People Power

Manufacturing Holds the Key

Since the 1980's India emerged out of the relative stagnation of the 'Hindu' rate of growth. In the liberalization phase starting from 1991, these robust growth rates are consolidated. India is now the second fastest growing nation among large economies. Global comparative studies indicate that our competitive advantage may continue for the next several decades, thanks to the young demographic profile, low cost economy, and large, ambitious, skilled manpower.

But these happy trends mask a less wholesome development. Manufacturing sector is growing only at 6.3% per annum, roughly at the same level as overall economic growth. Many fast growing economies record much faster growth of manufacturing than the other sectors. As a result, while India's services sector now accounts for 51% of GDP (42% in 1991), manufacturing accounts for only 17% of GDP. The decline of agriculture which now stands at 22%, is widely accepted as the inevitable consequence of modernization. But the relative decline in manufacturing has grievous consequences to employment, public revenues, standard of living, and wealth creation in general.

In this backdrop, the constitution of the National Manufacturing Competitiveness Council (NMCC) recently is a welcome development. The Council is earnestly applying itself to identifying areas of core competence, and is evolving sensible strategies for rapid growth of manufacturing sector.

Some economists argue that India already missed the bus in the manufacturing sector. China, which has emerged in the past two decades as the manufacturing hub of the world, has 35% contribution of manufacturing to its GDP. Other emerging Asian economies – Indonesia (25%), Malaysia (31%), and Thailand (34%) – show similar trends. Not surprisingly, as the NMCC report points out, our share of global trade, though it has risen from an abysmal 0.5% in 1991, is still at a low 1%. Our manufacturing exports account for only US $ 40 billion in 2002-03, as opposed to China's $ 300 billion, Taiwan's $ 140 billion, Mexico's $ 141 billion, Malaysia's $ 78 billion and Thailand's $ 55 billion. Therefore, these economists contend, we should focus on services sector where we seem to have competitive advantage, and India must aim to be the world's back office and services hub.

But such an argument suffers from there fallacies. First, growth in services is welcome and necessary. But services and manufacturing are not mutually exclusive. Second, in every large economy, it is manufacturing that provides productive employment for a large proportion of semi-skilled and skilled workers. If we focus only on high end services involving highly skilled workers, inequities will grow, and unemployment will lead to serious social and political instability, not to speak of human misery. Third, while we can offer good quality, low cost services to the developed world, there is a limit to back office operations, and therefore expansion of exportable services in India. But manufacturing, which involves physical transfer of goods, suffers no such limitation, provided our products are competitive in cost and quality.

NMCC points out several advantages of a strategy to promote manufacturing. Revival of manufacturing can create 2.5 million new jobs each year as opposed to one million jobs created per year over the last decade. Manufacturing promotes growth of agriculture and service sector too, and every rupee invested in this sector adds four rupees to GDP. Goods produced meet the basic needs of our population, eliminating poverty and improving standard of living. And a large economy of India's size and diversity cannot afford to ignore the vital manufacturing sector, particularly at our current phase of development.

What can the Finance Minister do to revive manufacturing? There are four areas which need urgent attention. First, indirect tax administration needs to be simplified, and made more transparent and industry-friendly. There has been significant improvement in the direct taxes regime in recent years. Even central excise and customs improved to some extent. But extortion, harassment and corruption continue in indirect taxes administration. Transparency, simplication, digitization and revenue neutrality should be the watch-words. In fact with an honest regime, revenues will significantly grow. In the earlier license raj, entrepreneurs enjoyed monopolies – through Internal entry barriers on account of licensing, and external barriers of trade and tariffs. Therefore extortion of tax inspectors was merely an added cost passed on to the hapless consumer. Now that both barriers are dismantled, we need to transform indirect tax regime to allow manufacturers the breathing space to focus on production and marketing in a rapidly changing, competitive scenario.

Second, as NMCC points out, India has a unique window of opportunity now in certain sectors like textiles and apparel, leather and leather goods, food processing, gems and jewellery and handicrafts. The recent removal of quotas under WTO gives us a great opportunity to expand our market share in garment industry. But we need rapid creation of infrastructure and promotion of skills in order to capitalize on our competitive advantage. Modest investments strategically made can stimulate manufacturing in these sectors, and create a large, skilled workforce which can be productively employed.

Third, while our banks are flush with funds, the small and medium enterprises (SME) are starved of credit. In a highly competitive global economy, rapid response to market forces is vital for the survival of a SME. But banks are often lazy and risk-averse, and genuine enterprise is stifled. Our credit policies must be aimed at supporting manufacturing, particularly the SMEs.

Finally, in a market economy a large number of businesses fail even as new businesses emerge. Risk and failure are the inevitable consequences of competition and free markets. When a business fails, the manufacturer must have a quick exit to cut his losses and start all over again. We made such exit excruciatingly painful and slow, deterring enterprise and employment. Our workers and managements have learned in the past two decades that the old, adversarial approach is counterproductive. As a result, industrial peace is now the norm. But when a unit has to close down, there must be painless way of dealing with workers. Reasonable ex-gratia, swift closure, rapid retraining to prepare workers for new jobs, and a security net to help those retrenched tide over the crisis are crucial for encouraging investment and minimizing misery. Otherwise, investment will shy away from manufacturing, and go into speculative areas like real estate, creating bubble economy.

The government still has a crucial role in promoting manufacturing and helping generate employment. Modest allocations strategically made, and farsighted policies can give us the competitive edge, and absorb tens of millions in the work force. Will the FM shed our economic orthodoxy, and bite the bullet of reform?

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