REVIVING MANUFACTURING SECTOR: NEED FOR GOVERNMENT INVESTMENT AND SUPPORT FOR MSMES

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- Manufacturing having attained 18% GDP in 2017-2018, has led to complacency among India's policy makers. However the IIP spells otherwise. Also, rising imports presents a case for greater fixed investment.
- As part of the mid-term review of the Foreign Trade Policy 2015-20, the GoI has raised export incentives to labour intensive MSMEs by 2%.
- Stepping up state support for MSMEs, raising fixed investment and thrusting the "Make in India" drive for India itself will surely be useful for 2025.

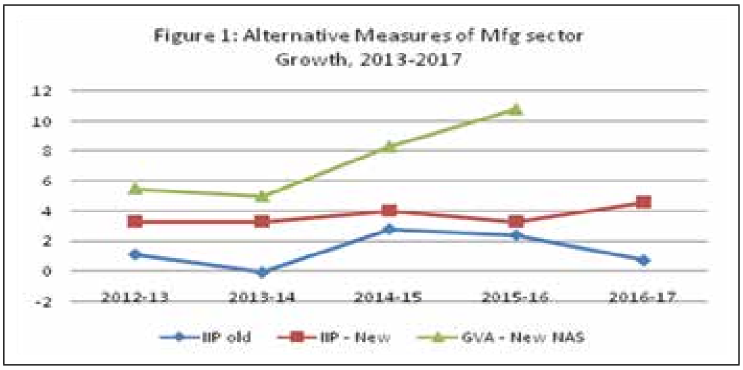
AN OVERVIEW:

Undeniably, industrial growth has slowed down during the last four years, whichever data series one looks at. There is no dispute about the slowing down of exports. An increase in the ratio of trade deficit to gross domestic product (GDP) is a matter of concern, as Mr. Rajiv Kumar, vice chairman of National Institution for Transforming India (NITI Aayog) cautioned recently. We believe the need of the hour is an industrial revival in order to stem import growth. There is need for greater public infrastructure investment to ease critical supply constraints and create demand for domestic industry. Micro, Small & Medium Enterprises (MSMEs) need better access to bank credit and strategic policy interventions to support labour-intensive industries.

ANALYSIS & DISCUSSIONS:

In accordance with the Indian system of National Accounts, the manufacturing sector has accounted for 18 percent of the country's GDP in 2017-18, employing probably about 11-12 per cent of the workforce. It is observed that there is complacency among policy makers about a gradual improvement in industrial output growth since 2011-14. However, a similar view is not borne out by the other indicators of industrial production (exhibits 1 and 2).

Exhibit 1: Alternative Measures of Manufacturing Sector Growth 2013-2017:



Source: RBI's Handbook of Statistics on Indian Economy

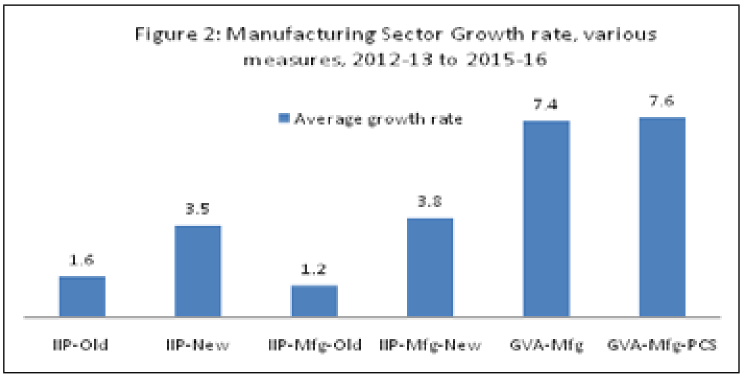
Legend:

IIP - old, Index of Industrial Production-total (old series):

IIP - New, Index of Industrial Production-total (new series):

GVA - New NAS, Gross Value added at constant prices (new series of National Account Statistics).

Exhibit 2: Manufacturing Sector Growth Rate – Various Measures, 2012-13 to 2015-16 :



Source: RBI's Handbook of Statistics on Indian Economy

Legend:

IIP - Old, Index of Industrial Production-total - old series;

IIP - New, Index of industrial production-total - new series;

IIP - Mfg-Old, Index of industrial production-manufacturing - old series;

IIP - Mfg-New, Index of industrial production-manufacturing-new series;

GVA - Mfg, Gross value added at constant prices in total manufacturing;

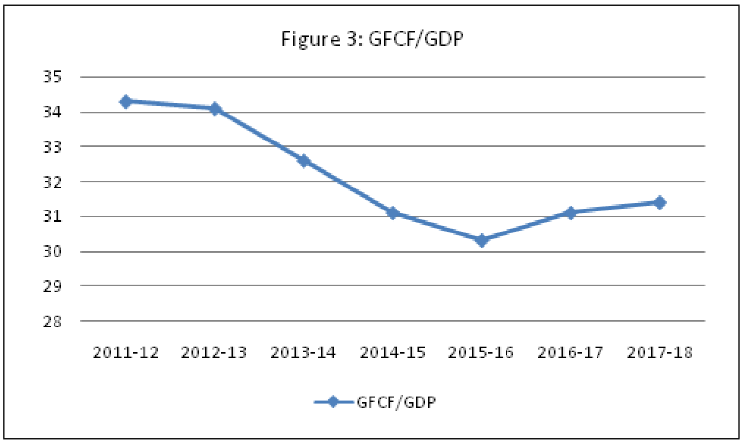
GVA - Mfg - PCS, Gross value added at constant prices in manufacturing in private corporate sector.

PRESENT SCENARIO

The policy shocks of demonetisation as well as the hasty introduction of Goods and Services Tax (GST) appear to have adversely affected industrial production in the unorganised sector; however, these events are inadequately captured in the official statistics. My field visits to about eight industrial centres across the country during March-May this year confirmed several of my hunches. Relatively, though, the bigger enterprises and the better-educated businessmen appear to have withstood the shocks better; most others have not. This is a controversial issue, so I would leave it at that.

Another measure of the economy's poor performance is decelerating ratio of fixed investment to GDP, which has fallen from 34.3 percent in 2011-12 to 31.4 per cent in 2017-18 (exhibit 3 below). Although there is a slight uptick during the last two years, the count is too meagre. To give a perspective, the fixed investment ratio was 37-38 percent of GDP in 2007-08, during the economic boom a decade ago, when manufacturing clocked an annual growth rate of 8-9% according to the older GDP series.

Exhibit 3: Gross Fixed Capital Formation (GFCF)/ GDP

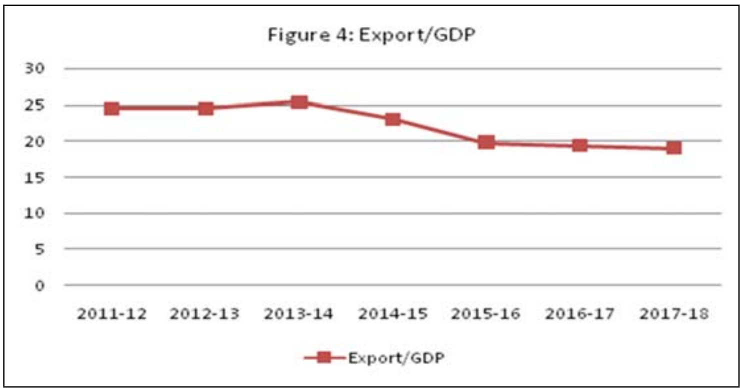


Source: National Accounts Statistics, Various Issues

Legend: Gross Fixed Capital Formation to GDP Ratio

An additional measure of economic performance is the Export/GDP ratio, which has also decelerated (exhibit 4 below). As manufactured products account for a significant share of exports, weak performance of the manufacturing segment has also adversely affected this ratio. We know that the trade deficit ratio has also mounted, implying that rising domestic consumption expenditure is being increasingly met by imports.

Exhibit 4: Export/GDP :



Source: National Accounts Statistics, Various Issues.

Legend: India's Exports to GDP Ratio

CONCLUSIONS:

Signals from Global Economy and Polity

We are effectively in a trade war like situation with the President of the USA, Mr. Donald Trump's unilateral actions. The US president is currently undoing the architecture of global trade built up since the end of the Cold War. It is in this context that one should consider what India's industrialisation policies should be, particularly for labour-intensive manufacturing. We hence make certain recommendations that will get India into the digital circa 2025:

- Avoid any knee-jerk reaction and respond to global threats in a calibrated manner.
- Consider a medium to long-term strategy to step up domestic investment to promote re-industrialisation.
- MSMEs need special attention, as they seem to have been frozen in time in terms of government's attention since the liberal reforms were initiated.
- My recent field visits suggest that MSMEs are not disinclined toward import competition, especially from China. What they look forward to from the Indian government is the kind of state support China offers.
- My field work has shown that wherever there has been systematic state support, whether Morbi in Gujarat, or Tirupur in Tamil Nadu, MSMEs have done well.

In sum, there is need for strategic thinking to step up investment to re-industrialise this sector, and within this, support from the state is needed for specific industries and locations. We will have to, per se, think of "Make in India" largely for India. This in itself will likely be a substantial opportunity given the high level of import to GDP ratio.