Land and labour reforms can attract foreign capital into India

COVID 19 pandemic may push down India's economic growth to negative territory in the current financial year. However, experts feel that with right policy regime, India stands a chance to attract foreign investment from companies seeking to diversify their supply chain away from China. In an interview to MVIRDC World Trade Center Mumbai, Dr. Pravakar Sahoo, Professor, Institute of Economic Growth, Delhi suggests that it is time to reflect why foreign firms are preferring Vietnam, Bangladesh and other Asian countries over India. Dr. Sahoo suggests specific reforms in land and labour to attract foreign investment into India.

Dr Sahoo also shares his views on the impact of COVID on near term growth prospects, based on his detailed research report published a few weeks ago.

Excerpts of the Interview:

1. **In your report on impact of COVID, you estimated India's economic impact based on four scenarios, two kinds of scenarios under V shaped recovery and another two kinds under U shaped recovery. With the evolving circumstances, which of the scenario seems likely and what is your revised growth estimate for GDP and exports in 2020?**

Response: We assess the impact of the Pandemic across sectors and in different scenarios of complete, extended and partial lockdown and at different levels of capacity utilisation. Overall our assessment throws a picture where the growth may vary from near zero to negative seven percent in best and worst case scenario. Today we are partially unlocking the economy and there is still lockdown in few states due to rise in Corona cases. The setback to local production networks and further slowdown of demand due to job losses etc would affect growth from both supply side and demand side. Given the uncertainties, it is most likely we will have a U-shaped recovery as mentioned in our paper. Though it is very difficult at this moment, we may witness a negative growth anything above 3 percent.

The sluggish demand in the country and the globe amid the shutdown and uncertainties will be a pull factor for slowdown. With rising uncertainties, the deferment of investment is most likely which in turn reduces the employment opportunities and further lowers the disposable income thereby pressing the demand on lower side. The domestic production networks are experiencing the shortage of raw materials, components and forced to bear the higher cost. The manual labour supply chain has been badly disrupted and the close down of industries may also lead to loss of skills which are tuned to industrial processes. Therefore, the negative growth for the year 2020 looks inevitable. Coming to exports, our estimate show that exports may shrink by 15 to 20 percent in 2020. In fact the fall out of Covid-19 on India's trade is visible as both exports and imports (Year on year) fell by round by 60 percent in April 2020 compared to 2019. This is in line with our assessment that the fallout may extend to around 60% for both exports and imports if the economy experiences partial lockdown till the mid of 2020 and assuming 90 % capacity utilization till September 2020. India is mainly reliant on EU, USA, China and South East Asian countries, collectively contributing around two third of India's exports. All these are also worst affected by the pandemic.

2. **In your report, you pointed out that basic metals and electrical equipment are the worst affected sectors in the industrial segment. What do you think is the impact of the crisis on industrial production and employment during 2020 and 2021?**

Response: Yes, basic metals and industrial equipments are some of the sectors expected to do badly along with few other sectors such as textiles; refined petroleum products, motor vehicles rubber & plastic products, non-metallic products among others. Industrial Equipment companies are grappling with the immediate impact of COVID-19 as both their manufacturing and supply chain operations are being disrupted, and their customers' own operations face similar challenges. Industrial equipment is an important sector for industrial production and growth for the world economy and also India. Industrial equipment sector with over $3 trillion in revenues, 25% per cent of the manufacturing GDP and 30 per cent of all manufacturing employees across the globe will have an exponential effect on growth especially when the industrial production was already facing a decline globally.

Overall there will be negative performance in manufacturing and industrial sector for at least first three quarters of 2020. Its not only the demand side but there are supply side constraints now. For example the top value added sectors such as base metals, electronics, machinery, coke & refined petroleum products, motor vehicles etc. have much dependence on the imports. As an instance electronics industry imports about 67% of electronic components from China. Further, take the example of automobile sector which is one of the success stories of Indian manufacturing in last decade. The sector was struggling to adjust to the new regulations of BS-VI regulations, effective 1 April 2020, before Covid and now facing challenges because of the dependency of the sector on China for the Original Equipment Manufacturers (OEMs). The Indian manufacturing sector is over-dependent on China for finished, intermediate and raw material. India imported about US$90 billion, or approx. INR 6.6 lakh crore, worth of goods from China in 2018 alone, according to World Bank data. Therefore, disruption to the trade and rise in protectionism will certainly affect the domestic supply chain of industrial section in general and manufacturing in particular. Manufacturing constitutes more than 60 percent of India's total exports and the import content of India's exports is very high. Some of sectors that feature in India's top exports are also in India's top imports. Therefore, lock down affecting imports used for manufacturing will severely affect India's exports. There are many problems and disruptions to the whole chain of domestic production network and manufacturing will take few months to come back to normalcy. Another serious problem is reverse migration of workers. The slowdown or negative growth will certain affect millions of jobs. There are already reports of very high unemployment across sectors.

3. **Government of India has announced a Rs. 20 lakh crore economic package (including the liquidity measures of RBI). Can we have your assessment of this**

package and what more should be done to support economic activity, within the fiscal constraints?

Response: Although there are quite a few redeemable qualities of the economic package much more could be done by the government. What we are facing is a health crisis that has escalated into a financial and economic crisis so any package would be inadequate. Although the package states that it is Rs. 20 lakh crore, it is only around 15 percent which is fiscal stimulus, the rest is loans, credit guarantees and funding schemes. Though all these economic packages are expected to help, its difficult to say what is the appetite of the market and firms to use this opportunity of availing loans and funding schemes, even at a lower rate of interest. When demand is down and there is so much of uncertainty, I am not sure about the effectiveness of the packages.

For example, what we really need for the MSMEs is an improvement in their business conditions – which means stronger growth as we come out of this recession –but also looking at the debt situation and finding ways to give them debt relief rather than additional debt. The current government scheme essentially just gives them more loans which they already have in plentiful. It is time to focus on the employment. But most of all, what is needed is for this package to have a trickle-down effect and reach from the hands of the government to the everyday people. Until that happens, nothing substantial can happen in the economy.

India's growth story is service sector-led growth story. I don't find much for the services sector. IT, Tourism, travel, hotel etc are all down. I don't see any sector specific fiscal stimulus for these sectors. The service accounts around 54% of total GVA, two thirds of total FDI inflows into India and about 38% of total exports. Therefore, an additional look is required at the services sector which is badly hit and provide fiscal stimulus and relief to them. Given the estimated fall out of Covid on Indian economy, the government should not worry about the fiscal rule and go all out in adopting counter cyclical fiscal measures to stop things from going bad to worse.

4. **What are your views on the expectation that global supply chain will diversify away from China in the post-COVID world? What are the specific policy measures you suggest for attracting FDI into India?**

Response: Yes there is an opportunity. Foreign companies heavily dependent on China are looking to diversify the risk to their supply chain due to rise in uncertainty owing to China-USA tariff war, geo political tension and now the fight over Corona management. India offers the best opportunity in terms of huge domestic markets and factor endowments. However, we need to create a conducive and favourable business environment that enables foreign firms to manufacture at a competitive cost and use abundant resources like manpower. It's time to think why foreign firms are opting for Vietnam, Bangladesh etc over India in few sectors. We need factor market reforms such as rationalising punitive land accusation clauses and multiple labour laws both at centre and State level.

In the land acquisition act, government needs to ease norms relating to consent clause for private and public projects, social impact assessment, rehabilitation and resettlement, etc. In fact, the central government had proposed around 15 amendments in the extant land acquisition act in 2015. But these amendments were not carried out subsequently.

With regards to labour laws, the government needs to work on four labour codes at the central level. India's biggest strength is manpower and we can not attract labour intensive foreign manufacturing firms if we don't reform multiple labour laws (around 240 or so together) both at centre and states. Some of the labour laws like Industrial dispute act, contract labour laws, apprenticeship act, trade union act etc are not facilitating labour intensive manufacturing in India. No wonder foreign firms are moving to Vietnam, Bangladesh and other countries. The central government has encouraged states to rationalise their labour laws. Government of Rajasthan has already taken progressive steps in this regard and a few other states are also doing it.

Also, government should augment the work on infrastructure, logistics and trade facilitation which reduces trade and transaction cost which is crucial for FDI firms.

It is heartening to note that Government of India is taking proactive steps to attract foreign firms. In fact, as reported, Indian government is in the process of identifying and developing 4.6 lakhs hectares of land including 1.1 lakhs hectares existing land in industrial areas and planning fiscal incentives in the form of preferential tax rates, the tax holiday etc to attract foreign firms. Further, few states governments are also proactively working at state level to capitalize on the opportunity.

Notifications

Press Information Bureau, Government of India

Prime Minister chairs cabinet meeting to reform farm sector

https://pib.gov.in/PressReleseDetail.aspx?PRID=1629032

CBIC

Amendment in notification based on Finance Bill 2020

https://www.cbic.gov.in/resources//htdocs-cbec/customs/cs-act/notifications/notfns-2020/cs-sg2020/cssg01-2020.pdf

Reduction in import duty on lentils

https://www.cbic.gov.in/resources//htdocs-cbec/customs/cs-act/notifications/notfns-2020/cs-tarr2020/cs26-2020.pdf