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AIC COMMENTARY

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Can India Take the Advantage of Covid-19 to Influence Manufacturers Moving Out of China?

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This commentary addresses the crucial factors that determine India's plan to be an attractive destination in the manufacturing sector. This commentary discusses the major challenges that India face in the process of attracting investments that are moving out of China. It also covers competitiveness and complementarities in terms of engaging in production networks for ASEAN and India.

1. Introduction

With the outbreak of Coronavirus from the Wuhan city of China a large group of foreign entrepreneurs with manufacturing plants in China mainland lost their confidence and started to explore opportunities elsewhere. India started to pursue these investors by offering several incentives. India has identified a group of industries where investment will be facilitated. The Government has instructed its foreign missions to launch campaign for the programme. State governments in Gujarat, Madhya Pradesh and Uttar Pradesh have immediately relaxed their labour laws. India is reportedly developing a land pool nearly double the size of Luxemburg to attract the investors. The lawmakers in India believe China's negative image due to mishandling the pandemic, weak Intellectual Property Right (IPR) laws and its diplomatic scuffle with many powerful nations including the USA that may help in getting investment to a significant amount[1]. The policymakers in India are of the view that it will boost its *Make in India* programme, adopted in 2014, to encourage manufacturing activities in the country[2]. As India desires to augment the foreign investment flows, it is important to examine if the country is ready for the same. In this context, this commentary addresses some of the crucial factors that will favour India's plan to become a nodal destination for the manufacturing sector. The commentary also discusses some of the prominent challenges that India may face in this direction.

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2. Determining Factors

2.1 Market Size

India’s large population along with growing middle class plays a determining role in attracting the FDI. India’s large population offers a ready market to the investors. Higher market size offers larger potential demand, higher purchasing power and low cost of operation due to economies of scale, where firms can potentially receive higher returns on investment on their capital and gain higher profit from their investment, *ceteris paribus*.

2.2 Tax Structure

India has introduced the Goods and Service Tax (GST) replacing the century-old tax structure. Application of GST has simplified various procedures related to tax filing. Further, India’s commendable step of reducing corporate tax to 15 per cent for the new companies in the manufacturing sector announced during the Union Budget of 2020-21 add to its competitiveness while drawing the attention of the prospective investors. The same budget claims India’s corporate tax rates are now amongst the lowest in the world. Lower tax rate reduces the cost of production, which in turn reduces the price of final goods and leads to higher demand for goods and services. It is commonly understood that there is a negative relationship between FDI inflow into a particular location and tax rate.

2.3 Rate of Inflation

Inflation rate plays an important role in attracting foreign investment. A low rate of inflation reduces uncertainty about the economy and boosts the confidence of businesses for making investment decisions. A low or a stable inflation rate indicates lower production cost and high demand for goods and services in that location. Hence, a lower level of inflation increases the potential for FDI inflow. India has been able to maintain stable inflation with moderate fluctuation in the recent past, and it helps investors to take their investment decision in India’s favour.

2.4 Institutional and Political Factors

As per the literature on institutional and political factors measured by good economic institutions, effective rule of law, political stability, government effectiveness, regulatory quality, control of corruption, and intellectual property rights (IPR), etc. facilitate the FDI inflows into the host country.[3] Strong institutions and political stability decrease the overall cost of production and uncertainty in the market. India can showcase its favourable policy milieu in appealing the investors. The Indian government has made myriad efforts to influence foreign investors since 2014 and its successive term in 2019. Foreign investors were invited to exploit the facilities offered under the *Make in India* programme. FDI policy was relaxed, while IPR laws were tightened. An Investor Facilitation Cell (IFC) was set up under the *Make in India* campaign in 2014 to assist investors in seeking regulatory approvals, hand-holding services through the pre-investment phase, execution and after-care support, among others.

India's recent amendment of the Insolvency and Bankruptcy Code prevents wilful defaulters from buying up any of their troubled assets at discounted rates. It brings trust among the business community as the defaulters cannot buy their own defaulted property. India's constant improvement in the Ease of Doing Business Index rank, constructed by the World Bank, may also favour its plan of building trust among the potential investors. India is also ranked moderately well in the Global Competitiveness Index, prepared by the World Economic Forum. Although a few indicators are not performing at a satisfactory level, factors like Corporate Governance, Shareholder Governance, etc. are ranked high under the same index. The report places India well ahead of most emerging economies in terms of innovation.

3. Challenges Remain

Despite numerous positive factors, India struggles to attract FDI in its manufacturing sector, especially greenfield investment. Hence, it is essential to understand what is hindering FDI inflows in the Indian manufacturing sector. One such crucial obstacle lies in the process and the regulations that govern in acquiring land in India.[4] Though a serious effort has been made to bring clarity by enacting the landmark Land Acquisition Act, 2013, but it had a little impact on the investment flow. While the Act has undoubtedly protected the interest of the landowners, it fails adequately to address the concern of a potential acquirer. It heavily restricts the government's power to mediate in the acquisition process and making it too difficult to acquire any land for any reason.[5]

Another major stumbling block for the manufacturing sector is India's complicated labour laws.[6] India's labour laws are restrictive and discourage investors in the manufacturing sector. Companies or manufacturing plants with more than 100 employees require government approval under the Industrial Disputes Act of 1947 before laying off any employee. In addition, the Contract Labour Act of 1970 requires necessary approval from the government and employee to make simple and basic changes in an employee's job description or duties. They discourage firms from introducing updated and more efficient technology that might require retrenching of a few workers.

During the Covid-19, India has relaxed a few labour laws to revitalise the manufacturing sector. Reforms were brought by both federal and state governments especially through granting exemption in working hours and raising the statutory thresholds, among others. States like Uttar Pradesh, Madhya Pradesh, Gujarat and Assam were the front runners in this regard.[7]

Most of the manufacturing firms in India are also facing the problems of environmental as well as other clearances. Due to more time consumption in availing all these clearances, starting a business takes a lot of time. For example, as per the Electricity Act of 2003, there is no license required for any thermal power plant, but until 2014, any company wishing to establish a thermal power plant in India had to take more than 65 clearances. Although the situation is better now, the environmental clearances remain a big challenge for the private sector in India.

Scarcity of skilled labour force to support the modern form of manufacturing is largely affecting the growth of this sector. Though India has a large pool of talents in the field of Information Technology and other high skilled jobs, it lacks in providing basic technical and professional education. Research by the National Institute of Public Finance and Policy (NIPFP) reveals that only about 2 per cent of Indian workers have qualified for certificates documenting their mastery of professional skills, compared with about 70per cent of workers in Europe and 80 per cent to 90 per cent in East Asian countries like Japan and South Korea.[8]

3.1 ASEAN Challenges

Apart from the above-mentioned challenges, India faces steep competition from the Association of South-East Asian Nations (ASEAN). Economies like Thailand, Vietnam and Malaysia with their strong and vibrant manufacturing environment and their strong position in global supply chain networks will pose a great threat to India in attracting investment from China. Studies revealed that in 2019, out of the 56 companies that shifted their production out of China, only three invested in India; while 26 went to Vietnam, 11 to Taiwan, and 8 to Thailand.[9]

4. Conclusions

Despite all these challenges, India still has an opportunity to revamp its manufacturing sector if it plays its card well. This opportunity arises from two distinct factors: first is losing the faith of manufacturers in China after the outbreak of Covid-19. Investors have realised the risk of putting their investment in a single location. Therefore, they are looking for different destinations to relocate their manufacturing units. Second, due to the uncertainty arising in China and the growing rivalry with the developed world, countries like Japan and the US have appealed their corporations to shift their businesses out of China. Japan has announced a fund of US$ 2.2 billion to help manufacturing firms relocating from China to elsewhere.[10]

India’s close ties with ASEAN will complement each other if they cooperate in taking the advantage of fragmentation in the production process and establishing digital and physical connectivity. Cooperation between the industries of various sectors in different stages of production network will help to tap the benefit arising from the manufacturing plants planning to shift due to the pandemic.

There is a big opportunity for India to act proactively and lure these enterprises. India can achieve remarkable progress in attracting FDI at the aftermath of the Covid-19 crisis. Though India has started to act positively in this respect, it will be interesting to see if India can seize the opportunity to influence the investors planning to shift their manufacturing facilities out of China.

Endnotes

1. Refer, for example, Choudhury and Maiti (2020)
2. Refer, for example, Bloomberg (2020)
3. Refer, for example, Rodrik and Subramanian (2003)
4. Refer, for example, Hoda and Rai (2015)
5. Refer, for example, Thakker and Albrecht (2019)
6. Refer, for example, Hoda and Rai (2015)
7. Refer, for example, Gopalakrishnan (2020)
8. Refer, for example, Mundle (2017)
9. Refer, for example, Bhowmick and Sahasrabudhe (2020)
10. Refer, for example, Reynolds (2020)

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About AIC

Considering the work of the ASEAN-India Eminent Persons Group (AIEPG), and its Report with recommendations for forging a closer partnership for peace, progress and shared prosperity, the Heads of the State/Government of ASEAN and India at the ASEAN-India Commemorative Summit 2012, held at New Delhi on 19-20 December 2012, recommended the establishment of ASEAN-India Centre (AIC), which was formally inaugurated by the Hon'ble External Affairs Minister of the Government of India on 21 June 2013 at RIS. AIC serves as a resource centre for ASEAN Member States and India to fill the knowledge gaps that currently limit the opportunities for cooperation. AIC is closely working with the Indo-Pacific Division of the Ministry of External Affairs (MEA), Government of India to undertake and disseminate evidence-based policy research and provide policy recommendations.

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