Steps to take before we can 'Make in India'

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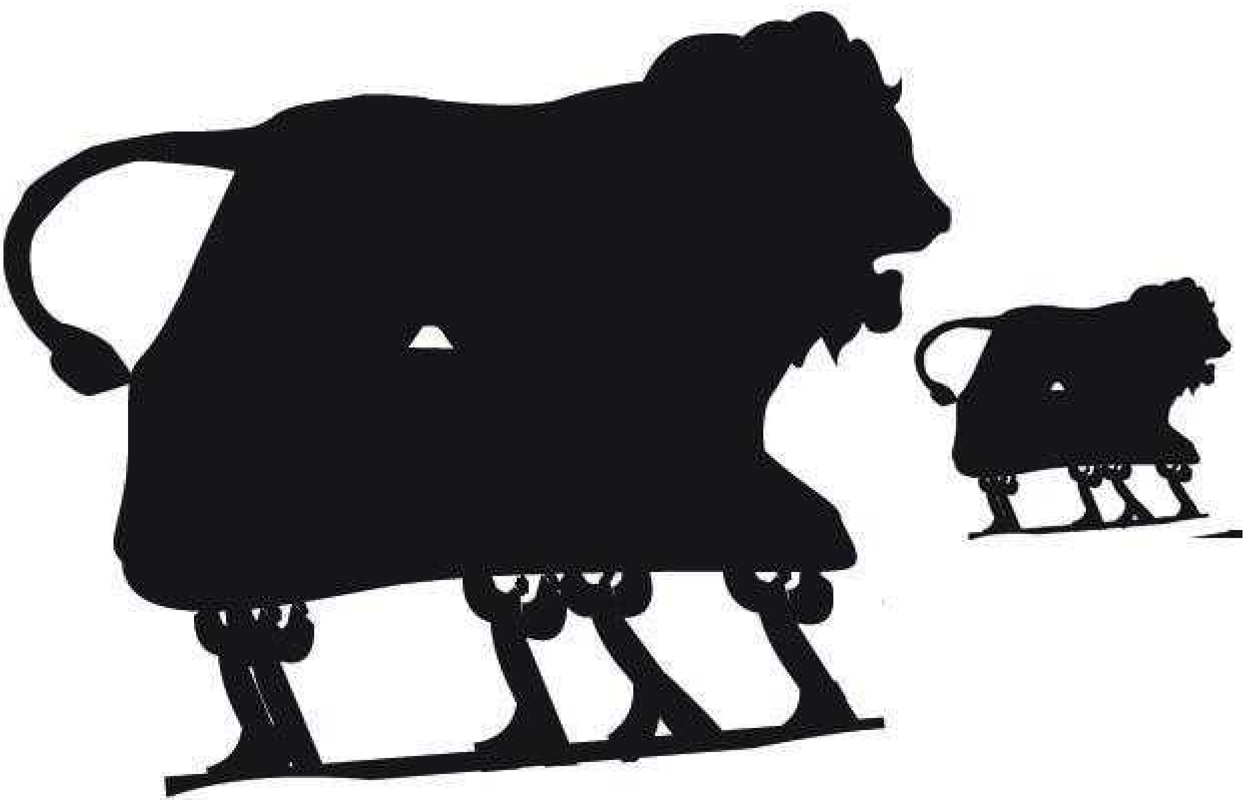

Make in India is the cornerstone for India's development plan. But India's desire to re-focus on manufacturing goes against established global norms. No economy with a dominant service sector has seen manufacturing return to dominance. India's manufacturing landscape is dominated by small enterprises and most of the activity is in the informal sector.

According to a report by the Exim Bank, majority of global firms are born small and tend to grow over the years, in size and number of employees. However, Indian firms tend to stay small. According to the same study, "In the US, in 35 years of existence, a company will grow to 10 times its original size both in terms of operations and employees. By contrast, productivity of a 35-year-old Indian firm merely doubles, while its headcount falls by a fourth”.

Multiple rounds of National Sample Survey Organisation (NSSO) data show that between financial year (FY) 2000 and FY12, India’s total employment elasticity was a mere 0.14%. This means that for every 1% increase in real gross domestic product (GDP), employment increased by 0.14%. For manufacturing, employment elasticity during the same period was 0.24%. Given poor education levels in India and average skill-set requirement in manufacturing being lower than in services, manufacturing does have the potential to create more job opportunities.

Nevertheless, if we assume similar employment elasticity through to 2022, manufacturing sector will have to grow at a real rate of 14.5% year-or-year (more than double the current rate) between FY12 and FY22 if 100 million additional jobs in manufacturing are to be created. But between FY12 and FY15, India’s manufacturing GDP grew at an average of 6.2% per annum. Clearly, India would be lucky to generate half the desired number of jobs.

Infrastructure deficit represents a major stumbling block. Land acquisition apart, challenges faced by India’s energy sector pose a big hurdle. While India’s energy demand increased fast, supply was affected due to poor availability of domestic coal, large transmission and distribution losses, and poor health of the State Electricity Boards (SEBs).

Fuel shortages, especially coal, resulted in India struggling to produce 100 gigawatt (GW) of electricity as against installed capacity of 160 GW. The situation is improving. Successful and transparent allocation of coal blocks, fast-track mine approvals, tighter production oversight and more flexibility in coal sales have helped power station coal stocks recover from a six-year low hit in October 2014. Even though coal production is improving, weak demand for power owing to poor financial health of the SEBs remains a big challenge.

With appropriate policies and reforms, contribution of manufacturing to GDP could go up and create ever-increasing employment opportunities. Even if ‘Make in India’ fails to meet the target, it should still remain a key policy focus, especially when around a million youth joins India’s workforce every month.

India’s manufacturing sector is hobbled by regulations relating to land and labour, complex taxation, lack of ease of doing business, and absence of adequate infrastructure. Uncertainty caused by complex and out-dated laws influence ‘labour market outcomes’. While smaller firms are not covered by these regulations, the onerous nature of the applicable laws has led the share of contract labour to rise in proportion to total employment in the organised manufacturing sector. According to Annual Survey of Industries (ASI) data, share of contract workers in manufacturing as a whole increased rapidly from 20.42% in FY01 to 34.58% in FY12.

Replacing existing labour laws with a new set suited to the 21st century is important for reviving India's manufacturing sector.

There is also a desperate need for fair and equitable land acquisition bill. The proposed amendment bill is facing immense political opposition. While we do expect the bill to eventually be passed, it may not happen before the end of 2016.

Implementation of the goods and services tax will require a constitutional amendment. Given that the ruling government is in a minority in the Rajya Sabha, its inability to get the opposition along in such a crucial piece of legislation during the monsoon session means that GST cannot be implemented before 1 April 2017.

Apart from laws, many operational matters also impede growth. There are too many touch points between government agencies and the manufacturing sector. While the government is committed to reducing red tape, India still ranks poorly in World Bank's Ease of Doing Business Index.

Manufacturing in India remains significantly reliant on government's ability to delivery public goods like infrastructure. Having failed to invest adequately in infrastructure (a manifestation of poor quality of fiscal deficit), the government is also guilty of failing to attract private investment in projects. And, with multiple projects being stuck at various levels, private companies are saddled with mounting debt while the banks struggle with elevated levels of non-performing assets.

It will be difficult to meet the goal of manufacturing accounting for 25% of India's GDP and generating 100 million jobs by 2022. Given the expectation of slower pace of reforms, manufacturing may grow at an average of 9% per annum, higher than the 6.3% per annum growth recorded during the previous three years (using the new data series). This will push up the share of manufacturing at most to 19.5% of GDP by FY22.

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