

Sowing the Seeds of India's Manufacturing Revival

India's real economy has been in a funk for some time. India has been in industrial recession for over 5 years now. India's average IIP growth over the last 5 years is at 4% as compared to last 25 years average of 6.5%. Thus, IIP growth over the last 5 years is 40% below the long term average.

The sharp industrial slowdown had led to one of the biggest asset bubble with in the real economy with \$200bn of bad loans in the banking system, which is about 30% of the total industrial loans outstanding. The second order impact of such industrial recession has been - sluggish overall economy, modest credit growth and impaired bank balance sheets in which the government had to infuse \$50 bn to recapitalize (2% of GDP).

Also, India's exports growth over the last 5 years have been a modest 1.4% CAGR with exports stagnating at around \$320bn. Since external growth was equally weak, the only driver of growth over the last 5 years has been consumption and government expenditure. Due to lack of rising income levels and inadequate job creation, large part of consumption growth was driven by rising leverage in the household balance sheet and was funded by NBFC's until they hit the wall in the aftermath of the ILFS crisis. The consumption growth has moderated significantly over the last 2 years. And given the fiscal constraints, government expenditure growth has its own limitations. As a consequence, the aggregate GDP growth slipped to around 5% over the last few qtrs.

Finally, the government has responded with some concrete and well thought out policy actions by providing major booster shot to the markets with significant tax cuts for the corporates and announcing a concessional tax rate at 17% for new manufacturing units. This concessional tax rate on manufacturing is a very bold and courageous move from the government and is a ***potential game changer***.

China ascendancy to being a super power has been pivoted by its manufacturing growth. Due to its low cost labor and superior infrastructure, global supply chains made China as its base and it emerged as the factory to the world. China's manufacturing renaissance in the 1990's was driven by the same strategy the British adopted in the early 19th century to kill American manufacturing by providing huge subsidy to domestic manufacturers and making exports at subsidized pricing to kill the nascent and vulnerable manufacturing in other parts of the world.

India's share in global manufacturing exports is a miniscule 1.4 per cent, far behind that of China which accounts for a massive 15 per cent. In fact, a number of South East Asian economies like South Korea, Malaysia, Singapore, Taiwan, and Thailand have pivoted their growth model around global manufacturing exports. It's quite ironical that Bangladesh' textile exports, Vietnam's electronic exports and Thailand's auto exports are higher than India's exports in these respective industries.

But today manufacturing in China is at cross roads with peaking demographics, rising labor cost and trade war with its largest trading partner. China itself is undergoing an economic transition from an investment driven and manufacturing led economy to technology driven and consumption led economy. Also, China is gradually exiting low end manufacturing.

This puts India into a pivot position of global manufacturing. The global supply chains are looking for a second home. No country other than India can provide them the resources and infrastructure on the scale that India can. India needs to get its act together and find its own strategy to leap frog Indian manufacturing to the pole position in the world.

Labor cost in India is 40% lower than China and even cheaper than other South Asian economies. ***Thus, now India has the unique vantage of being the least cost manufacturing location in the world along with lowest tax rates on offer.*** This puts India into a pivot position of global manufacturing and gives it an edge over its competitors viz; Vietnam, Thailand, Indonesia.

Given India's superior talent in hi-tech industry many MNC's are doing their global R&D in India and manufacturing in India will be a natural progression for them.

Increased investment in manufacturing in India should be driven by sharp increase in FDI. Annual FDI that India receives at \$40bn is a fraction of what China receives annually. Higher Manufacturing exports should enable India to neutralize its trade deficit and also lead to much higher domestic savings, improved per capita income and stable currency. Thus, India should aspire to double its manufacturing exports as it endeavors to get to \$5trn GDP by 2025.

The concessional tax on manufacturing makes a cogent case for "Make in India" and makes the value proposition extremely tempting. But at the same time, to harness the full potential of our resources and capabilities we need to supplement this policy action with flexible labor laws, superior infrastructure, transparent land acquisition and agile decision making.

Thus, India needs to take the baton from China and emerge as the leading low cost manufacturer on a global scale to meet its own growth and developmental needs. Manufacturing has a strategic role to play in India's journey of emerging as a super power over the next 20 years. The government has sown the seeds of India's Manufacturing Renaissance.

Date: October 11, 2019

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