1: Investment Limits in MSMEs (As per MSMED Act, 2006)

Manufacturing Sector	
Enterprises	Investment in Plant & Machinery
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
Service Sector	
Enterprises	Investment in Equipments
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 crore rupees

Source: Ministry of Micro, Small and Medium Enterprises (MSMEs), Government of India, Annual Report 2011-12 (Assessed from www.msme.gov.in)

5.2 Reservation Period and De-Reservation Period

The Reservation Policy was introduced in 1967 though the policy did not have any statutory backing (Mohan, 2002). In 1984 the policy was put under legal cover through IRD Act. The main concept of the policy is to earmark and reserve certain items for exclusive production/manufacture for the small industries. However, the non-SSI firms can produce such products provided they undertake 50 percent of export responsibilities of such products.

The chief reason for implementation of the policy as mentioned in 1967 was to increase competitiveness of the sector. However, it seems confusing as reservation policy is a protection policy not likely to increase competitiveness rather safeguards the sector from outside competitions (Sen & Ray, 2015). Therefore, the rationale was to protect the SSIs at the initial stages after independence. It was presumed that after almost 200 years of British rule the sector was not prepared to compete with the other industries and need adequate time to build infrastructure. Moreover, the imperfections in factor market, labour, capital and land affect the small industries more than the large industries as the large industries are better equipped to handle those imperfections. Therefore, the small enterprises were given some additional benefits through the implementation of reservation policy and few other protective measures.

Table 2: 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), Sen & Ray, 2015

Table 2 shows that the reservation process was started in 1967 and the maximum reservation was done in 1978 (1131 items) due to highly protective nature of Industrial Policy Statement 1977. In this statement it was decided that a product would qualify in the reservation list if it is physically manufactured by the SSI sector. From 1967 to 1990, 842 items were put into reservation list. Thus, this period (1967 to 1990) was the golden era of reservation for the SSIs as the number of items in the reservation list was increased in almost every year, many duty exemptions were allowed and budgetary allocations were increased in spite of loss in revenue. The focus of the policy makers was shifted from agriculture to the SSI sector. This sector was used as the solution of unemployment and widespread poverty (Sen & Ray, 2015). Thus, the period from 1967 to 1990 has been identified as the Period of Reservation where the main thrust of the policy makers was to develop the SSI sector by protecting the sector.

The signs of globalization were evident in India since 1991. Globalisation process advocates a free economic system without any hindrance or barriers among the different states or countries. Keeping in mind the impact of globalization several Quantitative and Qualitative Restrictions (QRs) were withdrawn (Lahiri, Rajib 2014). The main highlights of the Industrial Policy Act, 1995 were to exempt the SSIs from licensing for all articles of manufacture, increase the ceiling of investment of tiny units, allow 24 percent of equity participation in SSI units and introduce factoring system to prevent delayed collection of dues. All such measures were taken to prepare the MSMEs to absorb the shock of globalization and replace the protection measures with promotional measures. The Abid Hussain Committee (1997) observed that the reservation policy had become irrelevant in the context of globalization and should be withdrawn gradually. The committee suggested that the withdrawal of reservation policy must be supported by infrastructural development, adequate supply of credit and technological upgradation.

Table 3: De-Reservation of the MSME sector from 1993 to 2015

Year	Items under Reservation	No. of items De-reserved
1993	842	-----
1994	836	06
1995	836	NIL
1996	836	NIL
1997	836	NIL
1998	836	NIL
1999	821	15
2000	812	09
2001	812	NIL
2002	748	64
2003	675	73
2004	605	70
2005	506	99
2006	398	108
2007	239	159
2008	35	204
2009	21	14

2010	21	NIL
2011	20	01
2015	---	20
Total items de-reserved		842

Source: Ministry of Micro, Small and Medium Enterprises (MSMEs), Government of India, Annual Report (Relevant Years), Results Computed

As per Table 3, in 1993 842 items were in the reservation list for exclusive manufacture by the SSIs and by the end of 2015 the reservation policy was totally withdrawn by the Govt. as the remaining 20 items were de-reserved in 2015. The de-reservation process started since 1994 and got its momentum since 2002. The maximum de-reservation took place in 2008 as a result of implementation of Micro, Small and Medium Enterprises Development Act, 2006 and re-classification of the sector as MSMEs. The table reveals that the reservation policy has lost its existence.

5.3 Appraisal of the Reservation Policy

The Reservation Policy created a platform in which the SSIs got adequate opportunity to maintain their existence and get rid of outside competition. It was believed that the performance of the sector would improve if they were given exclusive right in production of reserved items. Unfortunately, the policy did not give rich dividends as the performance of the sector was not satisfactory considering the quantum of facilities given to the sector. The policy reduced the efficiency of the sector as the MSMEs did not feel the urge to increase their competitiveness (Little et al, 1987). The quality of the reserved products also deteriorated as there were no competitors of SSIs in production of these commodities. The awareness about the policy was poor as a number of SSIs are totally ignorant that they were producing reserved items. Surprisingly, many SSIs producing reserved items performed poorly than the SSIs producing non-reserved items (Morris et al, 2001). The Reservation Policy has adversely affected the manufacturing employment and export growth in the MSME sector. The damage caused by such policies was not much identifiable in 1970 as the degree of competition in export was not much intensified. Today with the change in taste and preference of the consumers, increasing level of income especially in the developed countries the export products must be of industry standard. The Indian SSIs failed miserably in this regard due to lack of competitiveness prevailing in the sector over a long period of time (Mohan, 2002). Thus, the Reservation Policy does not fulfill the needs of the MSME sector in the liberalized economy.

VI. CONCLUSION

Reservation Policy is not in coherence with the modern age of liberalization. The policy undoubtedly helped the MSMEs to strengthen their existence and protect the units from ruthless outside competition. However, the MSMEs suffered from the lack of competition and the consumers were deprived of best quality of products at a competitive price (Lahiri, Rajib 2014). The MSMEs did not show encouraging performance after enjoying reservation policy benefits for a long period of time. Moreover, the Govt. cannot safeguard the MSMEs always from outside competition. The political motivation on frequent addition of items in the reservation list cannot be denied. A few industry groups enjoyed the majority of the reserved items. This implies that the reservation was granted to satisfy the demands of the powerful industries and not on the basis of sound analysis of items appropriate for small-scale production. The sector must be made self-sufficient by supply of credit, state of art technology, entrepreneurship training. Thus, the Govt. is on the right direction by de-reserving a number of items in the reservation list in a phased manner and substituting the protection measures by the promotional policy initiatives.

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