

MARKETS

India wants to become the manufacturing hub. What it can learn from China, Taiwan, and South Korea



Workers at a factory of car manufacturer Daimler in Chennai.

Synopsis

Dedicated economic zones, making local players competitive at international level, and focusing on export-led growth have been the key takeaways in the manufacturing journeys of Asian powers like Taiwan, South Korea, and China. India plans to be the next exporting hub. It can take some lessons and chart its own path.

(Intro by Pravin Palande)

The last week was eventful. While the Adani Group companies grappled with a short-seller's report, we also had a Union budget with a huge outlay for infrastructure and manufacturing. **India** has lacked in this space for the last many years. But things are moving. Since April 2020, the BSE Manufacturing Index has given a return of 108% while the Sensex has returned 114% for the same period. While there is an underperformance, the movement is in the right direction.

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The Adani Group has become one of the big business groups for building ports,

airports, energy and even getting into agriculture and commodities. In a way, India is following a model that many South Asian countries have imbibed where they helped certain business groups by cutting imports and at the same time maintained healthy competition. While their focus was exports and manufacturing, India is concentrated on exports of services.

What can we learn from these countries?

The first export processing zone (EPZ) in India started in 1965 in Kandla -- same time as Kaohsiung EPZ in Taiwan. But while India had a good start, clearly China, Taiwan and South Korea decided to go for exports in a big way. Today, the world largest semi-conductor foundry is in Taiwan. China and South Korea are big exporters in hi-tech and automobiles.

They got their strategies, and more importantly, their scale right. For example, the Kandla SEZ and the Andheri SEEZ were 2.8 sq km and 0.4 sq km, respectively, in size. The Shenzhen SEZ in China at the start had size of 327 sq km. As these countries built policies to protect their industries to some extent, they also maintained healthy competition. Their export profiles changed from textiles to hi-tech goods. However, while they kept improving on the export front, they were clearly focused on adult education and creation of female workforce.

All these countries had to face challenges. South Korea started with a disadvantage after they parted with North Korea as 90% of the electricity-generation capacity and most of the heavy industry was based in North Korea. Then Park Chung-hee came along and changed the country's fortunes. During his regime banks were nationalised but exports got incentivised. Exporters got loans at lower interest rates. Chung-hee was also responsible for the rise of the Korean cheabols like Samsung and Hyundai. But South Korea also focused on results than simply making friends with large industrial groups. In the later part, the country focused heavily on education.

Similar is the case with China where the government gave freedom to enterprise and growth through exports was sought. Again, there was an EZP. In 1980s, China was exporting textile but by 2002 it had replaced Japan and Europe to become the largest hi-tech goods supplier. All these countries used tariffs to discourage foreign goods in their market.

India got its services right when it came to exports. Now, the country wants to be a manufacturing hub. What can we learn from Asian countries that have been successful in this area?

Let's take a deep dive.

The pharma dependency

We do not want to experience a Covid-19-like situation again. Of the many remedies used, sometimes after much debate on efficacy, there was wide use of azithromycin to treat Covid-19. Without getting into that debate of whether it was

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useful or not, what would your reaction be if I said that India is dependent almost completely on China for the active pharmaceutical ingredient (API) for azithromycin, a common antibiotic that finds its way into many prescriptions? Not only this medicine but multiple others like digoxin for cardiovascular disease and metformin for diabetes have a high dependence on China.

Why so? The reasons can be traced to around 40 years ago in the case of China. You will probably be surprised to know that India's GDP was very similar and the per-capita income levels in China were 25% lesser than those of India in 1980, around the time they executed reforms in 1978. As of 2021, China's GDP and per-capita income are 5.5x of India's. China leapfrogged past India. It planned for dominance in multiple areas and had good success too.

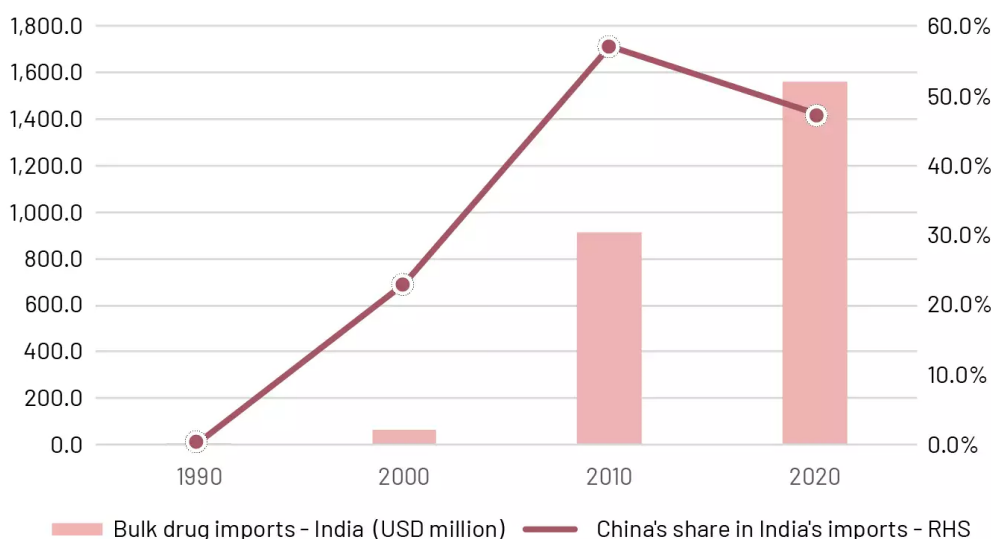
Why should we look at the past now?

India is going through its own push towards manufacturing. One reads about an announcement here and a policy change there. History rhymes even if it does not repeat. What is the big picture for India?

One of the government initiatives in the past few years is the production-linked incentive (PLI) scheme. There are various targeted sectors including medical devices, auto components and batteries for electric vehicles. India is attempting to claw back. One PLI scheme has also been rolled out for key starting materials (KSM), drug intermediates and API. The reasons are simple. India is a leading formulations supplier to the world but heavily dependent on China.

To understand the scale of China's dominance and what India would like to wrest away bit by bit, see the graphic below.

India's import dependence on China in pharma



Source: RIS Discussion Paper #268 by Sudip Chaudhuri

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India's bulk drug imports from China were minimal in 1990 and these had grown to almost half of India's bulk drug imports by 2020. How did this happen?

Methods adopted by China included massive state support like better infrastructure, capital support, and lax environmental monitoring. The Chinese state supported **penicillin fermenters**. A key cost item in fermentation processes for antibiotics is power and utilities cost. Benefits were given. The cost differential across China and India was just too much for the latter. These led to hollowing out of capacities of competitors **like India** and increased its dependence on China (greater than 80% of India's requirement in many antibiotics from China, for example). Drug prices would be dropped in a predatory manner to kill competition and once eliminated, prices would go back to reasonable levels.

Incentives for production are only part of the picture though. There are more variables at play.

China is not the only example. There are other Asian countries that did it well. These nations charted their own paths towards growth and escaped the poverty trap. The starting variables were different in each case respectively – education levels, initial per-capita income, level of industrialisation, forms of government, and competitive advantages among others. Geography even. The paths chosen were also different but there are similarities, across different points of time, which are useful when we try to study India today.

In the **previous article** we covered how India has generally missed the bus on the manufacturing front. In this article, I intend to take you through key things that stand out as relevant in the manufacturing journeys of three nations – Taiwan, South Korea, and China, and compare them to where we stand today. We will take a tour across tools and policies used like differential tariffs, incentives, infrastructure, industry-sector focus, labour-intensive to value-added work and more.

Taiwan – one of the four Asian Tigers

Starting in the 1950s, the country initially went down the path of import substitution, tight controls on capital, and arbitrary import and export interventions in the first decade of the new nation's existence. In hindsight, it has been read by a few as a sign of the government's insecurity about competing in a global market. The path upward started with a fascinating set of interactions between a couple of economists, Tsiang and Liu, and government officials. There was an attempt to be competitive at an international level and earn through exports rather than focusing only on saving foreign exchange via import substitution. The government moved ahead with economists' suggestions and gradually took steps, including:

- 1. Working with a more realistic exchange rate.
- 2. Positive real rates of interest that led to savings growth, which in turn helped investments (real rate is nominal rate less inflation).

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- 3.Reduced interventions in the import-export sphere.

There was agreement on letting the private sector, and not the public sector, take the lead. A key element, protection for businesses, was incrementally reduced over the years. They wanted to foster a culture where businesses would increase productivity and earn their fair share in the global market. Production moved away from basic agro-commodities to more labour-intensive industries including textiles and electronics assembly. Export-oriented industrialisation of the economy took place.

Over the past couple of decades, Indians became familiar with special export zones. The Taiwanese have to their credit one of the early EPZs in Asia. It was set up in Kaohsiung in 1966. Key features of this zone were – zero import duties on plant and machinery, and intermediate goods on which further value addition was to be done in the zone, time-limited tax holiday, low-cost electricity and other utilities, good rail and road connectivity, warehousing, and port infrastructure. Today, these are deemed as basic requirements for such zones.

Geopolitics helped. The US looked at Taiwan favourably against China. It pitched in with aid and investments in businesses.

Money is important but so is the process maturity and managerial talent. This is under-rated because it is beyond hard numbers. These skills and know-how are not present initially in most countries. Technological know-how and better processes came in through the foreign investments in the EPZ. Subsequently, this helped the economy as talent and skills moved from the EPZ to non-EPZ domestic-focused industries.

The “behind-the-scenes” social development of a country is very important. What stands out in Taiwan’s case is the high involvement of females in the workforce. By around 1980, 90% of the workforce in the Kaohsiung EPZ was female.

How did Taiwan fare with all of this? Industrialisation firmly kicked in. From 1960 to 1996, the share of agriculture came down from 29% to 3% while the share of industry grew to 38% from 24%.

Taiwan experienced handsome growth rates of almost 10% CAGR for two decades (1961-80) – a truly enviable feat.

The country eventually made its mark in the hi-tech industry. Today, the world’s largest semiconductor foundry owned by TSMC is in Taiwan. It is a rich country with a GDP per capita of ~USD36,800 as of 2021.

South Korea – birth of a nation

With 90% of the electricity-generation capacity and most of the heavy industries lying with North Korea post-partition, South Korea had to rebuild its basic industries.

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After the Korean War in 1953, the country followed import substitution for the first

eight years, similar to Taiwan. Its GDP grew at a slow pace and there was not much to show for development.

What followed over the next 18 years was defined by the rule of Park-Chung-hee. His name is inseparable from South Korea's rapid rise. He was a General who seized power through a coup in 1961 and was eventually shot dead by the head of the nation's intelligence agency in 1979. His rule has been controversial for having restricted freedoms and captured institutions but simultaneously delivering record growth and bringing the country out of poverty.

Multiple changes took place under his leadership:

- 1. Banks were nationalised so that the state had a bigger say in the economy.
- 2. The currency went through devaluation to make it align more with the kerb rate.
- 3. The government was aware of its own inadequacies. It co-opted industrial groups that could deliver better, into the sectors that the state chose.
- 4. The government looked outward for growth through exports.
- 5. This is similar to how Taiwan progressed but there was comparatively heavy state involvement in directing capital and efforts.

A key element of the policy was differential tariffs for promoting industries focused toward exports. The effective rate of protection using import tariffs for industries, where the government desired to see competition, was at an average of 92% and it stood as low as -10% for non-competing industries (effectively a grant for importing). A similar picture was seen for capital goods for industries as they were made duty-free. This will probably ring a bell for most readers when we connect this to the present direction of industrial policy in India. Think of recent export duty on steel for example. If the government has decided to promote auto components through PLI, is there some utility in also assisting with a benign environment on the raw materials front?

A very interesting feature of South Korea's policies was **differing interest rates** for export businesses against regular businesses. Interest rates on general loans were 18% from 1961 to 1965. In the same period, it was 9% for export loans. Rates on general loans increased further to 23% between 1966 and 1972 and interest rates for export loans remarkably dropped to 6%. There could not have been a clearer sign to any entrepreneur for where they should be looking to grow.

The South Koreans also established free export zones (FEZ), similar to Taiwan's EPZ concept. Five years after Kaohsiung EPZ was started in Taiwan, it opened Masan in 1971. By 1980, the contribution of Masan to the country's exports was 18%. It was one more country that benefited with dedicated zones.

Capitalism, consumerism, and chaebols

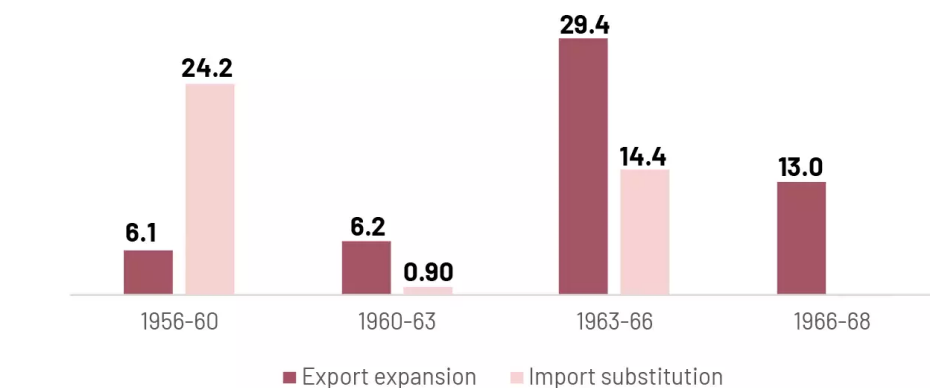
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Consider how the mix of exports changed. The most important items in goods

exports in 1960 were primary products including ores, rice, crude animal and vegetable products, fish, and seaweed. It is astonishing to see that in a decade, clothing products were 25% of exports, plywood and textile fabrics together were greater than 20% and electronics was about 5% of exports.

Import substitution focus gave way to focusing on exports and how! The graphic below plots direct contribution of efforts towards import substitution and export expansion to manufactured output.

South Korea: Export expansion



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A prominent feature of South Korea's growth was the rise of the chaebols. Prominent names of today like Samsung, Hyundai, and LG (earlier called Lucky Chemical Company) with businesses that span across many sectors, have their roots in the Park Chung-hee era.

Sectors like steel were focused on at the start with an eye on building downstream industries later. These included machinery, shipbuilding, chemicals, and automobiles. They were "handed" over to chaebols. Former RBI governor Raghuram Rajan spoke about crony capitalism in developing economies in his book, *Fault Lines*, where he says that it could be also termed as "managed capitalism" where the government gives firms protection from foreign competition and special privileges so that they grow, while maintaining some incentives for them to be efficient. A word of caution when one tries to extrapolate through experiences that are success stories.

Crony capitalism is not a sure-shot way out of a middling existence. It is indeed seen in multiple countries in their early stages of development, but there are many countries whose progress was derailed by corruption that was out of control.

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In South Korea, the government was focused on results even if it had co-opted

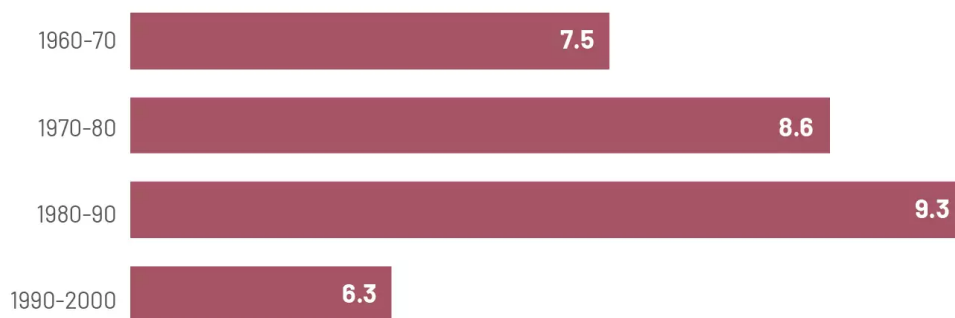
industrial groups. It was more than happy to wrest business away from one group and have another take over, with execution being foremost in mind.

An important starting factor that helped the nation was a comparatively better level of social development. In 1961, South Korea already had the highest rate of school enrollment within the set of countries that had a comparable GDP per capita.

Geopolitics helped South Korea too. The US was liberal with its financial aid in 1950s, mostly food-related. This helped the country in its first tumultuous years after the exit of Japan, the colonial power, and the subsequent partition.

Much like Taiwan, South Korea's share of agriculture reduced, and manufacturing increased rapidly. From 1956 to 1986, the share of agriculture declined from 44% to 13.5%, while manufacturing increased from 12% to 30%.

South Korea: average annual GDP growth



Figures in percent

Source: *The Republic of Korea's Economic Growth; Catch-Up: Implications for the People's Republic of China*

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A key takeaway from experiences of both these countries stress on making local players competitive at an international level, forcing them to be world-class, and focusing on export-led growth through industrialisation. The era, however, was that of a much less globalised world, making a fresh start after the horrors of World War II.

China – the dragon

China is an outlier. The country's high growth rates are unmatched to any other nation at this scale for this long in recent decades. But it was not like this at the start.

China had deep problems, and the progress in the 1950s-1970s was tepid. It had a communist rule with central planning. Under Mao there were severe failures that even led to disasters like the Great Chinese Famine in 1959-61.

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The country's annual growth rate in per-capita income was 2.34% from 1952 to

1978. Sluggish development forced its hand. This was the year when China woke up from its slumber, a couple of decades after South Korea and Taiwan had started their sharp upward journey.

The Chinese leadership concluded that *“the Maoist version of the centrally planned economy had failed to produce efficient economic growth and had caused China to fall far behind not only the industrialised nations of the West but also the new industrial powers of Asia: Japan, the Republic of Korea, Singapore, Taiwan, and Hong Kong.”* (December 1978, National Party Congress’ Eleventh Central Committee). Deng Xiaoping, the ruling premier at that time, was credited for spearheading reforms. Though like in most cases, part of the reasons for reforms was pure compulsion.

Multiple changes took place during his tenure:

- 1. Initially, agri-reforms were carried out to strengthen the role of the individual farmer rather than subsuming their identity to the collective like in the past. This improved agri-productivity.
- 2. As in the previous cases covered above, the currency went through a planned devaluation, followed by a dual system (internal and for external-facing use) until they were finally combined into one currency unit.
- 3. The government had realised the inadequacy of a command economy. It gave greater freedom to enterprises at the town and village level. These were the initial entrepreneurial hotbeds of activity.
- 4. The role of state-owned enterprises (SOEs) in the economy was reduced over time.
- 5. Again, growth through exports was sought.

As described for two other countries, social development is important during the progress of a nation. Life expectancy for China stood at 65 years in 1977 while for India it was 53 years, while India had a higher per-capita income level as mentioned above. Adult literacy rate in China was 69% in 1980. In India, in contrast, this level of 69% was achieved in 2011.

Like South Korea and Taiwan, China implemented an export zone policy. They had a few geographical advantages. Their neighbours like Hong Kong, then under British rule, and Taiwan, were already ahead of them in terms of availability of skills, technology, and capital. There were cultural ties between the populations across the borders.

In 1980, China created four Special Economic Zones (SEZs) in Shenzhen, Zhuhai, Shantou and Xiamen. The first three were located in Guangdong province. The first two SEZs were literally across the border between China and Hong Kong. Xiamen was across the Taiwan Straits. There were advantages provided to businesses located in the zones.

They attracted capital and technology. Labour came from the hinterland. The

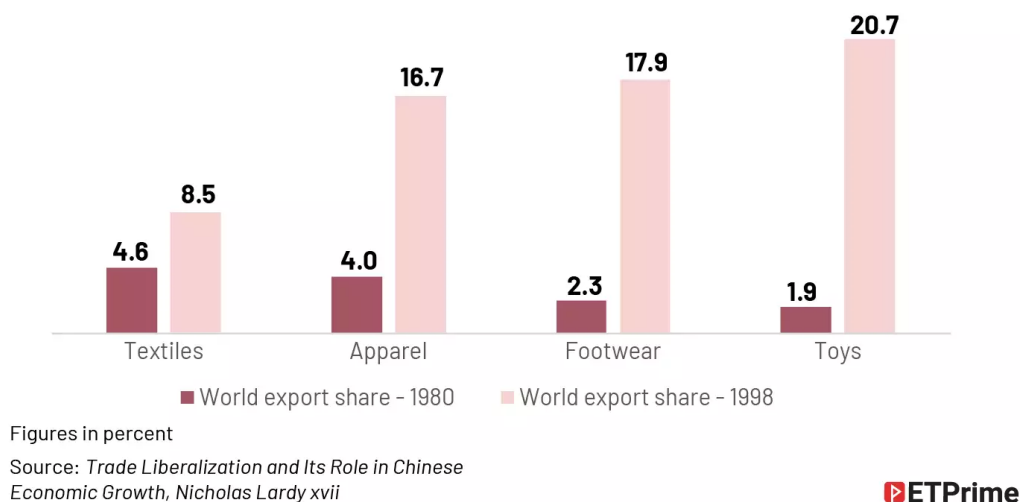
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success of the export-oriented policy can be seen from the fact that around 42% of the foreign direct investment (FDI) by 1990 was in one province Guangdong, which contributed to 20% of China's GDP that year. In the late 1990s, the 10 coastal provinces and municipalities had 10% of the population but generated about half of China's GDP.

In 1984, the nation focused on zones for another 14 coastal cities in addition to the initial four SEZs. The role of SEZs in the growth story of China cannot be emphasised enough.

Labour-intensive manufacturing was the route adopted, like was the case with Taiwan and South Korea. Light manufacturing in four areas, textiles, apparel, footwear, and toys rose from USD4.3 billion to USD53.5 billion from 1980 to 1998. It grabbed a significant market share at a global level.

China's share in manufacturing exports



Chinese exports rose by an average 5.7% per annum in the 1980s and an even more impressive 12.4% in the 1990s. As was the case with the others before, they moved subsequently into higher value-added manufacturing.

A common factor across the three nations was the use of tariffs. You could even say that there was the heavy hand of the government as it applied it to discourage the entry of foreign goods and allow domestic businesses to flourish. Intermediate goods imports were supported through rebates if they fed into goods for exports. You will see this same pattern emerging in India now.

In 1993, the Chinese government adopted a resolution that spoke of separation of government and enterprises that met the requirement of a market economy and socialist large-scale production. You will appreciate the phrasing "large scale production" when you think about the penicillin example at the start of this article. There are enough anecdotes one could give for other sectors and how China systematically achieved dominance.

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In early 2000s, China formally joined the WTO after which it continued to grow rapidly. In a nutshell, China was able to bring large sections of its population out of poverty. Today, its per-capita income stands at levels that would have been tough to imagine 43 years ago. Between 1979 and 2021 the GNP per capital income moved from USD184 to USD12,556.

India- where we stand

A common thread across all countries described above were resolute steps taken early on by their governments. They realised the limitations of looking inward. Once a certain level of development was attempted and achieved with import substitution, they attempted to grow by exporting to richer countries.

In hindsight, it is easy to forge a narrative and see a “grand plan”. Each example tells us that actions were not linear, mistakes were made, and novel actions were attempted.

One difference between today and then was that you objectively saw global trade as a percentage of global GDP rising. The last decade has seen this trend slow down. This is something that works against India today compared to others before us.

A key difference between these countries and India is that we fared better on the tertiary industry (services) front. The composition of GDP of an economy can be broken down into primary (agriculture, forestry, fisheries and the like), secondary (manufacturing, both light and heavy) and tertiary (services including health, communication and financial). India lagged in manufacturing.

SEZ experience in India

Most would be surprised to know that the first export processing zone in India started in 1965 in Kandla, at the same time as Kaohsiung EPZ, Taiwan! The next one, SEEPZ, started in Mumbai in what is now firmly Andheri (the S in SEEPZ was Santacruz, a suburb some distance away actually).

Unlike some countries where labour laws were made more flexible within SEZs, India did not go down that path. This may have been one reason why labour-intensive industries at scale did not pick up well.

We have had very healthy growth in services undoubtedly, and not as much in manufacturing. Around 58% of operational SEZs in India as of 2018 were focused on IT/ITeS, electronics and telecom hardware.

However, there are dangers from an imbalance in growth in any one export sector. Consider Bangladesh, albeit a very lopsided case study. 84% of its export earnings came from readymade garments. There was a huge volatility in end-demand of garments over the last two years and this has led to forex pressures on the nation. The learning is that diversification is healthy. There must be timely upgradation of capability up the value chain and over a wider span of sectors.

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The approach towards SEZs in India has evolved over time. The SEZ policy was announced in 2000. At that time, Murasoli Maran spoke of his visit to China and of the impression it left on him. The intent was to focus on SEZs for exports with some learnings from other countries that did well. Multiple EPZs from the past were subsumed and converted to SEZs. There was the promulgation of the SEZ ACT, 2005. There was a rapid increase in the notified SEZs in the next few years. There were problems too.

There was a scathing CAG report in 2014 that highlighted multiple problems. Key points from this report are as follows:

- 1.Diversion of land – 23% of lands were de-notified until 2012-13.Commercial benefits from land use change on what was land acquired for “public purposes” could have accrued to certain players.
- 2.There was a 93% shortfall in employment compared to projections at the time of filings, in the sample of 117 SEZ units chosen by auditors.
- 3.Similarly, there was a 58% shortfall in investments in the sample set.
- 4.More importantly, there was a 75% gap between exports achieved and projections made.
- 5.Significant tax revenue had been foregone by the government for objectives set out under the Act and benefits were not commensurate.
- 6.The CAG saw evidence of weak monitoring overall across multiple dimensions.

In 2018, a committee led by Baba Kalyani, chairman and managing director of Bharat Forge, was set up for re-evaluating the SEZ policy. They released a **report** that makes for an interesting read on possible directions that may be taken in the next leg of reforms on SEZs.

Its key recommendations that stood out was an overarching redefining of purpose – targeting domestic demand in addition to exports unlike only exports in the past. In fact, there is a proposal to rename SEZs as Employment and Economic Enclaves (3Es). Notice the de-emphasis on the word “exports” in the proposed acronym. This could be read in line with the present Aatmanirbhar thought process. We will revisit this point.

Other key proposals and the author’s comments are described below:

1.Utilisation of vacant space within existing SEZs. This appears useful when you consider the proliferation of SEZs and the potential under-utilization in the past 20 years.

2.Fine-tuning recommendations for manufacturing and services sectors

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respectively. The under-development of manufacturing vis-à-vis services merits this approach surely.

3. Various taxation related suggestions, proposals for reduction of bottlenecks in processes and logistics.

4. Flexibility in utilising non-processing area (SEZ NPA) - Allegations against SEZs have been made in the past on being a vehicle primarily for land value. There is a case for building integrated townships even in SEZs NPA from the perspective of employees needing accommodation and amenities. Considering criticism of incorrect land use in the past, this aspect will need greater control if these recommendations find their way into the law.

Until we get the SEZ reforms, there are actions possible even today. Even as late as 2019 and 2020, one sees SEZs lesser than 5 acres in size getting notified. In the past there were questions of whether one of the main benefits for enterprises setting up within an SEZ was the tax holiday. At small sizes, there is a chance that the SEZ did not even influence the set-up decision. One could even argue that the business would have got set up even outside the SEZ anyway. In future, there will need to be greater control to ensure that goals are met at the right scale.

One very interesting recommendation in the Baba Kalyani report is the creation of a limited number of large enclaves (not more than five) across the country with heavy government investment to back them (greater than USD1 billion). With scale difference across countries enumerated above, decisions on this front are keenly awaited, because one is reminded of the mega-SEZs of China which had the right infrastructure to support businesses.

Production-linked incentive scheme

The outlay towards the PLI schemes is often misunderstood by many to be a fresh allocation made by the government. The Merchandise Exports India Scheme (MEIS) existed from 2014-15 onwards. It faced challenges at the WTO that necessitated a termination of the scheme. There were also concerns that while the MEIS outlay doubled from the initial INR20,000 crore to INR45,000 crore in FY21, there was not much increase in the exports figure in the same period.

In FY21, the allocation for PLI was essentially the same amount as that in MEIS. However, the key difference being avoidance of any linkage to exports only. Maybe this is why we are seeing the usage of the word “Aatmanirbhar”. There is nothing that stops exports in such PLI-supported facilities though. The reader can make their interpretations about how things are different between a few decades ago and now, and how we are having to navigate this new international landscape.

Another difference between MEIS and PLI in implementation is a greater concentration of capital in government-chosen areas. This reminds one of the South Korean models where the government decided which sectors should be favoured for growth. In industries, where the PLI is directed, time-bound targets for investment and incremental production need to be met for receiving the

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incentive. Participants have to put down their contributions first and the government will share incentives later. The outlay for the government is greater than INR2.5 lakh crore over the next 5-6 years.

We will not dwell on the PLI schemes in general but rather see them through the lens of intended goals. There are some sectors focused on what clearly appears to be import substitution. For example, the APIs for medicines. Remember the azithromycin example that we started with. There are other sectors focused on like mobile manufacturing where the target is exports too.

One could ask why the country is looking inward at all. Why not only outward? In my view it is a bit of both. The Asian countries mentioned in this article shifted towards exports with vigour but in a different era with a different base. We do not have the same starting conditions now.

Import substitution

We shall delve into a sector where space is being reclaimed – import substitution in toys. The import of toys to India has decreased from USD332 million in FY15 to USD110 million in FY22. Export of toys has increased from USD96 million to USD327 million in the same period. In 2022, a dedicated toys manufacturing cluster has started operations in Karnataka. A tool to check imports of toys has been the use of Quality Control Orders (QCO). In January 2023, there has been muscular action to implement norms where uncertified toys (mostly imported) have been seized across major toy retail stores.

Certain sectors are under the lens and are generally seeing greater control over imports.

If we go back in time, the same toys products category was reserved for MSMEs. Between 1997 and 2001, the process of de-reservation started -- 39 products including toys and readymade garments were de-reserved. In the preceding 2-3 decades, when Asian competitors were operating at large-scale in these critical labour-intensive sectors, there was a simultaneous restriction on scale in some manner in India. Is it not natural that production at scale did not happen easily, *ceteris paribus*?

There is higher protectionism now. Average tariffs have increased from 13% to 18% over 2013 to 2020. This has an impact on inflation across goods in the wholesale and consumer categories. We will most probably see higher price increases in goods output from targeted sectors, until scale develops. It will also mean a consumer economy in transition as purchasing power may be in flux until you see a clear trend. Job growth may take time to kick in and there may be higher prices that flow through in the interim. This is a political economy choice that has a bearing on those of us in the investment management space as we navigate the markets.

Labour-intensive export sectors: why not seize the day?

Toys manufacturing is a small sector. What about a large sector like textiles and

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apparel (T&A)? T&A add up to around 10% of total exports for India. In the recent PLI scheme announcements, the government outlay towards man-made fibres and technical textiles was around INR10,000 crore. This is not a lot when you compare it to the total outlay across all PLI schemes.

In my view, the labour-intensive sectors are where one hopes to see more from the government. As per **research by Shoumitro Chatterjee and Arvind Subramanian**, we have a large pool of unskilled labour that is heavily underutilised. As of 2020, the potential production in the key low-skill textiles and clothing sector, that is “missing”, amounts to USD140 billion or 5% of GDP. They arrive at this by comparing the gap between potential (when compared to other low-income countries like us) and production. The corresponding figure for missing exports is estimated at USD60 billion.

Our overall exports figures are not bad in themselves. They stood around 20% of GDP for the last decade or so. There is a strong correlation between GDP growth and exports growth. We should not be ignoring low-hanging fruit that will help in GDP growth.

The data above was only for textiles. There are other sectors beyond this.

Again, the duo has shown that the share of low-skill intensive exports (manufacturing) in India declined from 34% to 20% from 1995 to 2018. Skill-based exports (manufacturing and services) rose from 42% to 65%.

This raises more questions even from a social perspective. Can India afford to leave one segment of the population behind?

There is additional data depicting case for focusing on the labour-intensive industries. A big competitor is potentially vacating some space as it moves up the value-chain. Consider that for a category like footwear, China lost around 7.5% of global market share post- global financial crisis (2008) until 2020. What did India gain relatively? A meagre 0.1%. Vietnam while being a much smaller country but an export powerhouse, took 5.9%. In apparel, 5.8% was lost by China. Vietnam and Bangladesh took around 2.8-2.9% each. India took home only 0.2%.

There are numerous examples of a K-shaped recovery amongst different income segments of our population. Problems may be exacerbated if inequality increases.

Social reforms that bring more women into the labour force are essential. Our labour force participation rate for females is low. Literacy levels and educational outcomes need to get better. Better healthcare access is needed for reducing chronic malnutrition and infant mortality.

One hopes that the next set of reforms will focus on these industries that are usual suspects in the trajectories of other countries before us respectively. Maybe the “enclaves” that the Kalyani report talks about hold some promise? Time will tell.

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Free trade agreements

In the past few years India has taken a more guarded stance in free trade agreements. India walked back from the Regional Comprehensive Economic Partnership (RCEP). There appears to be a greater tendency to sign bilateral agreements with individual countries rather than with blocs. There are worries that imbalances between imports and exports may grow. The question remains as to how benefits of exports may be availed of using the FTA route, else we risk getting excluded from global supply chains. It is worth noting that on the export front, it is a tougher environment to navigate compared to the 1960-2000 period.

Today, the WTO mechanisms are used more actively against exporting nations than before.

The outlook

Through this article I have attempted to cover a few key dimensions, mostly to do with manufacturing, in the journey of economies.

There are more factors at play that are not covered here in as much detail - labour laws in India (attempts being made to simplify further in favour of industries), and infrastructure (sorely underdeveloped but improving).

South Korea and China had an authoritarian rule in at least parts of their journey, if not more. It would be lazy thinking to wish for the same for India. Just because we have seen a few success stories in countries run by strongmen does not change the fact that there are more examples of failures under their rule across the world than successes.

Democracy is slower generally, but it has other benefits. The same China that delivered a growth miracle, also had a famine in which one of the causes was a campaign to eliminate sparrows saying that they consumed too much grain. Citizens followed exhortations and killed sparrows in thousands. The following year, the natural predators of insects and locusts were no more. The predators had a free run and they contributed to more crop destruction than what sparrows alone may have eaten.

A big plus point today is that geopolitics is favourable. Corporations want greater control of their supply chains. Moving away incrementally from China is real. It gives India a great chance to compete and win some of this business. It will be lazy thinking again to say assume that we are the only game in town for China + 1. It is China + n and we are one of the many contenders.

There will be steps taken by the government and we should accept that some mistakes will also be made. It was not any different in other case studies. It is important for timely course corrections to happen and for holistic reforms to be carried out. One wishes for inclusive growth that leads to improvement of social development parameters and rise in per-capita income, and progress for the nation.

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And lastly, one wishes that if we have the need to take any medicine in the years to come, the raw materials for the pill are made in India!

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Opinions expressed are personal.)*

(Graphics by Sadhana Saxena)

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