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Missing middle' and the Indian economic slowdown: A causal study

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Abstract
Growth and development in all major economies across the globe, is supported by the three pillars which comprise of agriculture, manufacturing and services. All the three sectors are important and the general progression in an economy as it develops is a move from the primary sector to the secondary and then to the tertiary sector. Industry plays a vital role in the growth and development of a country. Industrial growth the quality of life would lack basic necessities. Agriculture, by and large, offers the essentials of life. Industry, on the other hand, caters to diverse human needs, improving life much beyond the parameters of survival. Industrialisation enhances productivity, raises per-capita income and accelerates saving and capital formation and increases employment.

Missing middle is the middle sector of the economy, or the industrial and manufacturing sector, which has been conspicuous with its absence or lack of strength in the Indian economy on the basis of its contribution to GDP and Employment. Secondly 'missing middle' is the missing or absence of the medium-sized industries in the Indian Industrial sector. India is unique in having jumped from the agriculture sector to the services sector of the economy.

Objective of this study is to examine the 'missing middle' as a cause of economic slowdown. This study also tries to analyse the reason behind the 'missing middle' and tries to explore the cause for the 'middle middle' in the Indian economy. Research is designed through secondary data sourced from the Indian economic survey, World Bank, and other sources to find the impact and cause for the 'missing middle' situation on the Indian Economy as a whole.

'Missing middle' is a cause of concern for the Indian Economy. Contribution of industrial and manufacturing sector could have and should have been large and is a lacuna which it alone can fill and provide a much-needed fillip to the slowing Indian economy.

Keywords: manufacturing sector, indian economy; slowdown in growth; employment

1. Introduction

India's future growth depends critically on the nation's ability to populate its missing middle—the medium-sized producers and middle class of consumers. The greatest numbers of Indian businesses are small or microenterprises, many operating in the informal economy and not contributing to India's tax base.

The causes of the missing middle relate to government policies, such as a i) growth-stifling regulatory environment; ii) India's large population of individuals living below the poverty line; iii) perhaps of most concern for its pervasiveness, poor performance on human development measures; iv) an inadequate supply of skilled workers and low production output. The two important factors contributing to an inadequate labour supply are a) a deficit in education despite a generally adequate number of school buildings along with b) the low participation of women in the paid workforce are.

Without a middle class of producers (income earners), there is no middle class of consumers. A 2015 Pew Research Center survey found that less than 3 percent of the total population of India had incomes sufficient to be classified as middle class. In turn, the poor performance of India on labor market metrics suggests an extended period of drag on the national economy. As India stumbles toward crafting its missing middle, a generation or more is likely to pass before positive effects are felt in the market.

Small and Medium Enterprises (SME's) is really important for the Indian economic growth as it constitutes about 95% of all industrial units in the country and contributes more than 40% to the domestic industrial output. There are many issues related with the SME's like financial gaps, adequate, timely and cost-effective credit availability, access to equity, risk capital and financing innovation. In 1998, SME's and Global Value Chain defined what value chain is and how it is relevant for the SME's - where internationalization of manufacturing processes and which is to be conducted in several countries in different stages and production is located in different countries based on the low cost or the cost efficiency in different countries as a result of which individual countries get independence in terms of having their specialization in very specific segments of a particular commodity. According to (Niti Aayog 2016) [13], Government intervention in the form of strong infrastructure, strong science and technology, strong innovations is important to promote India's performance in GVC exports.

The objective of this study is to examine the 'missing middle' as a cause of economic slowdown. This study also tries to analyse the reason behind the 'missing middle' and tries to explore the cause for the 'middle middle' in the Indian economy. Research is designed through secondary data sourced from the Indian economic survey and other research sources to find the impact and cause for the 'missing middle' situation on the Indian Economy as a whole.

2. Review of Literature

Reviewing the sectors of the Indian economy to understand the 'missing middle': The Industrial sector led the GDP growth during the initial three decades of the development process after independence, with a growth rate of above 5.3% as against overall growth of 3.7%. It laid the foundation for production of basic and capital goods following the Mahalanobis model of growth. The share of Industry in GDP increased from 16 percent to 26 percent during this period. Industry lost its leading position later on. Industrial share fluctuated between 25 percent and 28 percent since 1981. Global economic trend in 2019-2020 has been slowest since the financial global crisis which led to softening of the Indian economy. Trade tensions have given their contribution too. With weakening global economic activity, inflation was muted leading to slack in consumer demand. Global slack in consumer demand affected industrial activity. In particular the automobile industry suffered due to decline in global demand mainly due to a change in technology and emission standards in many countries. Slowing economies led to drop in growth of manufacturing exports (GOI, 2020a) [7].

Service growth has been a major driver of growth in India during the last three decades with its share in GDP is rising from 38% in early 1980-81 to 53% in 2015-16. Moreover, the service sector employs 31% of the labour force (Panda, 2017) [10]. Service sector's significance has continually been increasing in the Indian economy, with the sector accounting for 55% of the total size of the economy and GVA growth, two thirds of total FDI inflows into India and 38% of exports (GOI, 2020b) [8].

Agriculture income growth has been low on a medium to long term basis. Known for its supply constraint, it has rarely attained a growth rate of 4 % on a five-year average. Recent food price inflation indicates that supply is lagging behind by the demand generated by the growth pattern as well as changing demand patterns. Agriculture production is shifting in favour of non-food grains (Panda, 2017) [11]. "Agriculture Development is essential for improving industrialization. Generally, the share of agriculture in total employment falls more slowly than its share in GDP. As a result, labour productivity falls behind that of non-agriculture sector. Although employment elasticity in agriculture declines over time, the absolute size of rural labour force continues till economies attain higher levels of transformation. Labour productivity in agriculture can be increased with structural change in agriculture development of rural non-farm sector or migration to urban areas." (Dev, 2018) [6] Migration increases with industrialization opportunities.

Sectoral Developments are dependent on movement of resources across sectors due to relative prices. Different sectors therefore grow at different rates. Share of agriculture and allied sectors (forestry and fishing) in the total GVA of the country has declined from 2009-14 to 2014-19 from 18.3 % to 16.1%, due mainly to higher growth performance of the service sector. This is a natural outcome of development process. The contribution of industrial sector to GVA has also declined from 2009-14 to 2014-19.

From 32.3% to 29.6%. The service sector has moved ahead faster distancing itself from Agriculture and industry. The contribution of service sector to GVA has increased from 2009-14 to 2014-19 from 49.4 % to 54.3%, (GOI, 2020a) [7].

3. Objective of Study

This study tries to analyse the reason behind the 'missing middle' and tries to explore the cause for the 'middle middle' in the Indian economy.

4. Hypothesis

H_1 = 'Missing middle' in form of lack of Manufacturing Industries development in comparison to Agriculture base and contribution and Services base and contribution is starkly visible in India

H_{a1} = 'Missing middle' in form of lack of Manufacturing Industries development in comparison to Agriculture base and contribution and Services base and contribution does not exists in India

H_2 = 'Missing middle' in form of lack of medium size industries in comparison to small sized industries and large sized industries exists in India

H_{a2} = 'Missing middle' in form of lack of medium size industries in comparison to small sized industries and large sized industries exists in India

5. Research Design

The area of study is Agriculture, Manufacturing and Service sector. The data is secondary and is collected from the Indian economic survey, World Bank, and other sources. These are analysed with the help of tables primarily

6. Analyzing the 'Missing Middle'

Missing middle is analysed on the basis of the following aspects

1. 'Missing middle' in form of lack of Manufacturing Industries development in comparison to Agriculture base and contribution and Services base and contribution
2. 'Missing middle' in form of lack of medium size industries in comparison to small sized industries and large sized industries.
3. The Causal factor which includes analysis of a) productivity differentials in manufacturing compared to the service sector and other emerging Asian economies; b) other causes for the manufacturing sector to have lagged behind

i. **Analysing the 'Missing Middle' in form of lack of Manufacturing Industries in the Indian economy:** The glaring missing middle problem is addressed through various tables which present one of the core reasons for the economic slowdown in the Indian Economy. Missing middle is the middle sector of the economy, or the industrial and manufacturing sector, which has been conspicuous with its absence or lack of strength in the Indian economy on the basis of its contribution to GDP and Employment. Secondly 'missing middle' is the missing or absence of the medium-sized industries in the Indian Industrial sector. India is unique for having jumped from the agriculture sector to the services sector of the economy.

Table 1: Balassa Index of Revealed Comparative Advantage (RCA)

Year	Agriculture	Manufacturing	Manufacturing and Commercial Services
2011	1.06	0.82	1.05
2012	1.33	0.81	1.06
2013	1.37	0.80	1.03
2014	1.24	0.83	1.05

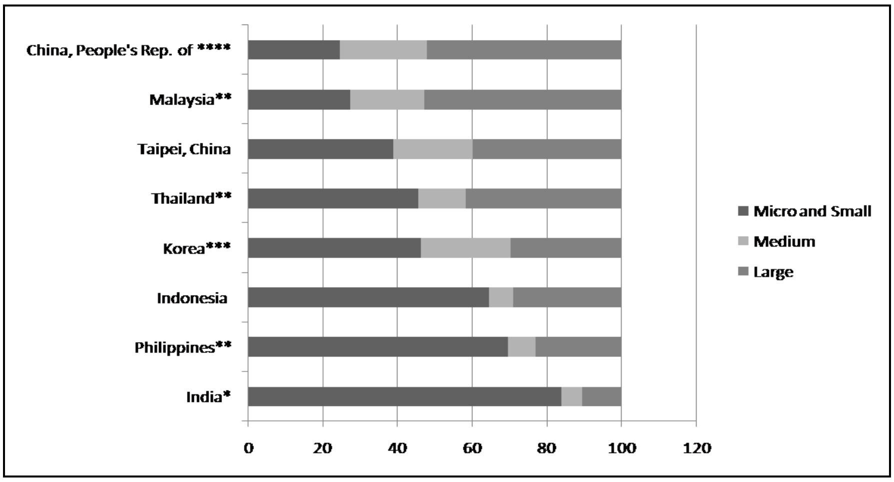
Source: Gulati & Saini 2017

Estimates of the Balassa Index of Revealed Comparative Advantage (RCA) suggest that Indian Agriculture and Services outshine Manufacturing Sector of India on a global platform.

Reasons for the 'missing middle' as missing in industrial sector are emphasized and proved by Bhagwati and Panagariya (2012) [4]. The causes for flight of Indian entrepreneur from labour is due to a) Slow growth of manufacturing, unlike the common feature in fast growing emerging economies in Asia and earlier in Europe and USA, of a trajectory from agriculture towards manufacturing, India exhibited a growth in services rather than in manufacturing. The share of manufacturing in GDP fell from 16.8% in 1980-82 to 15% in 2008-09. Bhagwati and Panagariya (2012) [4] blame b) multitude of labour laws for the missing industries in India. Additional layers of protection, regulations, barriers discourage emergence of labour intensive manufacturing in India. Apart from 52 independent central government laws in the area of labour in India, there are 150 state-level laws in India. the burden of labour laws rises with the increasing number of workers employed. Six or less workers are safer to employ thus a preference for small sized firm is prevalent.

The trajectory of growth in Indian economy has been unlike that in other developing countries. Between 1950 and 1990. "Agriculture's share in GDP declined by around 25% with the corresponding increase in the share of services and industry being distributed evenly". This starkly contrasts with post liberalisation scenario. In the period 1990-1994 the average contribution of industry to the overall GDP was at 22% which declined to 20% in the period 2005-2009. In this same period the contribution of services in the overall GDP rose to 64% from 48% in 1990. (Chanda, 2012) [5].

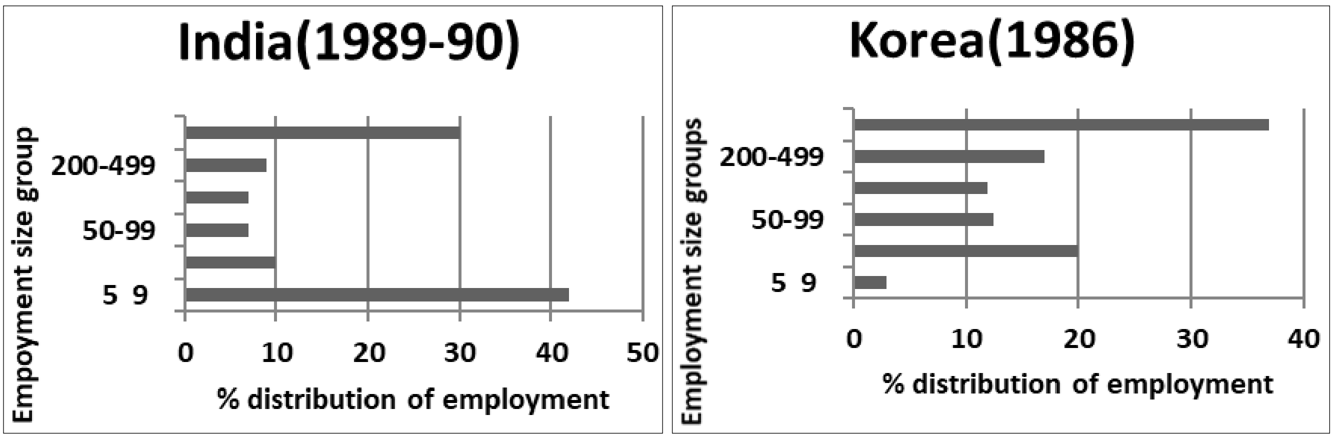
ii. **'Missing middle' in form of lack of medium size industries within the Industry sector:** Figure 1 clearly shows how India contrasts with the other emerging Asian economies in terms of size of enterprises and makes it starkly visible that small enterprises dominate the scenario



Source: Hasan and Jandoc 2010

Fig 1: Share of Manufacturing Employment by Enterprise Size Groups (percent)

India contrasts with other Asian economies in terms of employment distribution with respect of size of firms in terms of number of individuals employed in manufacturing firms as represented in the figure 2. Figure 2 supports the fact that the 'missing middle' problem in India is starkly visible even in terms of missing employment in medium sized manufacturing enterprises.



Source**:** Majumdar and Sarkar, 2009

Fig 2: The missing middle: Employment by size groups in Manufacturing Firms- India as compared to other Countries

The missing middle is further emphasized in the table 2. Inclusive growth has been non-existent in mid-sized firms as represented by the share of employment by the firm size as shown in table 2.

Table 2: Employment Share by Firm Size in India and China

Number of employees	India (Percent)	China (Percent)
<8	87.00%	1.00%
8-18	5.00%	3.00%
19-50	3.00%	10.00%
51-200	3.00%	32.00%
201-500	2.00%	36.00%
501-2000	4.00%	22.00%
>2000	2.3%	8.00%

Source**:** Bhagwati and Panagariya, 2012 [4]

Table 2 clearly emphasis that in India, the small enterprises outnumber the medium or large firms. China in comparison has focused on medium sized enterprises to be dominating their manufacturing sector.

Table 3: Employment Share by firm size in Apparel and Motor Vehicles and Motor Parts in India

Number of employees	Motor Vehicle (Percent)	Apparel (Percent)
1-4	6.00%	78.00%
5-10	17.00%	8.00%
11-20	5.00%	3.00%
21-50	9.00%	2.50%
51-100	7.00%	2.00%
101-200	7.90%	1.50%
>200	50.00%	6.00%

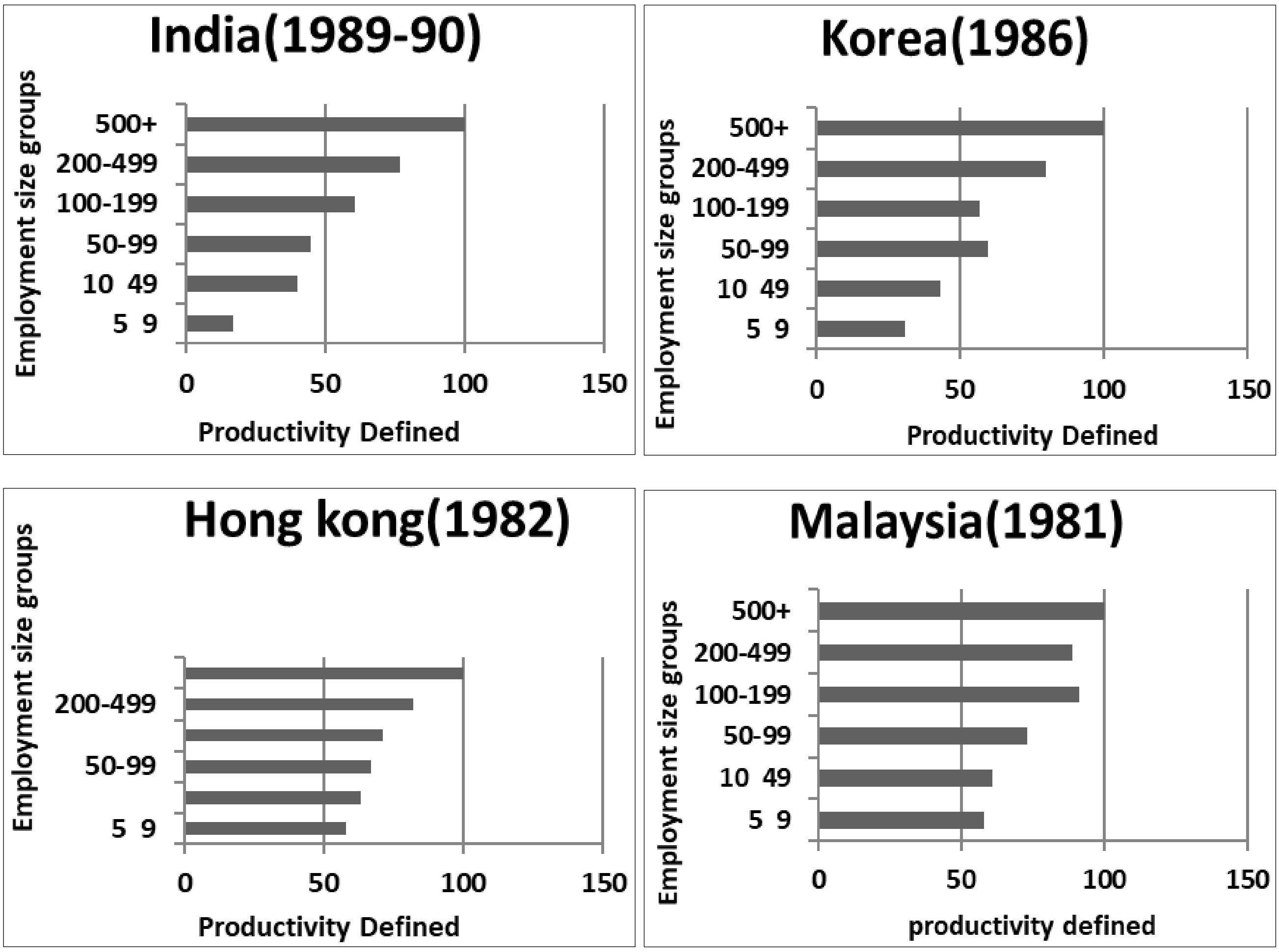
Source**:** Bhagwati and Panagariya, 2012 [4]

Table 3 shows Indian apparel industry being concentrated in the small size enterprises. The high employment sectors such as the apparel industry which also has a high degree of export intensiveness has been dominated by small sized enterprises. A country which requires a labour intensive approach in manufacturing exports does not have a comparative advantage in apparels as compared to other Asian economies because larger firms are able to take greater advantage of not only economies of scale but are able to meet standards of quality and acquire better technology and expertise.

iii. Causal factors: Manufacturing lagged behind before and after liberalization in India's growth story. The Indian economy has grown at a higher rate though it has been driven by the service sector.

a. Analysing productivity differential in the manufacturing sector

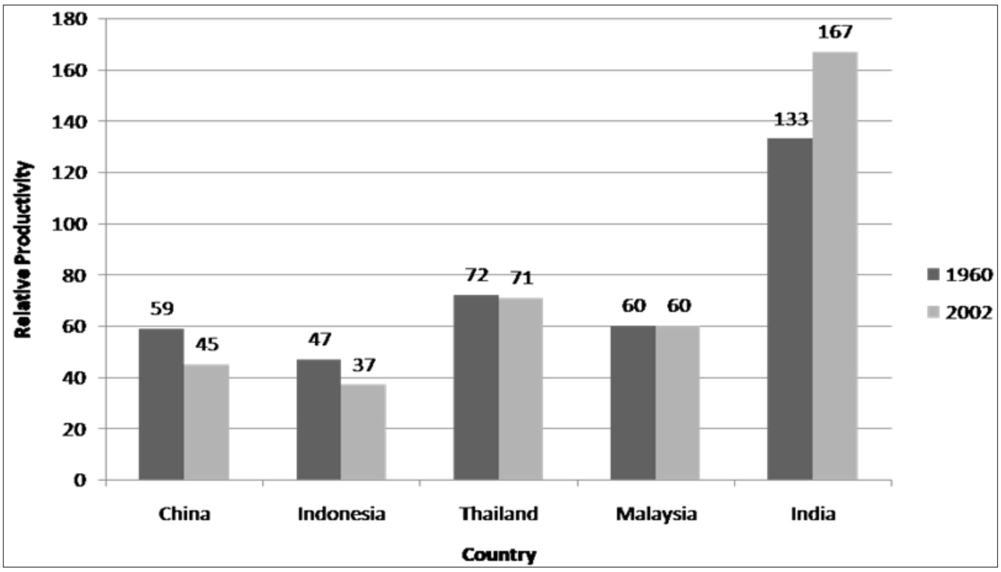
Productivity being low in manufacturing sector is also caused by small size of firms as they are not able to take advantage of economies of scale. Figure 3 clearly shows that the productivity is greater in larger sized firms irrespective of the country. In India the productivity as shown in figure 3 is lowest in small sized enterprises in comparison to other Asian economies also.



***Source*:** Majumdar and Sarkar, 2009

Fig 3: Productivity Differential by Size Groups-India as Compared to other countries (Productivity of 500+ equals 100)

Productivity differentials in small firms also lead to lack of entrepreneurial interest by firms but there are many reasons which are causing the missing middle effect in the Indian economy



***Source*:** Majumdar and Sarkar, 2009

Fig 4: Relative productivity in services vis-à-vis Industry in different Asian Economies

When we compare service sector and the industrial sector in the Indian economy, it is visible as in figure 4 how the service sector outperforms the industrial sector in India in contrast to other asian economies.

b. Other factors which have been a cause for the 'missing middle'

Immediately after independence modern industrial promotion began with planning for manufacturing which began with five-year plans in India. The second five-year plan tried to provide the big push with the Nehru-Mahalanobis strategy based on building heavy or capital-intensive industries (Balakrishnan, 2007). The reasons were deep to make the country self-reliant after 200 plus years of dominance and destruction of industries. If the strategy focused on consumer goods more labour intensive industries could have been established though it could have reduced the self-reliance which was at the heart of the heavy industries strategy.

Another major reason has been the slow growth of agriculture, slow agriculture production reduces earnings which are required to boost demand, and it also reduces the production of raw materials which are essential for industries.

The output growth and employment growth in India has been low, the total organized manufacturing employment in India increased by 0.4 million between 1980-1981 and 1991-1992 (Thomas, 2018) [14]. The multitude of labour laws which are biased towards small sized industries has also been cited as a cause. Labour laws are also cited for the prevalence of a larger share of the unorganized sector in employment in India (Mazumdar & Sarkar 2009). As seen the table 4 below.

Table 4: Increase in Employment in the Organized Sector as compared to the Unorganized Sector (in thousands)

Time Period	Increase in the Organized Sector	Increase in the Unorganized Sector	Total Employment in Manufacturing
1982-83 to 1993-94	569	7021	7590
1993-94 to 2004-05	629	12553	13182
2004-05 to 2011-12	4005	1090	5095

***Source*:** Thomas, 2018 [14]

The increase in employment in India has been due to the growth of the unorganized sector which has been caused by a number of factors as discussed above.

Slow growth of textiles has also been a reason for the missing middle. Due to policies the textile sector was constrained initially to the small sector and could not gain in terms of capital, technology which was imperative for this labour intensive sector to compete in the export market and subsequent absorption of the labour force. According to Thomas (2018) [14] the unorganized sector in the total cloth production in India rose from 62% in 1980-81 to 97 % in 2010-2011.

Post liberalisation constraints which the Indian manufacturing sector had to weather were (Thomas 2018) [14]. Supply side constraints which included shortage of electricity in every region of India and Infrastructure deficit; ii. Policies which led to availability of credit and cost of credit; exchange rates, price fluctuations and their links to capital flows; trade liberalization and rising import intensity of manufacturing; iii. Demand side constraints caused by low per capita income and high inequality in income distribution also dented the manufacturing growth.

The rise of import intensity in several areas of Indian manufacturing particularly in machinery industries has also impacted the manufacturing sector.

7. Conclusion and Recommendation

Hypothesis H_1 has been proved correct that 'Missing middle' in form of lack of medium size industries in comparison to small sized industries and large sized industries exists in India

Hypothesis $H_{2\text{ has}}$ been proved correct that 'Missing middle' in form of lack of Manufacturing Industrial development in comparison to Agriculture base and Services base and contribution is starkly visible in India

Development of the Indian economy which goes hand in hand with acceleration in growth as well as greater inclusion will require three key transformations a) movement of workers out of agriculture into industry and services, b) progressive shift of workers from informal to formal sector within industry and services and c) rapid urbanization (Bhagwati and Panagariya, 2012) [4]. Moreover, reformulation of labour laws and industrial structure to address the problem of low employment has to be analysed further.

Performance of the manufacturing sector has been far from impressive. In 2010 manufacturing accounted for only 15% of India's GDP, compared China's manufacturing sector contribution of 30% to the China's GDP. Moreover 53.3 million that is less than 12% of India's total workforce of 462 million is employed in the manufacturing sector. (Thomas, 2018) [14].

Gap in manufacturing through the missing middle has resulted in a) slowdown in the Indian economy, b) inflation surge, c) decline in public capital formation and d) widening fiscal deficit, e) negative trade balance. Inflation targeting should be followed through investment in manufacturing. Direction and composition of foreign trade can be changed by addressing the missing middle problem. Low cost labour and material inputs available in plenty in India like in other Asian economies could help penetrate markets in the high-income economies.

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