The manufacturing muddle

The Union Budget has reinforced the correction of the inverted duty structure (IDS) which has adversely impacted manufacturing for decades. An IDS means higher duty on intermediate as opposed to final/finished goods, with the latter often enjoying concessional custom duty under some schemes. The Budget has raised customs duties significantly; Chinese/other imports have swamped India's small- and medium-sized enterprises and large manufacturing companies, raising the import-intensity of manufacturing as well as dampening job growth by raising capital intensity. So it is no surprise that the share of manufacturing in GDP and employment has not risen since 1991. We have ceded ground to China as the 'factory of Asia and the world', a process that must be reversed urgently if we are to realise the 'Make in India' dream.

The goods and services tax (GST), especially the IGST or Integrated GST component, has begun to erode the advantage that the IDS was giving to foreign exporters in Indian markets. Also, the Finance Minister, in Budget 2014, announced the beginnings of a reversal of the IDS in electronics and has sustained that effort in subsequent Budgets. Unfortunately, a series of sectors remain adversely impacted by the IDS.

China had, thanks to a strategic industrial policy it followed for two decades, stolen a march on India in labour-intensive manufacturing exports. But India's policy structure failed to utilise its labour advantage to grow labour-intensive manufacturing exports. The result: while China reduced the absolute numbers and percentage of the poor in the population by absorbing surplus labour in manufacturing, India's poverty reduction was much slower. A major reason: while China's agricultural and rural income growth was much higher as it sustained consumer demand, it also generated industrial jobs much faster. While India grew construction jobs very fast since 2000, all the way to 2011-12, manufacturing output and employment growth left much to be desired.

Moreover, analysis shows that between 2004-05 and 2011-12, but much more between 2011-12 and 2015-16, the growth of manufacturing jobs not only first slowed after 2011-12 but also became negative. The most labour-intensive manufacturing sectors which account for over half of total manufacturing employment in India (60 million in 2011-12 to 2015-16) could get a fillip now due to raised customs duties, thanks to the Budget.

Customs duties have been raised on capital goods and electronics, and silica for use in manufacture of telecom grade optical fibre. These have been among the sectors adversely impacted by the IDS in the past 10 years or so. Duties have also been raised on labour-intensive manufactures such as food processing, footwear, jewellery, furniture, toys and games.

Some have seen this as a return to pre-1991 'protectionism'. This reading is misplaced for two reasons. Reduction of tariffs (1991-1998) was precipitous, from an average rate of 150% to 40% by 1999, and to 10% in 2007-08, especially in manufacturing. Indian manufacturers, unreasonably protected till 1990, were suddenly exposed to competition. A slower reduction would have enabled them to adjust to import competition, upgrade technology, and compete. The sudden onslaught of lower-priced imports decimated many domestic enterprises, although it benefited domestic consumers with an array of consumer products. Domestic traders gained too.

Unfortunately, this overexposure gathered momentum as from the early 2000s, free trade agreements with much of East/South-east Asia reduced tariffs further, flooding Indian markets with Chinese and other country products – consumer (durable and non-durable) and capital goods.

Meanwhile, beginning 2000, the number of those joining the labour force grew sharply to 12 million per annum till 2004-05; as domestic manufacturing employment growth was slow, they could only

be absorbed in agriculture or traditional services; and informal employment grew even more than ever before. However, with GDP growth picking up from 2003-04 onwards, non-agricultural jobs began to grow at 7.5 million per annum.

Two fortuitous, though policy-induced, developments have saved the day since 2004-05, reducing sharply the number of entrants to the labour force. First, as population growth fell from 1990 onwards, entrants to the labour force fell. Second, as school education access grew rapidly, post-Sarva Shiksha Abhiyaan, children remained in school.

However, these entrants, much better educated than the earlier cohort, are now entering the labour force. Where will they be absorbed? Not in agriculture. The hard labour of construction work is also not attractive to them. They want either white-collar jobs in the private or preferably public sector, or in industry or in modern services. But are such jobs growing fast enough?

Recent data from multiple sources such as the government's Annual Labour Bureau survey, with a sample size larger than the NSS, and the Centre for Monitoring Indian Economy indicate that job growth is lower than entrants to the labour force. The youthful labour force, between 15 and 29 years, saw a very sharp increase of 40 million, from 147 million to 187 million between 2011-12 and 2015-16.

The share of the workforce in agriculture has been falling steadily, from 60% in 1999-2000 to 49% in 2011-12, but the fall has slowed sharply after 2011-12, when the pace of non-agricultural job growth slowed along with GDP growth. Between 2004-05 and 2011-12, the numbers in agriculture had been at a rate of 5 million per year. Since 2012, the numbers leaving agriculture over 2011-12 to 2015-16 fell to 1 million per year, as non-agriculture jobs grew slowly since 2011-12.

More worrying is that while the number of youth in agriculture fell between 2004-05 and 2011-12 — from 87 million to 61 million — after 2011-12 there was a significant increase of youth in agriculture. Between 2011-12 and 2015-16, there was a 24 million increase, from 61 million to 85 million, in youth in agriculture, a retrogressive development since education levels have risen, while the aspiration of such youth is for non-agricultural jobs.

How slow job growth has been since 2011-12 is demonstrated by the manufacturing workforce (organised and unorganised) declining overall and for youth as well. It appears that as GDP growth slowed after 2011-12, youth who had benefited significantly from jobs in manufacturing have suffered disproportionately. Of all youth employed, those in manufacturing had risen between 2004-05 and 2011-12, from 14.5% to 16%. This dropped precipitously to 10.8%, just as the share of all employment in manufacturing fell, between 2011-12 and 2015-16. The only sector with a significant increase in labour absorption, especially the young, has been services, where employment rose from 36 million in 2011-12 to nearly 52 million in 2015-16 for them, and for all labour from 127 million to 141 million.

Incidentally, sheer formalisation of erstwhile informal jobs/enterprises, thanks partly to demonetisation and then GST, is not the same as new job creation (unlike what has been claimed, based on some ill-informed research).

The GST, especially its inter-State component, has resulted in a neutralisation of the IDS, which had come to prevail. It has also, as the Economic Survey 2018 has rightly claimed, led to a formalisation of some informal firms, and hence workers (by registration in the Employees' Provident Fund Organisation).

The resolution of the twin balance sheet problems (of companies being over-leveraged and banks unable to lend due to mounting non-performing assets), together with the Insolvency and

Bankruptcy Code, should now open the floodgates for new manufacturing investment.

Of course, manufacturing exports (labour or capital intensive ones) are unlikely to take-off if the rupee continues to strengthen against major foreign currencies. Exports are today well below what they were a decade ago.

Finally, policy must attempt to close the loop between rising demand and supply through consumer demand, which the Budget attempts through its agriculture and rural infrastructure focus. As GDP growth rate boomed between 2003-4 and 2013-14 to 7.9% per annum because of rising demand, real wages rose because agricultural growth revived and the rural labour market tightened. This is because non-agriculture jobs grew faster than entrants to the labour force. That sweet phase is long past. Without closing the loop of consumer demand and supply, neither GDP growth nor job growth will quicken. More manufacturing policy initiatives, such as an early announcement of an Industrial Policy by the Department of Industrial Policy and Promotion, must be sustained over 2018.

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