Ecowrap

'Be the Bank of Choice for a Transforming India'

Issue No. 57, FY21
Date: 02 November 2020

INDIA NEEDS TO FOCUS MORE ON INCREASING PRODUCTIVITY AND LESS ON IMPORT TARIFFS IN ITS QUEST FOR ATMANIRBHAR BHARAT

A cross country comparison of Manufacturing Value Added of top world manufacturers shows that between 2004 and 2017 China gained around 18% market share in Manufacturing GVA, while India gained 1.5%, the second highest(6th largest in global manufacturing share at 3%). Other emerging markets viz. Brazil, Indonesia, Turkey, Thailand have also increased their share in world manufacturing. However, the respective increase is less than 1% for each country. However, the per capita manufacturing still shows the lack of achievement of India's full potential.

We believe to accelerate India's progress towards Atmanirbhar Bharat, India needs to reduce its tariff. After 2004, India had witnessed rapid reduction in AHS Weighted Average (%) across all product categories. Despite the reduced tariffs, India has one of the highest weighted average tariffs in the world on manufactures. A regression of India's imports of raw materials, intermediate goods, capital and consumer goods in the respective AHS weighted average import tariff rates for the time period 1990-2017 shows that with even 1% increase in tariff the imports decline by around $2 billion on an average, thus possibly making a cause for improving the manufacturing base of the country, but they do not encourage improving productivity and are tantamount to taking the easy route. Also, in the export basket, the highest share is of consumer goods which are mostly manufactured products. This is followed by intermediate goods and these two attract the highest tariffs in the import basket, thus making a case against the fact that the higher import tariffs have not protected these industries. Other countries with much lower tariff structures have built manufacturing bases, which have helped them in their exports.

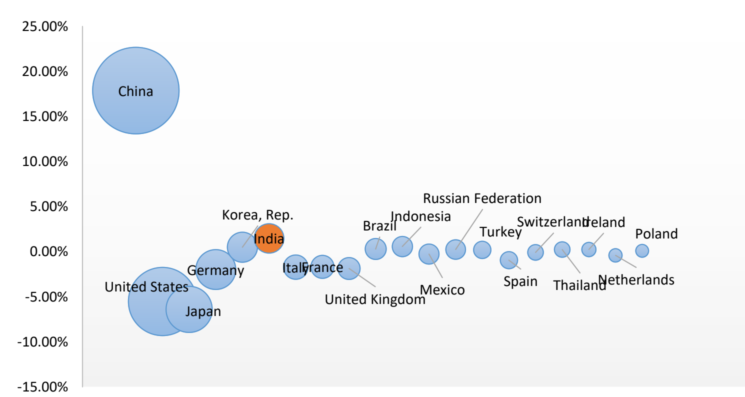
The high tariffs are clearly impacting India's position in Global Value Chains / GVC. Countries can participate in GVCs by engaging in either backward or forward linkages. Backward linkages are created when country A uses inputs from country B for domestic production. Forward linkages are created when country A supplies inputs that are used for production in country B. Countries with a larger position index are relatively more upstream, i.e., they contribute more value added to other countries exports than other countries contribute to theirs. When we construct these indices from the available data, we see that for India the GVC Participation has slowly increased over the years as the economy opened up and moved towards globalization. However, the Position index has followed a downward trend as the backward linkages have been more pronounced than the forward linkage. This is perhaps prompting India to raise tariffs but it could actually boomerang on India creating a self sustaining manufacturing base. With Atmanirbhar Bharat, the Government is hoping to increase the forward linkage.

Finally, an example of textile and apparel exports from India to the US, whose major imports have not changed looking back to 2004. However, what definitely changed was that by 2020, US textile and apparel imports became heavily sourced from China which had just 17% share in 2004 (peaked at 36.3% in 2016 and currently at 26.9%) .Bangladesh and India have gained comparable market share of around 3%-4% each. But given that the Bangladeshi economy is much smaller this gain in market share translates into bigger gains for Bangladesh vis-à-vis India. Bangladesh has chosen to specialise more in certain product categories viz. in trousers/slacks/breeches/short made out of cotton and has remarkable dividends since 2015 by increasing its market share in this category by 6-7% in just 5 years! Much more focused attention to apparel and textiles sector is thus required if India wants to compete with its Asian neighbours like Vietnam, Bangladesh and even Cambodia which surprisingly has shown a positive exports growth rate even in 2020! This can only happen through enhancing competitiveness in manufacturing and not by raising tariffs.

INDIA'S MANUFACTURING PERFORMANCE OVER THE YEARS

- India has embarked on a journey of self-reliance to get the nation out of the turmoil caused by the COVID pandemic. A new term is now a part of our vocabulary – "Atmanirbhar Bharat". The Five pillars of Atmanirbhar Bharat focus on: Economy, Infrastructure, System, Vibrant Demography and Demand and manufacturing is expected to play a key role in making India At-manirbhar. India's growth model has been peculiar in the sense that it jumped from being an agrarian economy to a services led economy . This is evident from the GDP data.
- The base changes in India make it notoriously hard to compare the growth rates of various economic parameters. However, looking at the data for manufacturing industrial production, it is evident that the manufacturing production growth rate in India has been dismal in the late 1990s and early 2000s. Barring 3 years period of 2005-06 and 2007-08, India has never experienced double digit manufacturing production growth. The overall share in GDP has also stayed in the 15-18% range over the past several years.
- A cross country comparison of Manufacturing Value Added (current US$) shows that between 2004 and 2017 China gained around 18% market share in Manufacturing GVA, while India gained 1.5%.
- Meanwhile, developed nations like United States, Japan, Italy, France, and United Kingdom lost market share in Manufacturing. Other emerging markets viz. Brazil, Indonesia, Turkey, Thailand have also increased their share in world manufacturing. However, the respective increase is less than 1% for each country.

Change in % Share in World Manufacturing(2017-2004)



Source: SBI Research

- Although India is one of the top 10 manufacturers, majorly due to its size, the per capita manufacturing shows the lack of achievement of India's full potential.

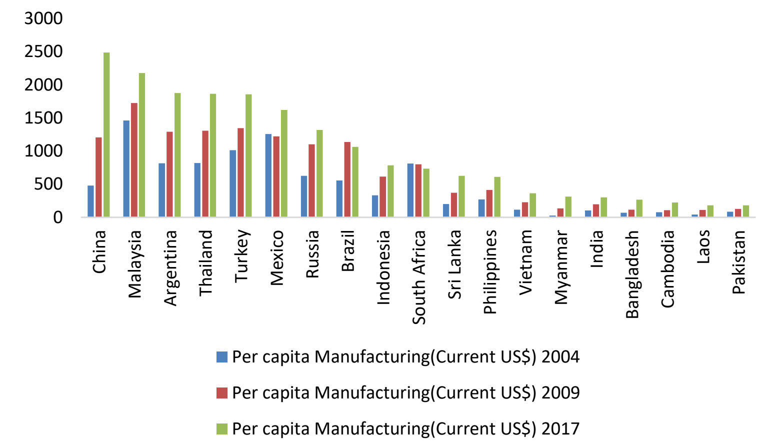
WHY HAS MANUFACTURING LANGUISHED IN INDIA: IS IT A CASE OF THE LAX TARIFF POLICY?

- After the launch of the Uruguay Round negotiating agenda, in September 1986, the world embarked on a journey of lower tariff rates. Achievements included reductions in agricultural subsidies, full access for textiles and clothing from developing countries, and an extension of intellectual property rights. The Round concluded in 1994 and in 1995, WTO was established. With the rapid progress in trade reforms, even the developing countries embarked on the journey of reducing their tariff rates.
- After 2004, India saw rapid reduction in AHS Weighted Average (%) across all product categories. Despite the reduced tariffs, if we look at the manufactured products tariff structure across the globe, India has one of the highest weighted average tariffs in the world on manufactures, which comprise of both consumer and capital goods. This complicates matters for those who argue that India has not developed a manufacturing base as its tariff structure has led to higher imports , thereby leading to reduced domestic manufacturing. We are already on the higher end of the spectrum. A regression of India's imports of raw materials, intermediate goods, capital and consumer goods in the respective AHS weighted average import tariff rates for the time period 1990-2017 shows that with even 1% increase in tariff the imports decline by around $2 billion on an average. Although the result is significant, this does justify the use of tariffs for improving the manufacturing base of the country, but they do not encourage improving productivity and are tantamount to taking the easy route. Other countries with much lower tariff structures have built manufacturing bases, which have helped them in their exports and India can learn from them.
- Also, in the export basket, the highest share is of consumer goods which are mostly manufactured products. This is followed by intermediate goods and these two attract the highest tariffs in the import basket, thus making a case against the fact that the higher import tariffs have not protected these industries.
- If India has to build Atmanirbhar Bharat, increasing tariffs is not the way to go. Rather, the focus should be on building the right infrastructure which can help in making India's exports more cost competitive. Also, the government should focus more and more on easing the processes for businesses to function easily.
- Another area is increased investment in R&D spend so that more innovative products are developed. India is planning to get integrated more and more into the global value chains and if India does not spend more on building its research capabilities it will get stuck in exporting low value intermediate inputs.

GLOBAL VALUE CHAINS AND INDIA

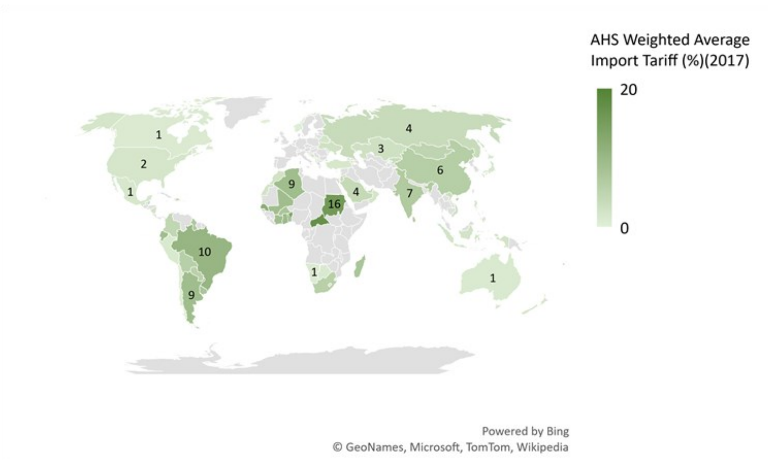
- Recently there have been talks of integrating India more and more into the Global Value Chains (GVCs). GVCs refer to international production sharing, a phenomenon where production is broken into activities and tasks carried out in different countries. Countries can participate in GVCs by engaging in either backward or forward linkages.

Manufacturing output per capita



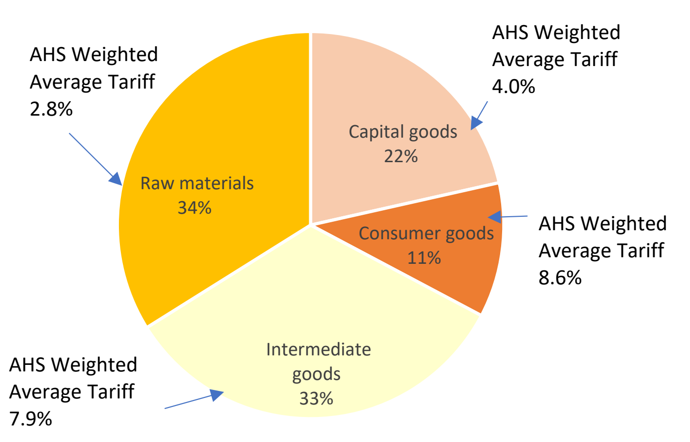
Source: SBI Research

AHS Weighted Average Import Tariff across the World(2017)



Source: SBI Research, WITS

India's Imports of Products and Applied Tariffs(2017)



Source: SBI Research, WITS

- Backward linkages are created when country A uses inputs from country B for domestic production. Forward linkages are created when country A supplies inputs that are used for production in country B. Products cross several borders in GVCs in different stages of production before they are turned into final goods. As such, trade in intermediate goods, which require further processing and are used as inputs for production – is often used as a proxy measure of GVCs.
- The UNCTAD-Eora database gives the main Global Value chain Indicators of different countries, which can be used to compute the extent of integration of an economy. In the UNCTAD-Eora database for value chains the Foreign Value Added (FVA) Component gives the measure of "backward participation" and DVX gives the measure of "forward participation". Using these, we estimated the GVC Participation Index by using the formula of $GVC_{Particpation} = \frac{FVA+DVX}{Gross\ Exports}$. This shows the level of involvement of a particular country in global value chain. However, a more granular picture can emerge when it is analysed whether the forward linkage is more or the backward linkage. To figure this out, we used Koopman et al. (2014) position index that characterizes the relative upstreamness of a country in particular industry.

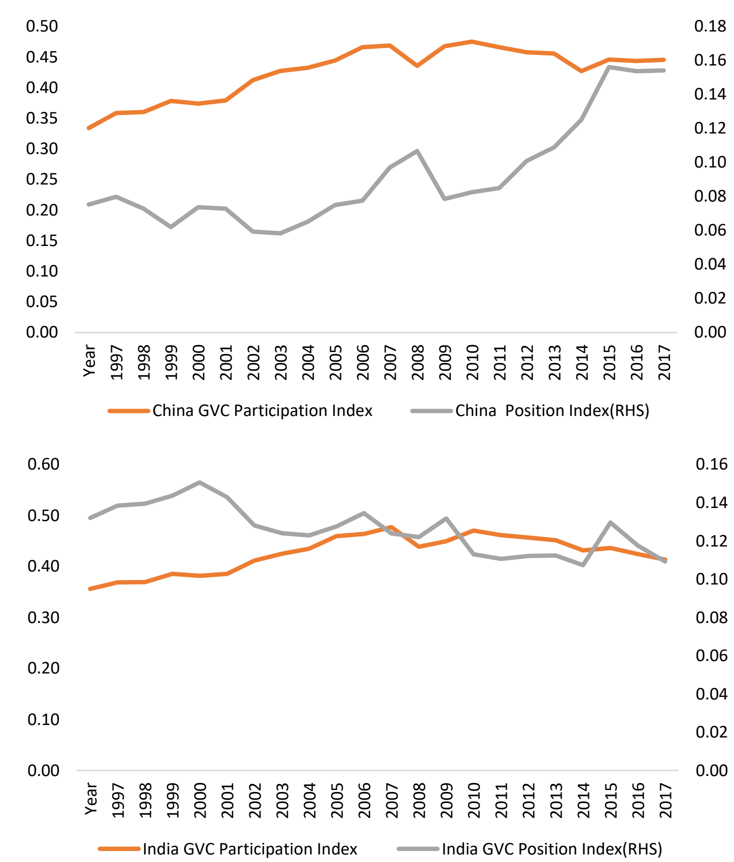
$$Position\ Index = \ln\left(1+\frac{DVX}{Gross\ Exports}\right) - \ln\left(1+\frac{FVA}{Gross\ Exports}\right)$$

- Countries with a larger position index are relatively more upstream, i.e., they contribute more value added to other countries exports than other countries contribute to theirs. When we construct these indices from the available data, we see that for India the GVC Participation has slowly increased over the years as the economy opened and moved towards globalization. However, the Position index has followed a downward trend as the backward linkages have been more pronounced than the forward linkage. In comparison, China has seen a steady increase in its position index over the years.
- With Atmanirbhar Bharat, the Government hopes to increase the forward linkage. However, a higher position index does not guarantee better economic condition or higher living standards. We have many high-income countries that have negative position index. Although India's fairly integrated in global value chains and has a higher level of upstreamness than many other nations, ultimately what matters is how much the exports of a country can command in value terms, because of their level of sophistication or quality. India's overall exports are more tilted towards consumer and intermediate goods and sophisticated merchandise exports in the form of capital goods needs to be encouraged too.
- In this regard, India should hone its services talent, especially the IT enabled services. India has demonstrated its capabilities in services exports. Now is the time to invest in the digital infrastructure as well as upskilling of its youth for jobs for a knowledge economy.

A CASE STUDY OF TEXTILES AND APPAREL EXPORTS: INDIA VIS-À-VIS OTHER ASIAN ECONOMIES

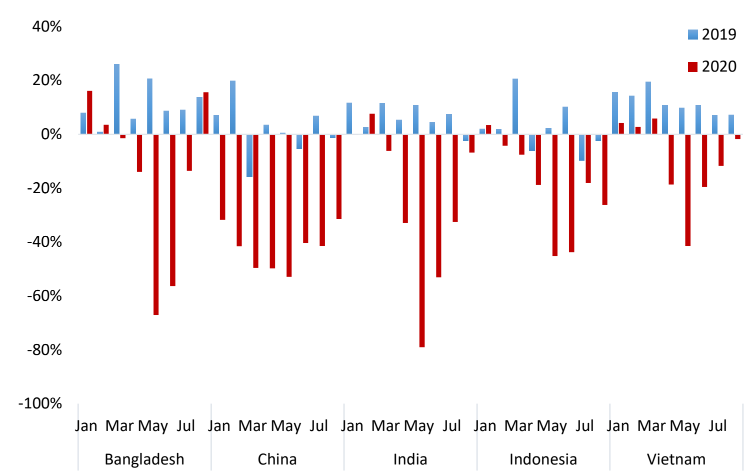
- Over 20% of India's textile and apparel exports go to USA. With the tariff war commencing with China, countries in Asia had gained market share. Vietnam, India, Bangladesh and Indonesia are the other Asian economies which are the top US exporters. In 2019, Vietnam and Bangladesh exports displayed positive growth rate for the entire Jan-Aug period.

India-China Movement in Global Value Chains



Source: SBI Research, UNCTAD-Eora

Y-o-Y monthly Growth rate of US Imports of apparel and textiles

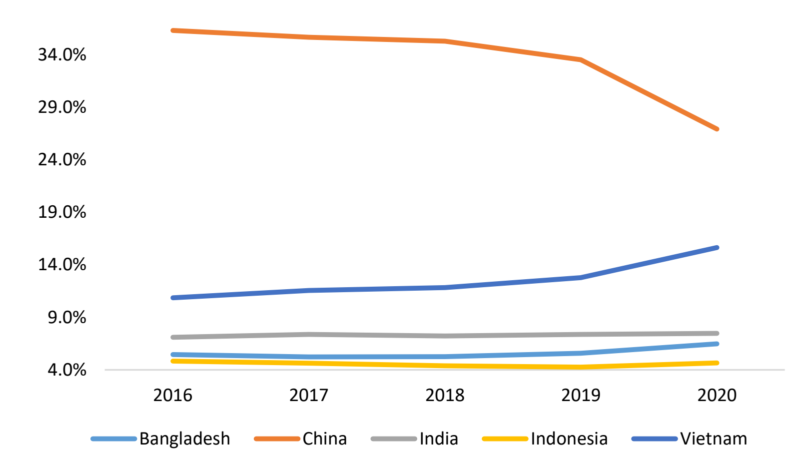


Source: SBI Research

- With COVID, US apparel and textiles imports for Jan-Aug'20 has declined by 26.5% and among its Asian partners China and India have shown the biggest decline in the Jan-Aug'20 growth rate. Meanwhile, despite growing at a much faster pace in 2019, Vietnamese and Bangladeshi imports' decline is lesser.

- Vietnam is already ahead of India in apparel and textile exports to the US, while Bangladesh is also catching up. In recent months also its exports growth recovery is much faster than India. However, it has to be kept in mind that the Bangladeshi export basket is not as diversified as India and its primary exports are apparel and textiles in which also it chooses to specialise in products.
- When the products at 3 digit Multi Fibre Agreement classification are looked at India has a more diversified base in terms of product exports, while Bangladesh has chosen to specialise more in certain product categories, in trousers/ slacks/breeches/short made out of cotton, Bangladesh has quite a bigger share as compared to India. Meanwhile in other exports they have more or less the same share.
- US's major imports have not changed much even if we look back to 2004. However, what definitely changed was that by 2020, US imports became heavily sourced from China which had just 17% share in 2004. Bangladesh and India have gained comparable market share of around 3%-4% each. But given that the Bangladeshi economy is much smaller than India this gain in market share translates into bigger gains for Bangladesh vis-à-vis India.
- Textile and Textile Articles commanded 12% share in India's exports in 2014-15 and by 2019-20 this share had come down to 11%. In absolute terms, too, textile and apparel have shown a CAGR decline of 2%. This is despite the incentives launched to support the textiles and garments industry. The Make in India campaign had aimed at boosting textile exports $31 bn, attracting investments worth $11.93 billion during 2018-2020. However, tepid global demand and pressure from other competitors has not translated in improved prospects for the textile and garments industry. The Make in India website quotes that the textile industry employed more than 45 million people directly in 2018-19. COVID poses further challenges for the growth of this sector and the people dependent on it.
- Much more focused attention to apparel and textiles sector is required if India wants to compete with its Asian neighbours like Vietnam, Bangladesh and even Cambodia which surprisingly has shown a positive exports growth rate of 7.9% in this sector in Jan-Aug'20.

Trend in % share of US imports of apparel and textiles



Source: SBI Research

% Share in US Top Textile and Apparel Imports

MFA Code	Product	2015		2018		2020 August YTD	
		Bangladesh	India	Bangladesh	India	Bangladesh	India
338	M/b knit shirts, cotton	5.0%	9.0%	5.0%	9.0%	6.0%	9.0%
348	W/g cotton trousers/slacks/shorts	10.0%	2.0%	12.0%	2.0%	16.0%	2.0%
659	Other man-made fibre(mmf) apparel	3.0%	2.0%	4.0%	2.0%	5.0%	1.0%
339	W/g knit shirts/blouses, cotton	3.0%	5.0%	4.0%	6.0%	5.0%	6.0%
347	M/b cot. Trousers /breeches/shorts	23.0%	2.0%	24.0%	3.0%	30.0%	3.0%
666	Other mmf furnishings	0.0%	1.0%	0.0%	2.0%	0.0%	2.0%
638	M/b mmf knit shirts	2.0%	0.0%	1.0%	0.0%	2.0%	0.0%
639	W/g mmf knit shirts / blouses	1.0%	1.0%	1.0%	1.0%	2.0%	1.0%
648	W/g mmf slacks /breeches/shorts	3.0%	1.0%	2.0%	1.0%	2.0%	1.0%
670	Mmf flat goods, handbags, luggage	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: SBI Research, OTEXA

Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
:@kantisoumya