

Exports: India's window of opportunity

The gains to an economy from engaging in international trade are well established. Since World War II, we have seen many countries grow on the back of rising investments and exports. Japan, South Korea, China, and to some extent, Thailand and Malaysia, are all examples of economies where exports played a major role in driving economic transformation. It has been clear for some time now that strong exports are crucial in driving development.

These countries recognised early on that all materials needed for production may not necessarily be the cheapest in domestic markets and so put in place liberal trade regimes for imported inputs. A large proportion of our imports, 32 per cent, consist of intermediate goods. Almost 70 per cent of all anti-dumping duties are levied on intermediate goods. This has a cascading effect on the pricing of downstream industries. India should not increase tariffs or raise non-tariff barriers on intermediate goods. This is because the goods that come into India flow into goods manufactured for exports. Any increase in the cost of such products indirectly increases production costs and hampers our exports. By raising the cost of these critical inputs, we end up further eroding our competitiveness, already burdened by a high cost of logistics, credit, and power. The experience of these Asian countries illustrates that imports and exports grow hand in hand. Take the automobile industry, for example. We import \$6.1 billion worth of auto components, but using these imports, our automobile industry exports \$18 billion worth of products.

This holds true at a broader level as well. For example, between 2001 and 2010, our trade-to-GDP ratio nearly doubled from 26 per cent to 49 per cent. Both imports and exports grew during this period. In nominal terms, both imports and exports grew at rates close to 20 per cent in this decade. An analysis of China's experience also shows imports and exports growing at similar rates. Digging deeper, academics have found that almost half of China's imports consisted of intermediate goods, which were then instrumental in raising their exports. Important to note is that a liberal import regime was followed for such intermediate goods, with duty-free imports allowed.



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A key learning from the Asian experience is that incentive structures were put in place to ensure higher relative profitability of exports compared to the rest of the sectors. The incentive structures ranged from subsidised bank credit, export targets linked to long-term credit, export subsidies, and incentives for research & development, amongst others. An important lesson is that while import substitution may have been in place, it was gradually phased out. Another important lesson is that these countries having developed their capabilities in labour-intensive industries gradually moved up the manufacturing value chain. Public investment in infrastructure to reduce the cost of logistics is another key policy intervention. Given that export incentives were functional and broad-based, it is pertinent to note that several strategic sectors were identified for promotion. The lessons from the experiences of Asia indicate that export promotion, rather than import substitution, drives development.

Yet, India was unable to replicate this model of export- and investment-led growth. According to the World Trade Organisation, India's share in global merchandise trade stood at less than 2 per cent, despite having the inherent strength and potential to do much better. Whilst we have done well in the services sector, manufacturing and exports growth have not been broad-based as in the case of other Asian nations. The result is clear to see, manufacturing as a share of GDP and employment remained stagnant between 1990 and 2020. Whilst exports have increased, they are dwarfed in scale by China. Even in traditional sectors, like food processing where we have one of the largest raw material bases in the world, we command a 2 per cent share in global exports. Several factors explain this. We lag in credit availability to the private sector. Domestic credit to the private sector, as a percentage of GDP, stood at 50 per cent in India, compared to 165 per cent in China and 123 per cent in other upper-middle income countries. Our private debt-to-GDP ratio is extremely low and there is immense possibility of enhancing it for manufacturing and exports. Cross-subsidisation of power, higher cost of logistics and labour laws have been the other constraints. Similarly, the composition of India's exports needs to undergo a radical change. Our export basket is

predominantly traditional and does not comprise cutting-edge products. As much as 70 per cent of India's exports target 30 per cent of world trade comprising items with a declining global share.

The need is to promote our domestic manufacturing industry to drive exports and growth. Several important policy steps have been taken in this regard over the past few years. First, the decision to lower the corporate tax rate to 22 per cent for all firms and 15 per cent for new manufacturing firms, will encourage the domestic manufacturing sector. The introduction of the production-linked incentive schemes in several key sectors, for the first time, incentivise production, rather than inputs. These schemes will help domestic manufacturing achieve size and scale. As many as 29 Central labour laws were rationalised into four codes. The definitions of micro, small and medium enterprises (MSMEs) have been raised upwards, allowing them to grow in size, whilst maintaining the benefits of MSMEs. All these steps should help domestic industry achieve size and scale.

Globally, demand is rising as the world is awash with liquidity. The various stimulus packages in the US total close to 27 per cent of its GDP, with the latest size of the stimulus package being \$1.9 trillion. The World Bank's forecast is that the global economy will grow at 5.6 per cent this year, making it the fastest post-recession recovery in 80 years. In its 2021 Global Outlook, Morgan Stanley predicted the global economy to grow by 6.4 per cent, with the US growing at 5.9 per cent, the Euro Area at 5.0 per cent and the UK at 5.3 per cent. Growth rates are likely to remain elevated for 2022 as well. As a result of these stimulus programmes, India's exports have been growing at a steady pace. Monthly exports between January and May 2021 have totalled \$152 billion, significantly higher than any similar period. Now is the time to give it a big push.

The possibility of a sharp recovery for the economy can only be realised through a strong focus on exports. The opportunity of India integrating itself into global value chains cannot be allowed to pass. Strong and coordinated policy action, across all levels of governments, is needed to realise this opportunity. Fiscal space is constrained, so is private consumption and investment. Exports must be the cylinder on which growth is fired for the foreseeable future.

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