How India lost out to China, rest of Asia in development race

Interview with Economist Prof Santosh Mehrotra, Jawaharlal Nehru University

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India is facing an unprecedented economic crisis. The world's fifth largest economy was suffering from a demand slump when the new coronavirus pandemic struck. The lockdown announced to stop the pandemic from spreading has virtually stalled the economy, which is facing a recession and a jobless rate unseen since independence.

Reviving Jobs: An Agenda for Growth (Penguin), a book edited by **Prof. Santosh Mehrotra**, traces the current crisis through the history of India's industrialisation. In an interview with Policy Circle's **Anil Nair**, he explains how the Asian Miracle eluded India. Second part of the edited excerpts:

When the Narendra Modi government came to power, it talked about stepping up manufacturing. It launched the Make in India initiative. During the US- China trade tension, lot of people expected companies to shift base to India. But such companies went to Vietnam, Bangladesh and Mexico. What is stopping India from becoming the manufacturing hub of the world?

There is a long list of impediments that are stopping us. Since 1991, for almost 30 years, we didn't have an explicit industrial policy. Let us remind ourselves that all East Asian countries including China had industrial policies in place — and within it a specific manufacturing strategy. That we didn't have a manufacturing strategy meant that while manufacturing has grown in India in absolute terms, it did not become the lead sector in our economy. By lead sector, I mean a sector that grows faster than the rest of the economy. Therefore, it can actually drive the overall GDP growth, as manufacturing did for East Asia.

In 1991, the share of manufacturing in India's GDP was 16-17%. Thirty years later, it still contributes the same percentage of the national output. The sector provided employment to 10.5% of the entire 380 million workforce in 1993. Most manufacturing was done in the unorganized sector. Even after 30 years, the share of manufacturing in employment remained at 11.5%. Over a 15-year period, the employment share increased by just one percentage point. It rose between 2004-5 and 2011-12 when it peaked at 12.8%. Had we maintained that trajectory, manufacturing employment would have been in the region of 15-16% of the workforce now.

Does the stagnation in Industrial activity coincide with China's rise as a manufacturing power?

Absolutely. China went on a trajectory set by the National Development and Reform Commission, which was an institution like the Planning Commission we had till 2014. China became the factory of the world since the 1990s. India has had a decline in the number of people employed in manufacturing sector since 2012, despite policies like Make in India. In the six years from 2012, number of manufacturing jobs fell by 3 million, a first in India's history. The sectors that contributed to the decline in manufacturing employment were precisely the sectors that you would want to see growing. These are the labour-intensive sectors that contribute half of the total manufacturing employment – textiles, garment and apparel, wood and furniture, food processing, and finally leather and footwear. Unfortunately, the policy environment for none of these sectors are encouraging. This has led to a decline in manufacturing employment. Compare this with Bangladesh where the share of manufacturing in total employment is 16%. So, we don't even measure up to Bangladesh now.

There is a lot of excitement in India about 1,000 companies planning to leave China. Of the companies that have decided to leave China, only three are coming to India while most are going to Vietnam and elsewhere. Why is the manufacturing sector not growing in India? My new book, Planning in the 20th Century and Beyond, published by Cambridge University Press, explains what should be the components of a manufacturing strategy. Let me say a few words about that now. One reason why India is not seen as an attractive destination for FDI compared to Vietnam, Indonesia or Philippines is poor hard infrastructure. But soft infrastructure comprising regulatory institutions and human capital is equally important.

The educational level of the workforce in India is really poor. That has been historically true for nearly 60 years since Independence. That has begun to change only recently. We universalized elementary education by the end of the first decade of this century. Secondary enrolment shot up from 58% in 2010 to about 80-85% by 2015, both among boys and girls. Tertiary enrolment also shot up from 11% of 19-23 year olds to 26% between 2006 and 2016y. The problem is in the quality of education, and that has been very low compared with China, Vietnam and Indonesia. In addition, they had an explicit industrial strategy for 30 years, and we didn't.

The second difference is that they had a technical and vocational education strategy. For almost 60 years since Independence, until the beginning of the Eleventh Five Year Plan in 2007, we had neglected skill development. The Eleventh Plan was the first document that had a separate chapter on skill development. Then, the government expanded capacity certainly, but the capacity expansion was itself not sufficient; it did not lead to an improvement in the quality of skill delivery. Importantly the expansion of capacity also happened in general education. It resulted in a precipitous decline in quality, which was not very high in the first place. Contrast this with East Asia where they had an education and skilling strategy aligned to the industrial policy. Here, we neither had an Industrial policy, nor an effective skilling plan, let alone quality.

Problem number three is again historical. In the Second Five Year plan, we adopted a strategy of import substituting industrialization, which was focused on heavy industry. There was a particular twist in our strategy that is not reflected in the Mahalanobis model. The Second Plan focused on heavy industry first in the public sector. That was not going to generate jobs. I'm not questioning the second plan strategy. What I'm questioning is what became a corollary of that – agriculture that had received a fair amount of attention in the First Plan went out of favour. As a result, the output and incomes in agricultural sector grew more slowly. This meant demand from the rural sector, which would have created consumer goods demand for new manufactures, never materialized. We became self-sufficient in food since the mid-1970s, but agri incomes have grown much more slowly than incomes in the non-agri sector. Another problem was that the school system was not expanding, especially in the rural areas.

Female literacy was not growing and this impacted adversely our population growth rate. We were a much smaller population than China in 1947. We were merely 330 million people when China was 500 million. We allowed the population to grow, which was a natural outcome of limited investment in education and basic health services, which included reproductive health, family planning and education of girls. We paid the price for that and have become the most populous country in the world. This is a very serious problem that impacted agriculture adversely because it meant that plot sizes kept shrinking and non-agricultural job growth was slow. When agri productivity and rural incomes are not rising, how could the demand for consumer goods rise? This neglect of education and health had a catastrophic effect on many sectors of the economy. This was one of the reasons why we could not attract foreign investment.

The foreign companies made a beeline for East Asia including China because they had much better levels of education and their workforce was better equipped for manufacturing industry. Our advantage, unfortunately, turned out to be in the services sector, because we invested in tertiary education. The better educated from tertiary institutes got absorbed into services sector. That's how India became a services-driven economy. But there is a limit to the labour absorption capacity of services industry. This is an additional problem.

The fourth reason for stagnation of manufacturing output and employment was also policy-induced. We opened up the economy very fast after 1991. Because of the industrial policy followed from 1956, there was this practice of reserving products for small-scale industry. This was started because of the focus on capital goods Industry that could not create too many jobs. We encouraged small scale industries, khadi and village Industries and cottage industries. There was a Gandhian mindset at work along with the Soviet style planning that favoured heavy industry in the public sector. The problem with reserving products for SSIs was that the policy killed the SSI's incentive to grow. This had a distortionary effect on the structure of enterprises in our country.

Let me give you some data. You will be stunned to hear that today in the non-agricultural sector, there are 63 million enterprises or units. No country in the world has such a large number of units. They are all concentrated in the unorganized sector. Of that, 70% are unregistered units. The government is practically not aware of their existence. So, it means that you created a registered SSI sector. But the SSI sector needs a whole network of relationships within local suppliers which generated millions of unregistered micro and nano enterprises. We got caught up in this small-scale industry model. There was no incentive for SSIs to grow because if they became medium-sized, they would lose all the special benefits. So, the reservation of products had a disincentivising effect on firm-size growth and distortionary effect on size structure of enterprises in India.

We were burdened with a missing middle, and even a missing small sector that started disappearing after the economy was opened up to international competition. The SSIs should have been opened up to domestic competition first, before allowing international competition. Faced with international competition, the SSIs mostly collapsed. Today, the size structure of India's enterprises is dominated by micro, unorganized units at one extreme, and large corporates on the other hand. Even in Bangladesh, a garment and textiles company will have anywhere between 4,000 and 5,000 workers. If we don't have that scale, how can we compete in today's world?

From 1956 to 1990, the number of products reserved grew to 836. Right after the reforms were initiated, their numbers began to fall. But when the Narasimha Rao government lost in 1996, the process of dereservation of products lost momentum. The process could restart only after 2005. This was already too late. Eliminating reservation could have taught the enterprises to compete with each other and scale up to medium or large firms. But what did we do? We reduced tariffs and allowed foreign consumer goods to flood the market. Tariff rates were sharply reduced from 150% to 40% by 1998 then further down to 10% by 2002. While the intent was right, the sequence of reforms was completely wrong. So, a lot of these SSIs, even the good ones, got destroyed.

The Chinese experience was different... They opened up sectors at a slow pace to gauge the impact of the policy...

Yes. In the 1980s, they allowed their township and village enterprises to grow and generate margins. They continued to create jobs while India's SSIs remained dwarfs. You need to grow in order to improve your margins, create jobs, upgrade technology and enhance productivity. And that is a virtuous circle. We got trapped in a vicious circle of low productivity, low technology, and low earnings – with millions of nano enterprises cropping up. This only led to a mass of poor being created. The Lakdawala poverty line tells us that there were 320 million poor in 1973-74. The number of poor remained at 320 million in 1983-84 and in 1993-94. In 2004, we still had 302 million, just a minor decline. In other words, it's only after 2004-5 that we got fast growth in non-agri employment. Non-agricultural growth rate improved, especially in non-farm labour-intensive jobs.

When construction, industry and services jobs grow fast, people start moving out of agriculture. This whole story is narrated in our book. It explains what mistakes we made and what are the elements of a manufacturing strategy that need to be adopted.

(Santosh Mehrotra is Professor of Economics, Jawaharlal Nehru University, who specialises in labour, employment, and the economics of education. He has been an advisor to the United Nations and the government of India. Kindle edition of the book, Reviving Jobs: An Agenda for Growth, the third in Samrudha Bharat Foundation's Rethinking India series, is available on Amazon.)

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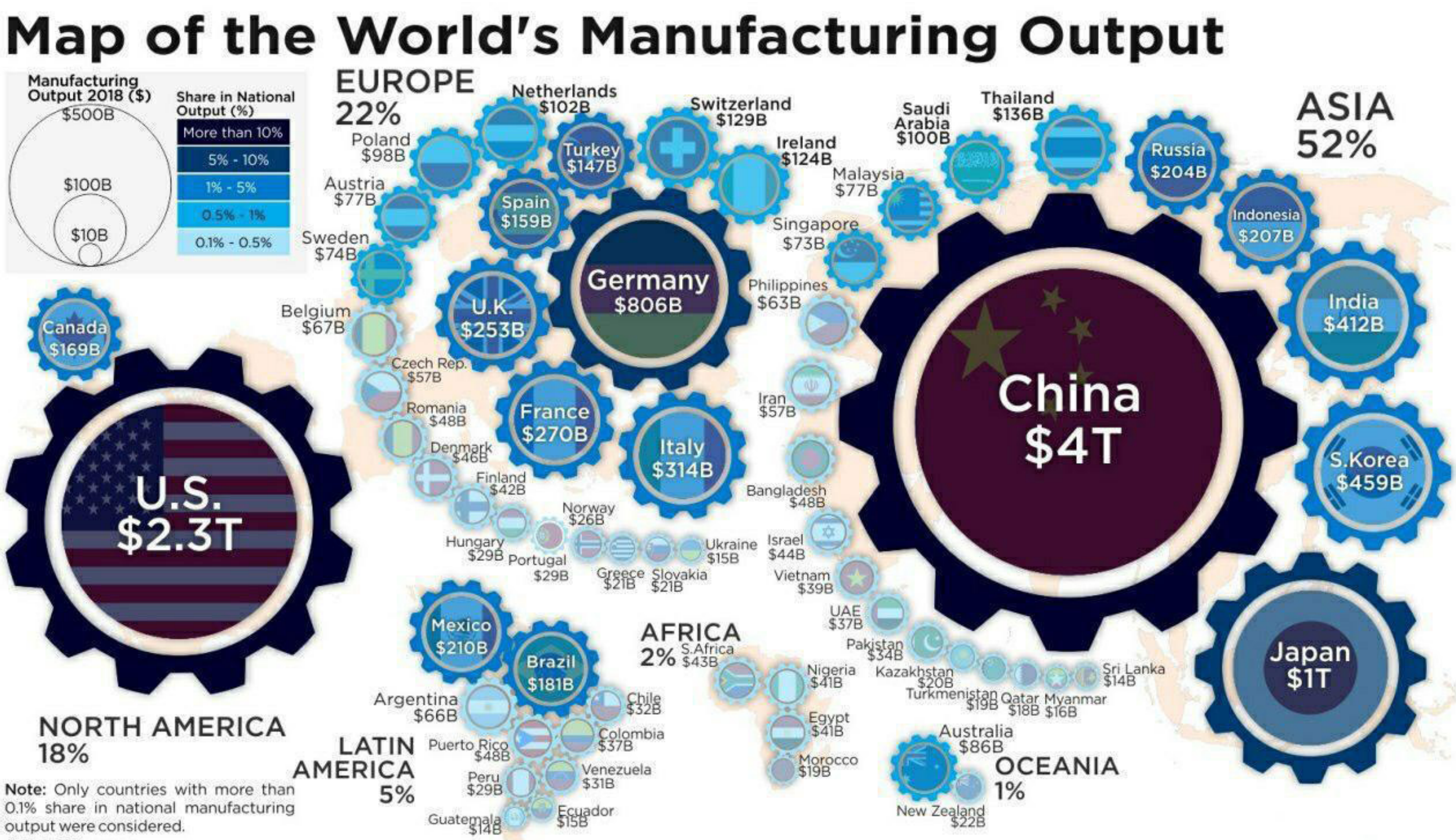

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