

India Cannot Afford to Ignore Manufacturing

Review article based on “Breaking the Mould: Reimagining India’s Economic Future” by Raghuram Rajan and Rohit Lamba.

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At a time when India is deeply polarised and when facts seem to not matter, Raghuram Rajan and Rohit Lamba attempt to show willing Indians a mirror. This is not to say that the authors’ political leanings are invisible; that said, the authors do support many of their arguments with facts and logic.

The question in many people’s minds a decade after the NDA came to power – and a few months before the 2024 election – is whether the fabled “*Acche Din*” are here.

The authors make no bones about what they think: we are not there yet and will not be there soon. As they clearly say, while India is the fifth largest economy by GDP (2022), and is the fastest growing economy among the G20 (Trading Economics 2023), it is also the poorest country by per capita income among the G20 (Trading Economics 2022).

Once the authors make it clear that “*Acche Din*” are far away, they go on to point out that the direction India is taking may not get us there soon. At her current pace of growth, she will not even reach China’s current per capita income by 2047.¹ The authors suggest that India’s posturing in the world stage as a superpower needs to be moderated by facts. Such posturing may have some positive domestic impact on the electorate but may not suffice to reach our economic goals in this manner.

The authors bring a fresh perspective to the discussion about the direction India should take towards becoming a developed country by 2047, the hundredth year of India’s independence. They say focus on education, grow in services, devolve more power and resources to local government, and build good relationships with other countries to de-risk our supply chains and promote peace.

Manufacturing vs Services

The authors question the obsession with manufacturing as the way to grow India’s economy. They argue eloquently that it is intellectual property and services that gives Apple a \$3 Trillion market capitalization while manufacturing prowess gives Foxconn, the company that makes all the iPhones, only a market capitalization of \$50 Billion. This seems to suggest that if India focuses on manufacturing competitiveness at the cost of services excellence, it would be highly inefficient.

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The authors suggest India should try to become for services what China became for manufacturing. (Khan 1997) However, it is important to note that services as a share of global trade is still quite small, at 23% (UNCTAD 2023), and growing exports in services will take a long time.

The enormous number of unskilled youth seeking jobs in India could benefit from a growth in manufacturing jobs. Devashish Mitra writes in detail about the low education levels of youth in India, and strongly argues that their lack of higher education and low skill levels makes them prime candidates for jobs in labour-intensive manufacturing and not services jobs. (Mitra 2022)

China's manufacturing output is over 10 times that of India, at \$4.98 trillion while India is at \$456 Billion. (Manufacturing value added by country 2022) The developed world has been using China as the preferred source of manufactured goods for a long time, but now seeks an additional source. (Reuters 2023) This could be a real opportunity for India to gain some market share from China.

The other — and potentially more important — trend is that “India and some of the developing countries are becoming more prosperous”. (The World Bank in India 2023) There is a vast market which has been deprived of goods due to poverty; as these economies are emerging from such destitution, the demand for manufactured goods could grow locally. The authors seem to ignore the opportunity to tap into this demand and be a preferred supplier of manufactured goods to the developing world. Given the need for creating large scale employment in India and the still untapped potential for manufactured goods exports, India cannot yet afford to ignore manufacturing.

Nevertheless, it is possible and desirable for India to look at high-end services like chip design, while also making it possible for large scale low-skill manufacturing to grow. The authors claim they are not against growth in manufacturing, but question the large subsidies given by the government for creating manufacturing jobs – for example, subsidies to the tune of ₹16,500 crores given to Micron in Gujarat for assembling and testing chips. They calculate that these subsidies amount to spending ₹3.2 crores for creating one job, since only 5,000 jobs will be created by Micron through this effort.

While it may be prudent for the subsidies to be in line with the number of jobs created, the authors fail to highlight the other benefits of building capabilities in high-end electronics. There is a strategic need for India to build capability in multiple stages of the chip supply chain, and this is one viable way of building that capability. Government-owned companies like Semi-Conductor Laboratories (SCL) have not seen remarkable success in this endeavour in the ~4 decades of their existence. (Economic Times 2023). Subsidies to those who have demonstrated capabilities in the chip supply chain can kickstart the effort in our country.

The 2023 Future of Jobs Report by the World Economic Forum (The Future of Jobs Report 2023) indicates that the jobs of the future are not in manufacturing but in services.

The areas in which India is strong, namely trade in computer services, have been growing even more rapidly than all services, at 10% p.a., according to the same report. With technological advances in digital, “sections of services such as those in education, health and environmental services could see a significant rise” according to this report.

Growth in services will require Indians to upskill themselves very significantly. The authors suggest that the government should invest more in higher education. However, upskilling efforts are not a one-time investment but rather a continuous process, as technology makes one set of skills redundant and others desirable.

In this context, this author had contributed a piece on career impact bonds and how it could help finance the upskilling efforts of a large population. (Krishna 2021) This involves providing people desiring new skills with an “at-risk” loan, to procure training in these skills, repayable under certain conditions (getting a job, earning more than a certain amount of money, etc.) These loans are pooled and structured into career impact bonds with multiple tranches. The tranches which are less risky may see investments from financial investors, while the riskier tranches could use money from the government, CSR funds of companies, and the training institutes themselves. The financial markets will ensure money goes towards training programmes and training institutions that help students get good jobs.

International Relations

India’s trade policies and diplomacy need to also focus more on agreements around services with our trade partners. However, “failures to advance multilateral and regional trade integration through Trade in services Agreement (TISA)” (WTO 2023) adds to scepticism that India can grow quickly in services trade.

While India has had troubled relationships with China and Pakistan for decades, she currently has the worst-possible relationships with all her neighbours. The authors cite the case of Bangladesh, where some of India’s majoritarian politicians have targeted Bangladeshi immigrants with abuse. They point out that China’s increasing influence in Nepal, Sri Lanka, and even Bhutan is making it attractive for these countries to keep India guessing about their alignment when faced with a muscularly nationalistic India.

Nitin Pai, in his blog, talks about how India’s interests are best served by selectively aligning with either the United States or China by issue. (Pai 2010) Similarly, it is in the interest of many of India’s neighbours to align with India or China selectively by issue. The authors may be reading too much into this, but India would do well to make more friends in her neighbourhood.

The authors claim our desire to coerce and even insult other countries, to try and cow them, resembles the “Wolf Warrior” approach taken by parts of the Chinese establishment. They feel our efforts at chest-thumping could be counterproductive and are premature. Too much chest-thumping could lead to fears from the developed western world that India is another aggressive China in the making, and this could scuttle our efforts to become a developed nation ourselves. This would not be a favourable outcome for India and India should walk the tight rope of diplomacy between aggression and assertiveness.

Governance and Decentralisation

The authors point out that India is a large country – the most populous in the world – and needs more decentralisation, not less. Poor state capacity is a big problem. The number of government and public sector employees is low and has been going down. India has less than 4.5 civilian employees per 1,000 population according to the authors. In comparison, they point out the US federal government has 8.07 civilian employees per 1,000 population. When one looks at local government, in the US and China, two-thirds of the government employees are in the local government, but in the case of India, only 12% of government employees are in the local government.

As per the 2011 census, 69% of India's population live in rural areas. (Press Information Bureau 2022). The government had made big promises about doubling farmers' income. The reforms to farm laws might have been beneficial to farmers, but the inadequate quality of effort in explaining the benefits of the bill led to long and widespread protests, eventually leading to the withdrawal of the bill. Subsidies to agriculture through fertiliser subsidies, free power in many states (GOI 2021) and free water have distorted the market, and – according to the authors – have not been efficient or effective.

The authors make a convincing case for further devolution of powers and resources to the states, and then to the local district and panchayat levels. This, they feel, will create greater accountability and efficiency in the delivery of public services and goods, tailored to local needs.

Education and Healthcare

The authors compare many of the subsidies given to promote manufacturing and even agriculture with budgetary allocation for primary and higher education and try to make a case for greater investment in education. They point out that the subsidies given to Micron was 50% of the entire education budget.

This is indeed a key point of great concern. India's spend on education as percentage of GDP is very low, at 2.9%. (Bhattacharya 2024) In comparison, the United States of America spends 6% of its (substantially higher) GDP on education, and the United Kingdom, 4.2% (on a significantly smaller population). The authors feel the money will be better spent on education than on many of the above subsidies. India does require a much higher spend on education, but it is more than just money. Ensuring greater accountability of teachers in government schools can be achieved, according to the authors, on devolution of authority and budgets to local bodies.

Freedom and culture

Lastly the authors talk about a culture of freedom of thought and expression to create an environment of innovation and progress. A culture of innovation is required to drive research and development. This is also required to achieve and maintain competitiveness in every sphere of work.

The authors question whether a regime which seems to tolerate no dissent will be able to foster innovation. The authors doubt India will be able to see the return of many of its highly qualified engineers and scientists from the US and other countries unless there is a culture of freedom. Some may argue that an authoritarian regime like China has succeeded in attracting their talent back to their country, and almost 46% of all global patents filed were from China, but the authors make a valid argument that long-term innovation and progress will require freedom of thoughts and expression.

Overall, this is a delightful read, with many things to think about even if one does not agree with all of them.

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Notes

ⁱ If we grow at 6% per annum, in 24 years our per capita GDP will quadruple and at \$10,000 it will still be less than \$11,560 (Trading Economics 2022) which is China’s GDP today.