The Make in India Initiative: Has it Worked?

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Abstract

Manufacturing sector has the potential to lift half a billion more of India's population out of poverty through income, export and employment growth. For a broad economic growth, India must focus both on domestic production to satisfy its large domestic demand and producing goods for global markets. However, value added manufacturing, as a percentage of GDP, has remained constant since 2000. *Make in India* was launched in 2014 to bring manufacturing back into the spotlight. The article looks at the relevant progress made since the launch of *Make in India*. Since then, the country has improved its rank consistently and has seen a significant jump of 30 places in 2017 in the World Bank's annual ease of doing business survey and has eased statutory restrictions on foreign direct investment across sectors. Consequently, FDI inflows saw a rise, but the investment to GDP and the ratio of value added manufacturing to GDP have been declining. The downward trend in many of the economic variables like the current account has been unambiguous since the beginning of 2017. There is a broad consensus amongst commentators about the downward trend in the economic variables related to manufacturing and the structural impediments facing manufacturing in India. To achieve the objectives of *Make in India*, India must position itself to benefit from the structural changes in technology and other emerging forces of globalization. For this, India needs to address a number of structural bottlenecks, which have intensified India's loss of competitiveness in the manufacturing sector. The article discusses the ten most important of these structural impediments and evaluates the progress India has made since the launch of Make in India and bolsters its arguments with international indices capturing trends in those structural variables. However, it is too early to call *Make in India* a success or a failure. Although India has introduced some significant policy changes, the success of these policies is dependent on their effective implementation.

Keywords: *Make in India, manufacturing value added, factor markets, infrastructure, regulatory bottlenecks.*

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INTRODUCTION

During 2003-08, a big reason for optimism in the Indian economy was higher capital expenditure by private firms, which rose during that period by 36 percent of GDP. The 26 percent decline in corporate investment since then has been the single biggest cause of India's slowdown.

Value-added manufacturing accounted for only 16.5 percent of India's GDP, compared to the services sector which contributes nearly 53.8 percent to the GDP in 2016 (World Bank, 2017). Manufacturing value-added as a percentage of GDP has remained more or less stagnant since 2000.

In terms of employment, manufacturing has not been a major long-term driver of job creation in India. After fluctuating around 11 percent for some time, it increased quite strongly to 12.6 percent in 2011-12 before declining to 10.7 percent in 2013-14 (ILO,2016). Between 2004-05 and 2011-12, when total employment outside of agriculture rose around 51 million, only 6 million jobs were created in manufacturing. Most of them were informal jobs.

Although, the share of merchandise exports in GDP increased from about 8 percent in 1999–2000 to 16.8 percent in 2013–14, India's share in global merchandise exports has remained low. India represents slightly more than 2 percent of the world's manufacturing output, a tenth of what China contributes.

To capitalize on the demographic dividend, India must create nearly one million jobs per month over the next decade. Manufacturing is seen to have the potential to provide large-scale employment to the young Indian population, at a time when manufacturing jobs are shrinking globally and a new global economic paradigm is emerging, driven by the rapid growth in digital technologies. A McKinsey study finds that rising demand in India, together with the multinationals' desire to diversify their production to include low-cost plants in countries other than China, could together help India's manufacturing sector to grow six-fold by 2025, to $1 trillion and could create up to 90 million domestic jobs (Dhawan, Swaroop & Zainulbhai, 2012).

With this conviction, the current government launched the *Make in India* initiative in 2014, aimed at making India a global manufacturing hub by urging investors to think of India not only as a big emerging market, but also as a place for production. 'Make in India' is designed to facilitate investment, foster innovation, protect intellectual property, and build best-in-class manufacturing infrastructure in India.

The ambitious initiative represented an attitudinal shift in how India relates to investors: not as a permit-issuing authority, but as a facilitator of business and as a business partner. The initiative identified 25 growth sectors, and includes the creation of a website through which companies can seek policy clarifications within 72 hours.

The plan specifically included proposals to cut red tape, develop infrastructure and make it easier for companies to do business. In 2014, India ranked 134th (out of 189 countries) in the World Bank's ease of doing business survey. Measures to reduce complexity and to improve transparency in regulation have been therefore a significant part of the *Make in India* initiative. An investor facilitation team was set up to be the first reference point for guiding foreign investors on all aspects of regulatory and policy issues.

This article looks at the progress that India has made in the last three years since the launch of the *Make in India* initiative and whether economic reforms have strengthened the country's manufacturing ecosystem sufficiently to make it a viable global manufacturing hub.

THE ROLE OF MANUFACTURING IN ECONOMIC GROWTH AND EMPLOYMENT

Since the industrial revolution, almost all countries that have managed the transition from low to high income have undergone industrialization, diversifying and upgrading their production structure, reducing their dependence on agriculture and natural resources. Understanding the channels through which manufacturing growth affects economic growth and employment, is essential to consider how Make in India will mobilize higher labor absorption and lead to better economic outcomes.

Kaldor examined the relationship between industrial development and economic growth, and based on empirical results, characterized the manufacturing sector as "the main engine of fast growth" (Kaldor, 1967). He argued that manufacturing had the capacity to generate 'dynamic increasing returns' i.e. manufacturing not only has the potential to increase its output more than proportionate to the increase in inputs (i.e. increasing returns to scale), but also, the faster the rate of growth of output in manufacturing, the faster the rate of growth of both manufacturing and economy-wide productivity (dynamic increasing returns) (Thirlwall, 1983). This implies that manufacturing is the core driver of GDP growth and employment while the service sector is likely to grow on the basis of the growing demand derived from (and resulting from) an increasing GDP.

This not only was true for the 12 early industrializers Kaldor examined, from UK to Japan, but was also the characteristic of South-east Asian countries that have experienced rapid, sustained growth. The 2008 Commission on Growth and Development identified common features of catching up countries that have achieved 'episodes of high and sustained growth' in excess of 7% per annum for 25 years or more (World Bank,2008). Nine of the thirteen success stories were cases of manufacturing-led growth: Brazil, China, Indonesia, the Republic of Korea, Malaysia, Singapore, Taiwan, China and Thailand. Only a few countries endowed with natural resources, and with small populations, have gone through a period of sustained economic growth without advancing manufacturing production, like Botswana and Oman. In recent years, however, very few countries have achieved such a sustained period of high growth and job creation, other than China.

A number of researchers have tested Kaldor's hypotheses across a range of developing countries (Dasgupta & Singh, 2005) (Wells & Thirlwall, 2003). They found that manufacturing has a positive correlation with GDP growth. Szirmai and Verspagen (2015) tested the relationship between the value-added share of manufacturing and growth of GDP per capita. This relationship was examined for three periods, 1950–1970, 1970–1990 and 1990–2005, and compared with the service sector. It was found that manufacturing acts, as an engine of growth for low and for some middle-income countries, provided they have a sufficient level of human capital. The findings for more recent periods indicate that a higher level of human

capital (at least 7-8 years of education) is necessary for manufacturing to play the role of engine of growth in developing countries (Adam & Verspagen, 2015).

In India, Chakravarty and Mitra (2009) found manufacturing to have been one of the drivers of growth, together with construction and services between 1973-2004 period (Chakravarty & Mitra 2009). For the period between 1994-2006, Kathuria and Raj (2013) found that in 15 states manufacturing had indeed acted as an engine of growth in India, despite its declining share in GDP (Vinish & Natarajan, 2013).

India is part of the general trend of premature deindustrialization which is prevalent in developing countries with the share of manufacturing value-added (MVA) relative to that of other sectors and employment decreasing significantly. However, it has been widely witnessed that manufacturing jobs are shrinking globally as the service sector's share of production and employment is large and growing in most advanced and many developing countries. The growth of productivity and of income has historically appeared to slow once factors of production began to shift from manufacturing to services (Baumol,1967). This phenomenon facing the global economy is the 'post-industrial' state in which development does not rely on industrialization. This phenomenon could be especially worrisome for developing economies where employment shares are shifting from agriculture to services, bypassing manufacturing, given that skipping the industrialization phase could constrain their ability to narrow income gaps (Rodrik, 2016).

The model of globalization that shaped the economic growth of countries - from low to medium / high income and that followed the transition from agriculture to light manufacturing and rapid growth of exports, followed by development of heavy industry and then services - has been disrupted today by the growth in digital technologies, including manufacturing technologies. These new technologies are resulting in large-scale manufacturing and global merchandise exports losing their primacy as drivers of growth and jobs in the medium to longer term. In addition, the competitiveness of countries with low cost labor advantage is eroding due to growing local regulation and protectionism. Given these global policy and technology shifts, is India's focus both on domestically-oriented production to satisfy

large domestic demand and producing goods for global markets a viable economic model? Although a stronger manufacturing sector could help link India to global supply chains, boost exports, and create jobs, is Make in India too little, too late? India needs to adapt its policies to reflect the changing nature of the industry and accommodate changes over many policy areas simultaneously.

MAKE IN INDIA AND ITS PROGRESS SINCE THE LAUNCH

Despite the advantage of low level wages and the rapidly eroding availability of abundant labor force, there is unanimity in that India would have to compete against most countries in the production and export of manufactured goods. Whereas India has been unable to do so; so far it is due to rigid labor and taxation laws, difficult process of land acquisition, regulation, and poor infrastructure; all of these have been significant constraints in achieving higher growth targets.

Nonetheless, over the past decade, the country's auto industry has been an exception to the general decline in manufacturing. According to the Society of Indian Automobile Manufacturers (SIAM), in terms of output—more than 3 million cars have been produced in India since 2011-12. In the mid-1990s, India opened its automobile industry for the investments of foreign manufacturers. By the early 2000s, India had become a global source for auto-components supplying global car manufacturers for their local as well as global supply chains. In the late 2000s, Indian automakers began to acquire auto companies overseas. Participation of foreign manufacturers provided the technology in making Indian parts and vehicles competent with global standards. In 2004, India produced 1.18 million cars, and by the end of 2016, it produced 3.68 million cars. The auto industry contributes 7 percent of GDP and employs, directly or indirectly, around 19 million people (SIAM). The challenge for Indian policymakers is to repeat the success achieved in the automobile sector in other manufacturing sectors.

Manufacturing is key to generating the jobs required to employ the 12 million new entrants to the labor market each year. While value-added services have provided 54 percent of India's GDP and especially the information-technology sector has contributed to 67 percent of India's services exports, Indian manufacturing has trailed not only that of East

Asian countries such as South Korea and Taiwan, but also of smaller economies like Vietnam and Bangladesh. As a percentage of GDP (16.5 percent), manufacturing in India has remained unchanged since the liberalization of economic activity in 1991. In comparison, manufacturing accounts for 29 percent of economic output in China and South Korea, and 27 percent in Thailand.

It is not surprising then that India plans to raise manufacturing as a percentage of GDP from 17 percent to 25 percent, and to create 100 million jobs within a decade. The 2014 National Manufacturing Policy (Make in India) addressed the areas of regulation, infrastructure, skills development, technology, availability of funding, exit mechanism etc. It is unlikely that India will be able to replicate the manufacturing success of its East Asian peers as its prospects will transect with global technological and economic trends. The rise of automation has raised questions about whether a focus on manufacturing can lead to a faster economic growth.

India has a revealed comparative advantage (RCA) only in a small number of manufacturing sub-sectors when compared to other emerging economies, according to the OECD data on trade in value-added. In addition, when a manufacturing sub-sector displays an RCA, it tends to be relatively small, as for example in the case of the production of textiles, textile products, leather and footwear. The main exception is the jewelry sector, where India has a significant RCA (Kaldor, 1967).

However, an IMF study (Thirlwall,1983) suggests that India has immense potential to diversify into products (emerging RCA) that are closely related to its current capabilities. In addition, it has good potential in expanding the exports to new areas, increasing the share of manufacturing in exports, increasing the sophistication of goods, and in improving the quality and complexity of exporting products. These products with emerging RCA belong to the 25 growth sectors as recognized by the *Make in India* initiative. *Make in India* took steps in the right direction by recognizing sectors with emerging comparative advantage.

Since the launch of *Make in India*, the country has improved its rank consistently and has seen a significant jump of 30 places in 2017 in the World Bank's annual ease of doing business survey (Figure 1) and has

eased statutory restrictions on foreign direct investment across sectors (as measured by the OECD's FDI Regulatory Restrictiveness Index (Figure 2) where restrictions are evaluated on a 0 (open) to 1 (closed) scale).

Figure 1: Ease of doing business index

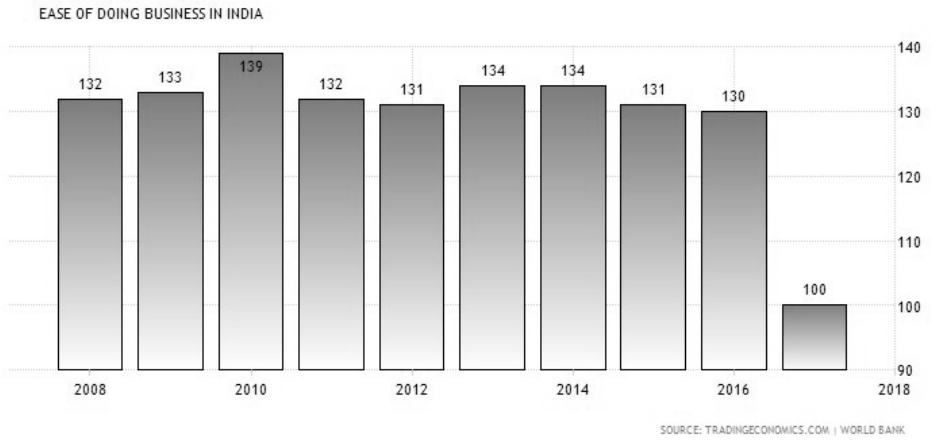
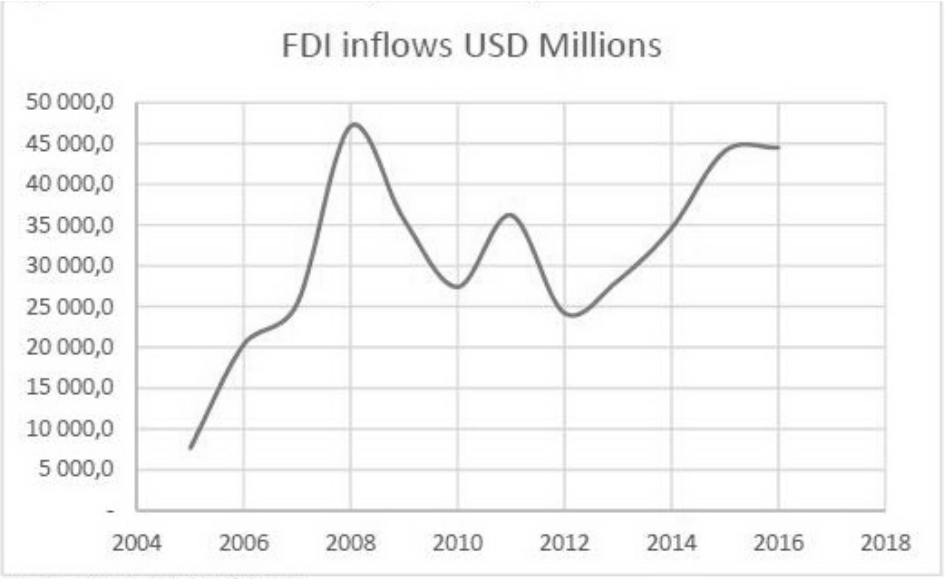


Figure 2: OECD FDI Regulatory Restrictiveness Index

Source: OECD FDI Regulatory Restrictiveness Index – extracted 25 September 2017.

Current FDI policy in India is considered among the most liberal compared to other emerging economies. FDI of up to 100 percent is allowed under the automatic route in most sectors and activities. FDI inflows have grown by 15 percent between 2014-16 (Figure 3). In 2015, India surpassed China to become the top destination for FDI in Asia, attracting around US$63 billion investment flows. However, the number of greenfield FDI projects in India during 2017 fell sharply by 21% according to the 2018 FDI Report. China received foreign capital investment of $50.8 billion in 2017 in greenfield projects, where India attracted $25.1 billion.

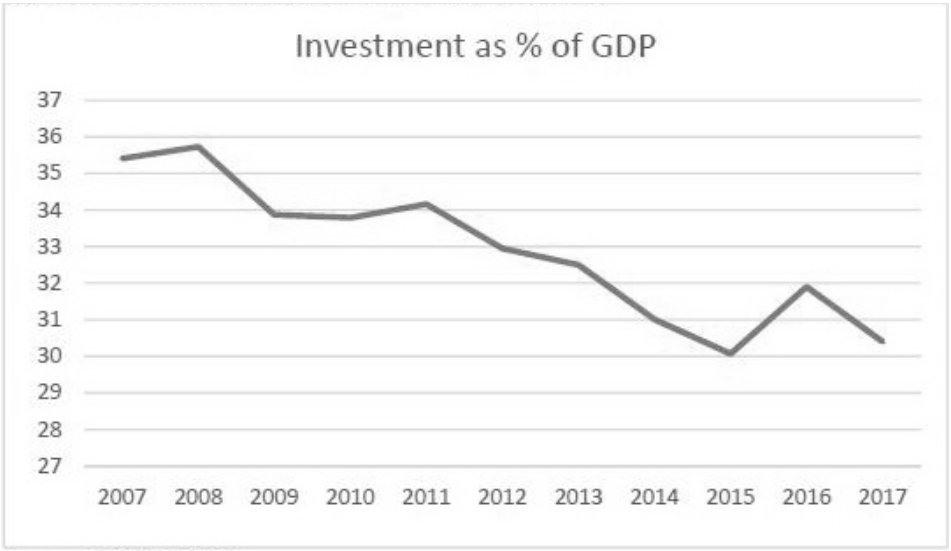
Figure 3: FDI inflows to India (USD Millions)



Source: UNCTAD, WIR 2017.

Although FDI inflows were on the rise between 2014-16, the declining investment to GDP ratio (Figure 4) suggests FDI flowing towards brownfield investments in the face of collapsing domestic private and public investment.

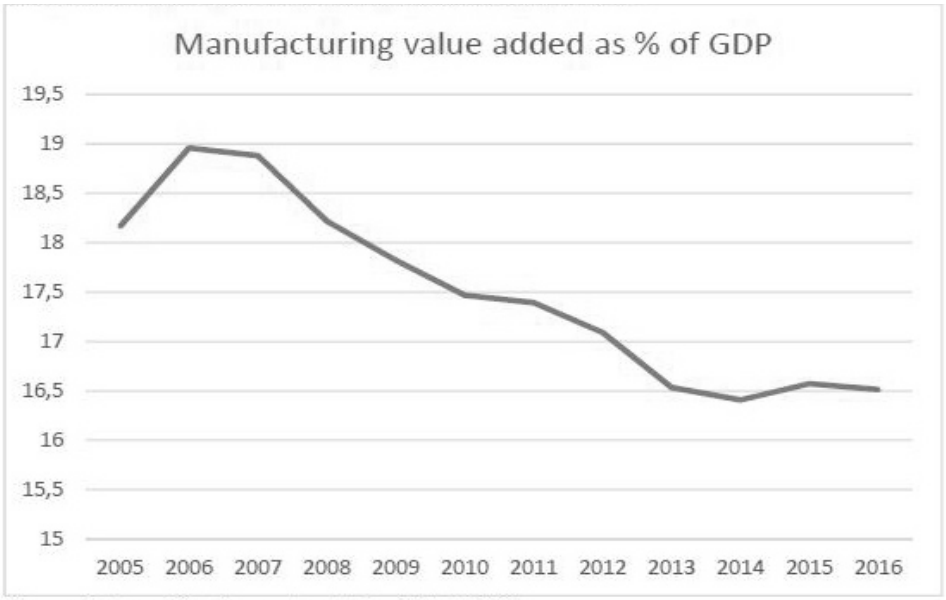
Figure 4: Investment (GFCF) as a percentage of GDP



Source: OECD (2017)

Falling domestic investment has mirrored the decline in value-added manufacturing in India's GDP (Figure 5) (World Bank, 2008).

Figure 5: Contribution of manufacturing to India's GDP



Source: data.worldbank.org extracted on 11 Oct 2017.

Figures on real gross value-added (GVA) for 2015-16 revealed that higher growth rates were spurred by strong industrial growth (Table 1). In 2015-16, growth in agriculture and related activities were estimated at just 1.2 percent while growth in the industrial and services sectors reached 7.4 and 8.9 percent respectively. The growth rate in manufacturing at 9.3 percent in 2015-16 was credited to the *Make in India* initiative.

Despite this sudden elevated growth rate in real GVA for the years 2015-16 (concerns have been raised that the new National Accounts Statistics (NAS) Series significantly over-states growth in manufacturing), there is no denying that the share of manufacturing in economic activity has revealed a downward trend since 2012-13.

Figures 6, 7 and 8 on IIP, India's manufacturing production and PMI demonstrate this declining trend.

Table 1: Real GVA growth in Indian manufacturing (%)

	2012-13	2013-14	2014-15	2015-16
Real GVA from the new NAS (base 2011-12)	6.0	5.6	5.5	9.3
Real GVA in manufacturing obtained from ASI data	6.5	2.0	NA	NA
Real GVA in private sector manufacturing companies covered in the RBI quarterly survey	1.7	0.9	3.3	9.7
Index of Industrial production, manufacturing	1.3	-0.8	2.3	2.0
Real GVA from the previous NAS series (base 2004-05)	1.1	-0.7		

Source: Goldar (2016)

Figure 6: Growth India industrial production index %
(covers mining, manufacturing and electricity)

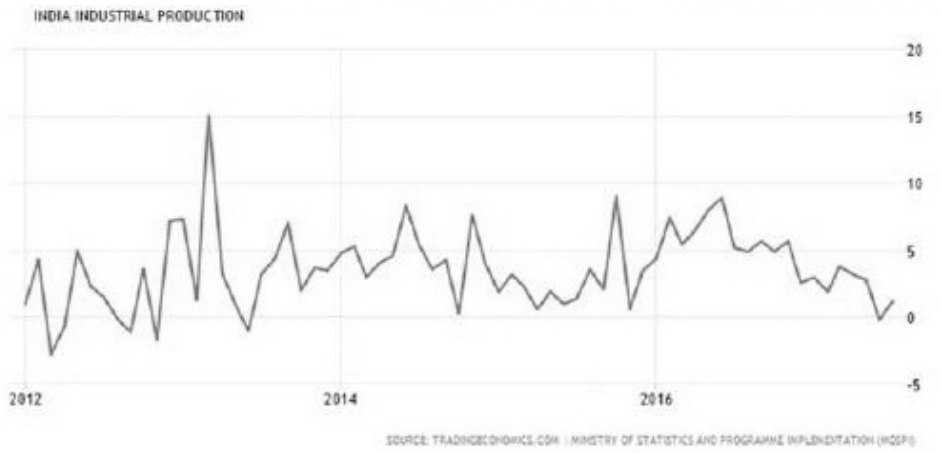


Figure 7: Growth in manufacturing production %

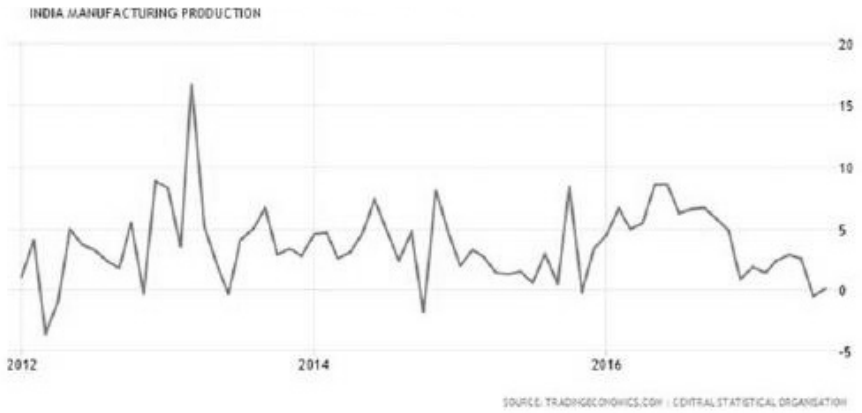
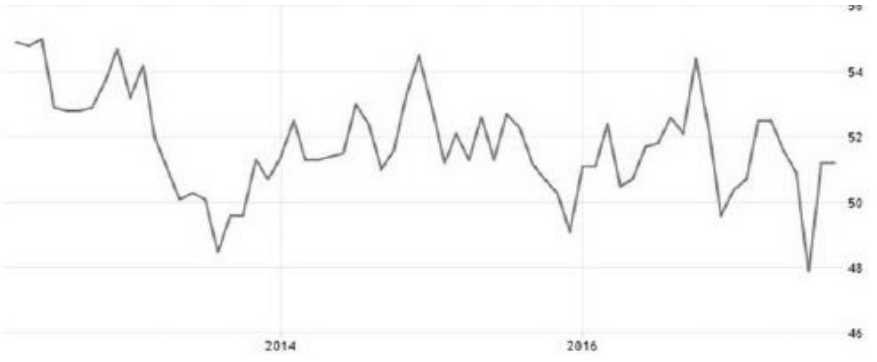


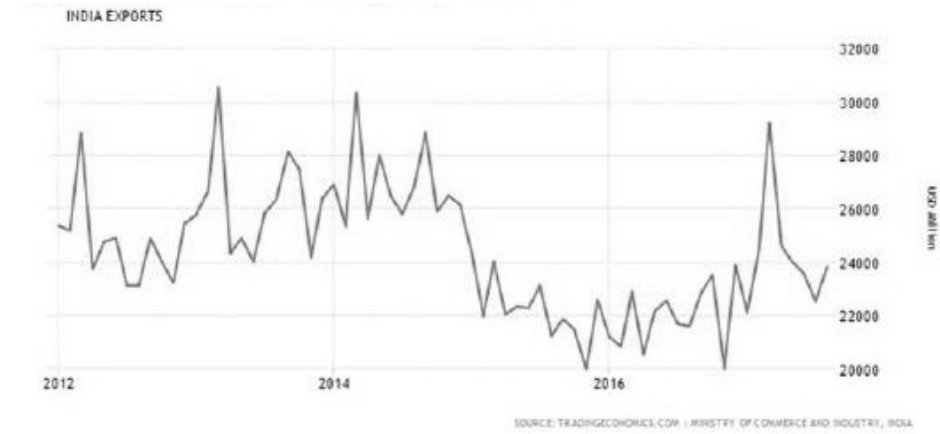
Figure 8: India Purchasing Manager's Index



Source: Markit Economics

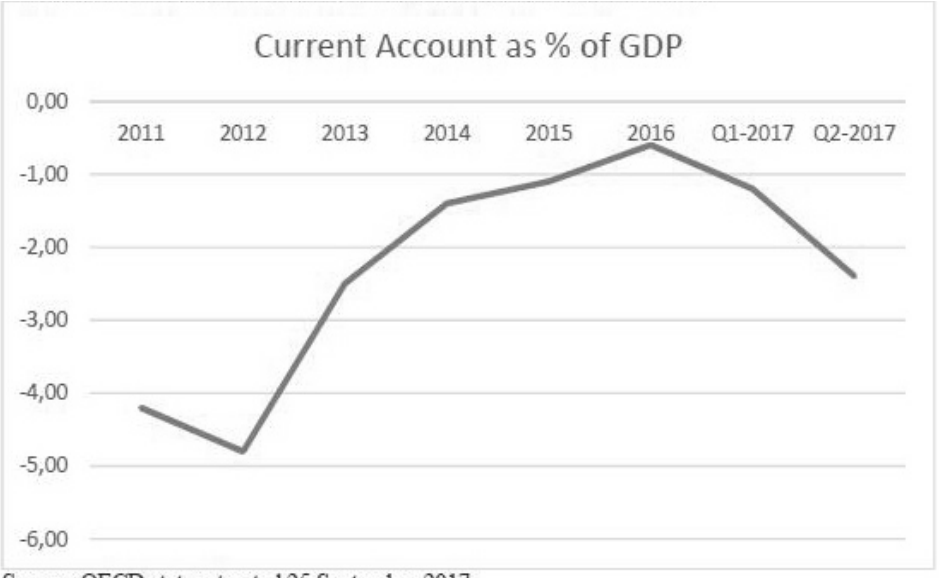
This downward trend has been manifested in exports of manufactured goods as well (Figure 9). India's exports which were sliding steadily since 2014, showed an increase of 4.7 percent in 2016-17. However, that increase has stalled.

Figure 9: India Volume of Exports in USD Million



The current account after having declined consecutively for 4 years, has risen again in 2017 on the back of a higher imports manufacturing (Figure 10).

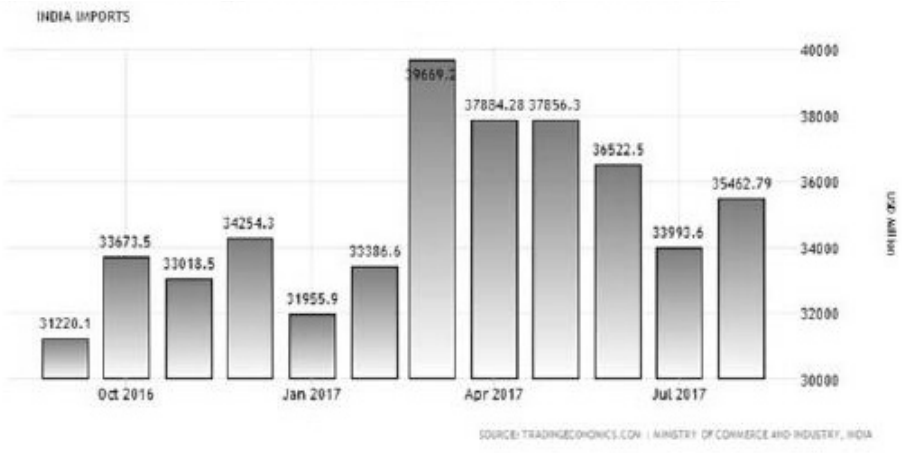
Figure 10: India's current account deficit as percentage of GDP



Source: OECD stat, extracted 25 September 2017.

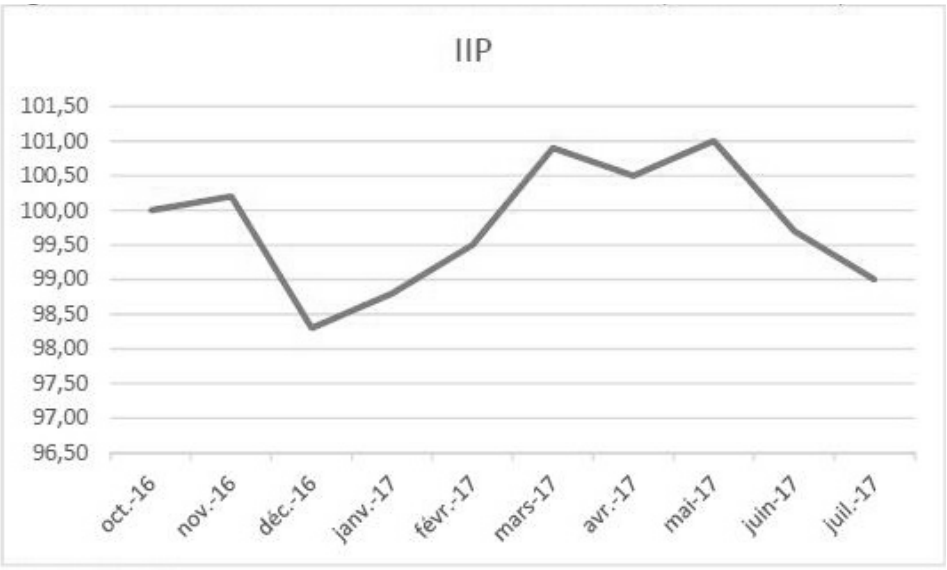
The downward trend in many of the economic variables has been unambiguous since the beginning of 2017. The output growth has slowed to 5.7 percent against the backdrop of demonetization and introduction of the GST. Imports to India jumped by 21 percent compared to the previous year in August 2017. In April-August 2017-18, imports climbed to 26.6 percent over the same period of 2016 (Figure 11).

Figure 11: India's imports since demonetisation (USD Millions)



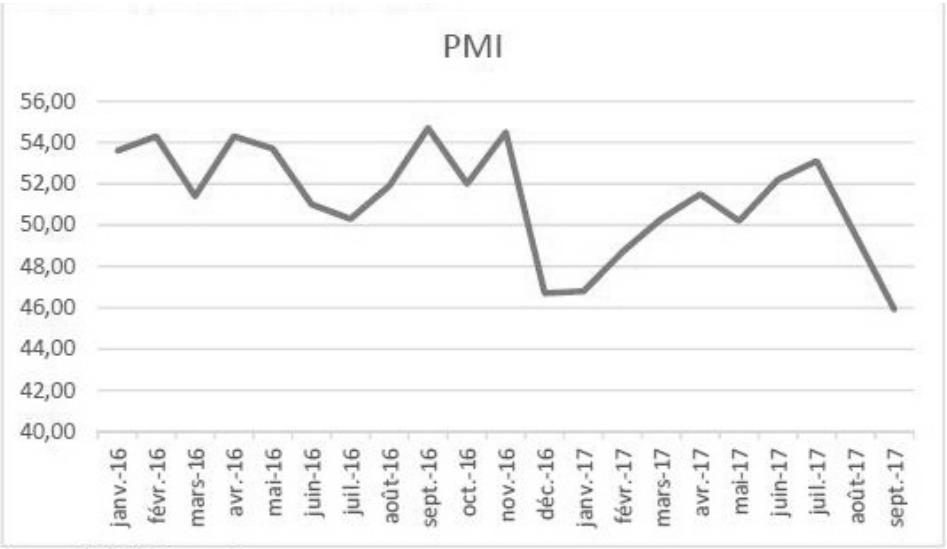
Stronger imports have affected GDP growth. Furthermore, as imports have surged, domestic production (IP, PMIs) has stumbled (Figures 12, 13). This suggests that domestic supply chains have potentially been disrupted in the manufacturing sector post-demonetization – likely to involve small and medium enterprises (SMEs) – and that activity has been replaced by imports, despite slowing domestic demand.

Figure 12: India's Index of Industrial Production 2016-17
(Oct 2016=100)



Source: MOSPI

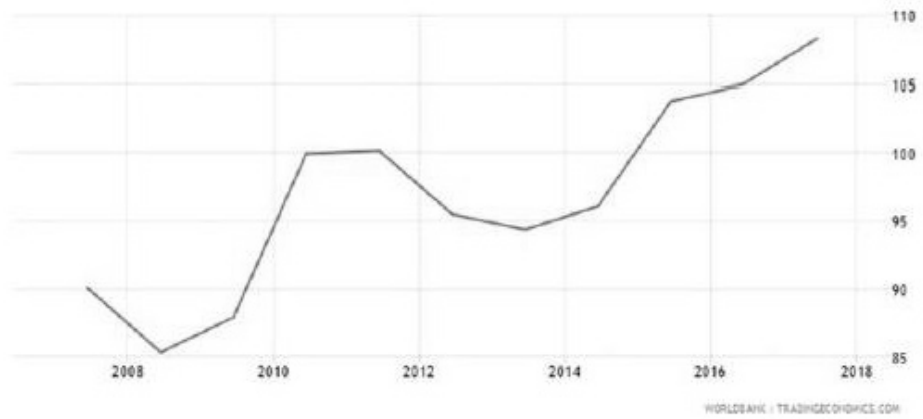
Figure 13: Purchasing Manager's Index



Source: Markit Economics

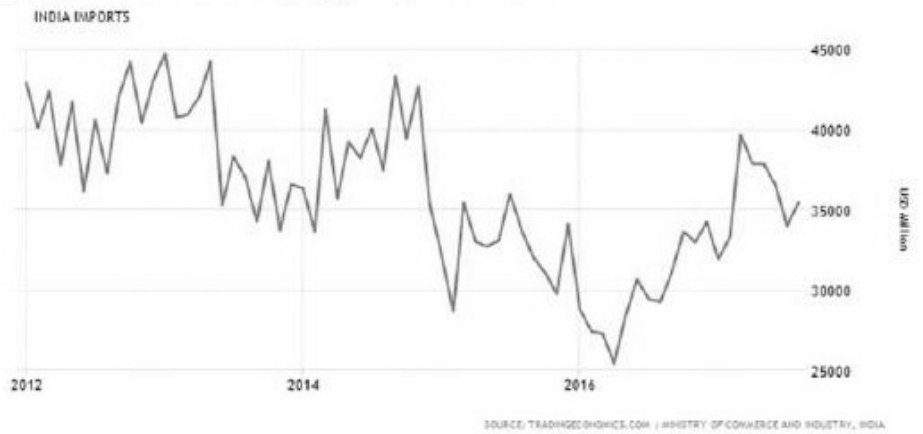
In addition, the economy has been suffering from the cumulative impact of an overvalued exchange rate that has adversely affected domestic production and has been sucking in imports (Figure 14).

Figure 14: India's real effective exchange rate (REER)



The introduction of GST in July 2017 has been beset by technical problems, undermining India's exports. Small and Medium Enterprises (SMEs) raised concerns about the compliance burden and difficulties in filing monthly returns while exporters have faced difficulties in securing tax refunds resulting in access to working capital (Wells & Thirlwall, 2003). This supply side disruption was inevitable after demonetization and GST, and the gap has been fulfilled by imports (Figure 15).

Figure 15: India volume of imports in USD Million



The challenge is in ensuring that this transitory phenomenon of increased imports does not become permanent. The cumulative effect of an overvalued currency, demonetization and the hurried implementation of GST may have exacerbated an enduring trend in the loss of India's competitiveness in production and exports of manufactured goods.

That loss of competitiveness in manufacturing is directly related to rigidity in the quality of, and access to, India's factor markets as well as several infrastructural and regulatory bottlenecks, resulting in considerable factor market misallocation and lower productivity.

CURRENT CHALLENGES FACING INDIA IN BECOMING A MANUFACTURING HUB

The success of the auto industry offers significant experience to Indian manufacturing, especially to advanced manufacturing sectors such as defense, aircraft, and ship building. The government has introduced significant policy changes to realize this objective and expand the experience of the auto industry. However, manufacturers still face significant hurdles. The majority of FDI, since *Make in India*'s inauguration, has been in the services sector, which attracted 60 percent of India's total FDI inflows from 2016 to 2017.Weak infrastructure has hindered the *Make in India* initiative. The futuristic *Smart Cities Mission*, set out to develop infrastructure, has not yet come to fruition in a way to stimulate growth in manufacturing. The requirements of high skilled people for the manufacturing sector are misaligned with the existing skill profile of India's young labor force. Regulations that have yet to be streamlined and a shallow supply chain ecosystem are additional challenges.

It is too early to call *Make in India* a success or a failure. Despite some significant policy changes, India still urgently needs to address a number of policy and practical implementation issues before investors shift their attention away from goods that are made in China for decades and towards 'Make in India'. The ten most important of these are discussed in detail below and include, *inter alia*:

- Reforming labor regulations to support enterprise growth
- Improving education and training
- Making land acquisition more efficient

- Reforming corporate and other taxation as it relates to manufacturing
- Making Bilateral Investment Treaties (BITs) more user friendly
- Improving and quickening regulatory approvals
- Removing infrastructure bottlenecks
- Dealing with high tariff and non-tariff barriers, and trade facilitation
- Dealing with the non-performing assets in public sector banks; and, finally
- Eliminating high levels of endemic corruption at central, state and local levels of government which continue to persist despite an ostensible anti-corruption stance.

Reforming labor regulations to support enterprise growth: Among reforms in factor markets, reforming labor laws is crucial for creating more jobs. Despite an abundance in unskilled labor, Indian firms have expanded largely in capital-intensive sectors (engineering goods, pharmaceuticals) or used excessively capital-intensive technologies in other sectors, resulting in low utilization of labor.

Labor laws which make firing (and therefore hiring) difficult also introduce other rigidities leading to increase in the cost of labor, thus incentivizing deployment of highly capital-intensive technologies. Regulating companies' ability to fire factory workers, especially for larger companies, led to many factories staying small to avoid increased regulatory burdens, while many others try to have their records show their workers as contract labor.

Labor market rigidities remain high because of the multiplicity of labor laws and high costs of meeting legal requirements. The Industrial Disputes Act (IDA) of 1947 is the basis of industrial labor regulations in India (it requires firms employing 100 workers or more to seek government's permission to dismiss a worker or to close a plant); firms are required to comply with numerous, complex and ambiguous laws governing different aspects of the labor market (such as laws governing minimum wages, resolution of industrial disputes, conditions for hiring and firing workers, and conditions for the closure of establishments etc.).

Labor market rigidities have resulted in a large informal (unorganized) sector which employs nearly 90 percent of the Indian workforce. Although the informal sector provides useful employment opportunities, the persistent high level of informality has failed to improve labor welfare (as workers operate in an unregulated environment, are paid low wages with no job security), negating the very motive of India's pro-worker regulations. The government has simplified administration of labor laws through an online portal called Shram Suvidha.

Although several initiatives have been taken at central and state government levels to reduce the detrimental effects of India's onerous and rigid labor regulations, significant reforms are needed to promote quality employment and reduce income inequality. These regulations protect the formal sector while increasing the size of the informal sector that evades them.

Reform of labor regulations should aim at providing a minimum floor of pay as well as adequate social and labor protection for all workers, irrespective of the status, size and activity of any firm. This would require introducing a comprehensive labor law which would consolidate and simplify existing regulations and reduce uncertainty surrounding regulations as well as compliance costs for companies. Legislative changes to bring about some significant labor reforms, like simplification of labor laws reducing the 44 labor laws into 4 codes, have been delayed. In the meantime, the responsibility for introducing labor reforms has been delegated to state governments.

Improving education and training: The average age of India's population by 2020 is projected to be the lowest in the world— around 29 whereas it is 37 in China and the United States of America, 45 in West Europe, and 48 in Japan. While the global economy is expected to witness a shortage in the young population by 2020 with around 56 million, India will be the only country with a youth surplus of 47 million.

India's demographic transition makes it imperative to ensure employment opportunities for millions of youth each year. Alongside employment, skill development is equally important as over the years jobs have become more skill-intensive with changes in technology as well as increased inter-linkages across economic activities.

India needs to equip 15 million people by 2020 with the skills necessary to realize Make in India's aim to bring more high-grade manufacturing to the country. The country, however, faces a big challenge ahead. It is estimated (per the latest survey by the Labor Bureau for 2013-14) that only 4.69 percent of persons aged 15 years and above have received or were receiving vocational training, of which only 2.8 percent was through formal channels while 4 percent was through the informal system (Szirmai & Bart, 2015).

The skill development issue in India is pertinent both at the demand and supply level. Generating employment is a challenge given the enormity of population entering the workforce each year. From the supply side, the issue is primarily related to employability of the workforce due to varying reasons ranging from poor education, lack of training facilities, inadequate skilling, quality issues leading to the mismatch of skill requirements, and poor perception of vocational skilling vis-à-vis formal education.

Aspiring Minds, an Indian employability assessment firm, has suggested in its 2016 report that more than 80 percent of engineers in India are "unemployable," after a study of about 150,000 engineering students in around 650 engineering colleges in the country. Workers trained in the vocational education and training system often require significant on-the-job training.

Given the lack of access to education and quality of education, continuing to improve access to education, especially at the secondary level, and improving the quality of education is imperative. As a step to raising quality, monitoring learning outcomes, tracking implementation and follow-up in monitoring the reforms is essential. India should collaborate closely with employers when designing vocational education and training programs to ensure that they are relevant to labor market needs.

Making land acquisition more efficient: India's new land law was designed to resolve one of the most vexing problems of state acquisition of agricultural land for industry, infrastructure and urban development. India's previous 1894 land acquisition law gave the state unchecked powers to take private land for projects deemed of public interest, including private investments. Private companies have mostly relied on state procured land

for big projects. However, these powers were widely abused, with farmers coerced into relinquishing land at throwaway prices usually to see the land resold afterwards for far more; with middlemen (usually local and state-level politicians) reaping windfall profits. This exploitation, and lack of alternative livelihoods, led to fierce resistance.

To address the land acquisition issue, Parliament passed the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Bill in 2013. It took effect in 2014, offering a fairer, more transparent process that protects the interests of land sellers and land seekers, thus facilitating land acquisition deals. While the new Land Acquisition Bill will increase the direct cost of land acquisition, it is also expected to reduce the indirect costs as the incidence of disputes and litigation should decline.

Still, the process of acquiring land may be long and fraught. Land ownership still remains opaque, and re-zoning, from agricultural to industrial zones, has been fraught with risks and delays. Implementation of the law in practice needs to be more flexible and closely monitored; the weaknesses should be amended as needed. The government urgently needs to review the timelines established by the Bill and aim to make land acquisition faster. The institutional set-up should allow for swift resolution of disputes.

The government introduced nine main amendments to the 2013 legislation through an ordinance in 2014, and subsequently as part of an amendment Bill in 2015. However, due to stiff opposition from various political parties, the government agreed to drop most of its amendments and reintroduced clauses related to consent of affected families and social impact assessments. Other amendments are now under the consideration of a joint parliamentary committee.

Reforming taxation: The World Bank ranks India 172nd out of 190 countries in 2017 in the "Ease of Paying Taxes". The overall effective tax rate for small to medium sized companies is relatively high. The indirect tax system is complex, costly to comply with and puts India's manufacturing sector at a competitive disadvantage in international markets.

The Goods and Services Tax (GST) which was introduced in July 2017, is expected to result in the dismantling of inter-state check posts, and to improve the domestic and international competitiveness of Indian manufacturing firms significantly. Simply halving the delays due to road blocks, tolls and other stoppages could cut freight times by 20-30 percent and logistics costs by an even higher amount, 30-40 percent. This alone can go a long way in boosting the competitiveness of India's key manufacturing sectors by 3 to 4 percent of net sales, thereby helping India return to a high growth path and enabling large scale job creation.

State border check-points, tasked primarily with carrying out compliance procedures for the diverse sales and entry tax requirements of different states, combined with other delays, keep trucks from moving during 60 percent of the entire end-to-end transit time. High variability and unpredictability in shipments add to total logistics costs in the form of higher-than-optimal buffer stocks and lost sales, pushing logistics costs in India 2-3 times more than those of international benchmarks (Chakravarty & Mitra, 2009).

The corporate income tax (CIT) system in India is characterized by high effective tax rates and a narrow tax base. High effective tax rates result from the imposition of several charges on top of an already significant statutory CIT rate, together with a corporate-level tax on distributed dividends (the dividend distribution tax). Even after the proposed reduction in the statutory CIT rate, effective tax rates for equity-financed investment will remain high, discouraging such investment. For example, average effective tax rates for an equity-financed investment range from 37.8 percent to 44.8 percent depending on asset type, while marginal effective tax rates range from 24.3 percent to 52.7 percent (Kathuria,& Rajesh, 2013).

The corporate tax base is narrow due to a wide range of tax concessions, while multinational enterprises are also able to minimize their tax liability in India by exploiting mismatches in international tax rules. These concessions result in some corporations paying significantly less tax than the high effective tax rates imply (Baumol, 1967).

Total gross corporate income tax concessions are estimated at INR 984 billion (Rodrik, 2016). This equates to 21.8 percent of CIT revenue (0.8 percent of GDP) in 2014-15. In addition to the loss in tax revenue, the effectiveness of such concessions in achieving their policy goals is often mixed and the concessions are relatively complex leading to costly disputes over eligibility, facilitating outright abuse. The overall business tax base is narrowed by a high degree of informality amongst small businesses.

To reduce the relatively high statutory CIT rate and broaden the narrow corporate tax base as compared to other major economies, the government announced in its 2015 budget that it would undertake CIT reform. Over four years from 2016, the government has proposed to reduce the statutory CIT rate (for resident corporations) from 30 percent to 25 percent. In addition, the government has proposed "rationalization and removal of various kinds of tax exemptions".

Meanwhile, apart from the complexity of the Indian tax system which complicates its interpretation and leaves too much to official discretion, an aggressive audit process and frequent changes in tax laws with retrospective effect have also undermined economic activity and resulted in India leading the world in numbers of tax disputes (OECD, 2014).

CBDT data show that in 2012-13, India had over 381,000 tax disputes. In particular, the implementation of retrospective legislation on the taxation of indirect transfers of assets, and tax administration rulings regarding the application of MAT (minimum alternative tax) to foreign institutional investors have been particularly damaging.

However, the recent introduction of an advance pricing agreement (APA) regime has increased business certainty for multinationals. The Easwar Committee was set up in 2015 to identify parts of the Income Tax Act that are unclear and lead to unnecessary disputes. It reported its findings in early 2016 and the government is currently considering its recommendations. Nevertheless, issues remain regarding the audit processes and transfer pricing rules (Anand, Kalpana & Saurabh, 2015).

Bilateral Investment Treaties (BITs): Since 1994, India had signed 84 BITs with countries such as the UK, France, Germany, Australia, China, Malaysia, Thailand, Mexico, Russia, Egypt, Saudi Arabia, the UAE, Turkey and others. Many of these BITs contained protection for investors (including commitments to fair and equitable treatment (FET), non-discrimination and most favored nation treatment (MFN), the ability to repatriate proceeds, and protection from expropriation. They also allowed for arbitration of alleged breaches of these protections directly between the investor and the host government.

However, in recent years, India has been facing several arbitration claims from investors under its BITs. This began with India losing a claim in 2011 that was brought by Australia alleging excessive judicial delays in enforcing a commercial arbitration award through the Indian courts. Further claims have since been brought on retrospective taxation, the allocation of satellite spectrum. In 2016, India was one of the most frequently-named respondent states in BIT proceedings (Mehrotra, 2017).

In early 2017, the government terminated bilateral investment treaties with 58 countries, including 22 EU countries. Many of these BITs ceased to apply to new investments from April 2017. For the remaining 26 of its BITs that have not completed their initial term, there is a proposed joint interpretative statement to the counterparties to align the ongoing treaties with the 2015 Model BIT. On the other hand, investments made before the termination of the 58 treaties may be protected for some years under the 'sunset' clauses in those BITs.

The new Model BIT contains more restrictive definitions of 'investor' and 'investment' and is intended to reduce the exposure of the Indian government to future claims, by excluding taxation measures from its domain and removing or qualifying the MFN and FET protections. The 2015 Model BIT preserves the mechanism for settlement of investor-state disputes by arbitration.

Until new arrangements are agreed between India and relevant counterparty states, new investments of foreign investors to be made in India and Indian investments to be made in the counterparty country will cease to receive BIT protections. The termination of BITs has sent mixed messages

at a time when the government is taking vital steps to attract inbound investment through Make in India and when the outbound investment by Indian companies continues to increase in both developed and developing economies (Goldar, 2016).

Regulatory Approvals: Foreign investment in India has always been heavily regulated, requiring approvals from various government ministries. As a result, the Foreign Investment Promotion Board (FIPB) was established in August 1991. Regulatory approvals have caused substantial delays in project implementation. There were multiple agencies involved and various approvals were required across different stages of the project cycle. Many of the guidelines evolved continuously (often whimsically) and are needed to be implemented, not only in new projects, but also in under-construction projects, which then had to comply with revised standards midway through their execution stage. Several approvals did not have defined timelines.

In 2017, the government decided to get away with the FIPB. Now, foreign investment in any of the 11 notified sectors requires approval only from the concerned administrative ministry. The Department of Industrial Policy and Promotion has issued a Standard Operating Procedure (SoP) for processing FDI proposals under this new regime. The most significant feature of this SoP is the time period of 8-10 weeks within which investment applications are required to be cleared by the ministries concerned.

However, there are fundamental problems in the current Indian legal institutional framework around FDI approvals. the primary law concerning foreign investment – the Foreign Exchange Management Act, 1999 (FEMA) – does not create any institutional accountability. It does not prescribe any time limits for the finance ministry to clear foreign investment applications. FEMA does not clarify the purpose of government approval itself. Further, the law does not require the government to give any reasons for rejecting an investment application.

The DIPP's new SoP does not resolve any of these fundamental issues. The timelines it imposes on the ministries for various actions are not binding. The SoP does not change the internal incentive structure of the bureaucracy to ensure that they comply with the timelines, leading to a lack of time-bound inter-ministerial coordination needed for the grant of approvals (the Goods and Service Tax Council (GST), 2017).

The OECD Product Market Regulation Index (PMR) (Figure 16) measures the extent of a growth enhancing competitive environment in a country and a level playing field among firms. The aggregate PMR indicator is the simple average across three indicators that are state control, barriers to entrepreneurship and barriers to trade and investment. OECD estimates suggest that reducing India's score on the OECD's product market regulation indicator by 20 percent could boost the level of productivity by around 2 percent over the next 5 years (FICCI & Konrad, 2015) (World Bank, 2014).

Figure 16: OECD Product Market Regulation Index

Source: OECD PMR Index, extracted 5 Oct 2017.

Infrastructure bottlenecks: In the last 20 years, although not as much as China, India has made substantial investments in infrastructure. In many areas, the investment and maintenance targets have not been met, leaving infrastructure in very poor condition. Firms in India face frequent power outages and transport infrastructure is below par.

Major new infrastructure investments are required because logistical bottlenecks need to be removed to lower the cost of doing business in India. The approach document for the 12th Five Year Plan (2012-17) projected a requirement of US$ 1 trillion for India's infrastructure development. Yet, infrastructure investment in India has been held back by poor governance, political challenges, lack of transparency in PPP bidding and awarding processes, delays in regulatory approvals and land clearances, lack of

availability of long term debt, taxation issues (provisions to tax indirect investments) and lack of independent regulatory authorities in each of the infrastructure sectors.

Infrastructure bottlenecks have contributed to longer lead times and excess inventory having to be held across the value chain. Poor supply chain performance and reliability is one of the reasons why many foreign companies use their Indian factories mainly to serve the domestic market and avoid integrating them into their global networks.

Lack of investment in physical infrastructure has hampered integration not just domestically (connecting more remote regions), but also regionally and internationally. Investment in the maintenance and upgrading of existing and new infrastructure could provide an important boost to economic activity.

Beyond connectivity issues, India faces the critical challenge of power shortages (Thomas, 2017), which impedes the smooth functioning of GVCs. Electricity supply in India is seen to be on par with Cambodia, the worst performer in SEA. In terms of logistics performance, India's performance stands between that of Thailand and Indonesia (OECD, 2017).

The government has taken several steps to promote the flow of long-term funds into infrastructure investment e.g. setting up Infrastructure Debt Funds, raising foreign institutional investor (FII) limits for infrastructure, and liberalizing external commercial borrowing (ECB) limits. India has also attracted private capital in recent years. Deepening bond markets by gradually relaxing the restrictions on domestic and foreign investors would expand financing.

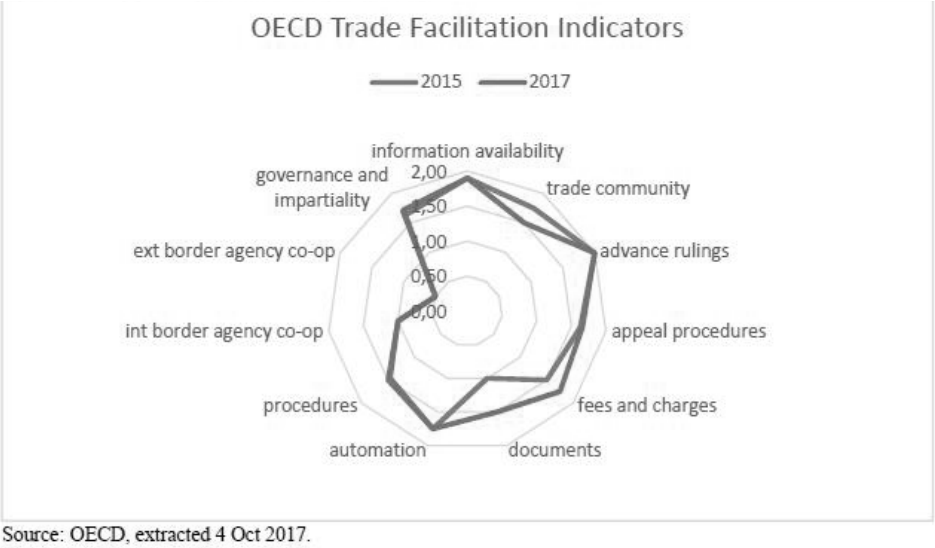
High tariff and non-tariff barriers, trade facilitation: High import tariffs and non-tariff barriers also hinder the productivity and competitiveness of the manufacturing sector. Tariffs have been cut significantly since the early 1990s, yet tariffs remain high compared to other BRICs and OECD countries. India also imposes non-tariff barriers in the form of quantitative restrictions, import licensing, burdensome mandatory testing and certification for a large number of products.

In terms of trade facilitation, the World Bank (2010) has noted that for Nepal to trade goods with India, it takes around 200 signatures; while trading from India to Nepal requires around 140. At one important border between Bangladesh and India, trucks are often required to wait over four days in order to cross the border.

The OECD Trade Facilitation Indicators suggest that India performs better than the averages of Asian and lower-middle income countries in a number of areas including information availability, involvement of the trade community, advance rulings, appeal procedures and fees and charges (Figure 17). However, India could draw considerable benefits in terms of trade volumes and trade costs by streamlining border procedures.

Trade facilitation and better infrastructure are necessary, but are insufficient conditions for further value chain participation. These measures need to be complemented with MFN tariff liberalization and institutional reform. Efforts to this end could help attract foreign investment in new technologies complementary to India's labor abundance. In many respects, and particularly in terms of labor endowments, India resembles many South East Asian countries, and therefore should be able to attract important GVC activity, which may help further regional development objectives (MAT, 2014/2015).

Figure 17: OECD Trace Facilitation Indicators



Source: OECD, extracted 4 Oct 2017.
Note: The TFIs take values from 0 to 2, where 2 represents the best performance that can be achieved.

Non-performing assets in public sector banks: Corporate and banking sector vulnerabilities have had serious implications on the overall investment environment of the country. According to the 2016-17 Economic Survey, 57 percent of the top stressed debtors would require to reduce their debt levels by 75 percent to restore viability, suggesting that there is little capacity to raise funding for capital expenditure or to attract investors to turn the assets around.

The NPA problem of public sector banks is a deep structural sign of crony capitalism. To deal with the NPA problem the government has reformed insolvency laws by enacting the Insolvency and Bankruptcy Code in 2016 and made it operational soon. Until the Code, there was no single legislation that governed corporate insolvency and bankruptcy proceedings in India. The government has empowered the Reserve Bank of India (RBI) to force banks to resolve and restructure stressed assets by invoking the bankruptcy code against defaulters. The government has also consolidated one bank—the State Bank. However, these measures have failed to provide a comprehensive strategy of how the public sector banking can return to sustainability.

Moreover, in October 2017, the government agreed to recapitalize public sector banks by Rs. 2.11 trillion (equivalent to about 1.3 percent of GDP) between 2017-19 as banks undergo the resolution process through the new bankruptcy law. What is different about this recapitalization is that the government will issue Rs. 1.35 trillion as "recapitalization bonds" over the next two years. Along with this, recent steps to overhaul the bankruptcy laws have finally drawn a line under delinquent loans. It is expected that during 2018-19, the assets and debts of about 50 largest defaulters may be sold off by court-appointed professionals, in a process in which banks are likely to face losses of up to 60 percent on their loans.

Public sector banks have been used by political parties over the years to sustain political corruption and to implement government policies. The fight against corruption will be incomplete if it does not include policies to tackle the issues of corporate governance in public sector banks.

Corruption: India has been overwhelmed by endemic corruption in recent times. According to Transparency International's 2016 Corruption Perception Index, India ranks 79th, tied with China, among 176 countries. Corruption has acted as a non-transparent tax on India's growth leading to higher costs and delays. Corruption is especially prevalent in the judiciary, police, tax, public services and public procurement sectors.

Due to varying levels of corruption and the poor quality of government operations across India, local investment conditions vary between and within states. The Prevention of Corruption Act is the principal legal framework that focuses on corruption in the public sector. Both active and passive bribery are covered by this legislation, and public officials are only allowed to accept gifts of nominal value.

Due to low levels of enforcement and monitoring however, integrity in state bodies is lacking, and corrupt practices such as facilitation payments and bribes persist. Significant reasons most frequently put forward for the level of corruption in India are its public and corporate governance regimes. The new Companies Act, enacted in 2013, is seen as important in improving the ease and efficiency of doing business in India. It deals with strengthening of the internal controls through corporate governance, corporate social responsibility, auditor rotation, and investor protection.

The New Act holds out the possibility of reducing the risk of corrupt practices. Despite the government has stepped up its efforts to counter corruption, red tape and bribery continue to be widespread.

CONCLUSION

Manufacturing has the potential to lift half a billion more of India's population out of poverty through income, export and employment growth. However, the contribution of manufacturing in India's economic activity has been declining steadily for the last ten years. Recently, demonetization, technical problems associated with the introduction of GST and an overvalued currency, have exacerbated an enduring trend in the loss of India's competitiveness in the production and the exports of manufactured goods.

Structural bottlenecks have long affected the manufacturing sector, more than the services sector. India's failure to industrialize is due to labor market legislation which puts a tariff on large-scale manufacturing establishments and the long and fraught process to acquire land for industrial or infrastructure projects. Firms often cannot find employees with the right skills and training. Power outages and poor infrastructure also make it difficult for firms to be competitive and reach new markets.

If India was successful in unlocking its factor markets, especially land and labor for manufacturing, domestic and global corporations will accelerate the transformation. Unfortunately, the half measures taken to unlock land and labor have included passing the responsibility to regional governments, anticipating strong resistance from trade unions and caste lobbies.

In 2015, the government failed to repeal and replace the Land Acquisition Act of the previous government. That experience early in its term has resulted in the government proceeding cautiously in getting vital legislation passed. Despite the frequent assertion of nationalism, decisions on rational economic policies give precedence to the most divisive local interests, show weakness in face of mass defiance and show the government's inability to break the trade-off between alleviating a problem and tackling it.

Despite the government's inclination, the introduction of the GST is a significant reform which establishes a single market in goods and services with a uniform indirect tax structure. The fact that it has taken 15 years to pass the legislation on GST is an indictment of India's corrosive politics. However, GST was compromised by poor design and implementation; with far too many rates over-complicating the regime, creating goods classification problems and imposing administrative burdens. The teething problems are much larger and therefore will take much longer to resolve.

There is no disagreement over why India has been steadily losing its competitiveness in manufacturing. Addressing structural bottlenecks, in particular rigid labor laws, inadequate investment in human capital, difficult process of land acquisition, regulation, and access to funding has been constrained by India's political compunctions.

Consequently, the progress that India has made in driving forward its *Make in India* initiative is confined largely to processes related to the ease of doing business, trade facilitation, and easing statutory restrictions on foreign direct investment across sectors.

For the *Make in India* initiative to have any realistic chance of any significant success, India urgently needs to address its more fundamental structural bottlenecks. Notwithstanding the dynamic marketing and exhortative campaigns for driving the *Make in India* initiative, achieving its objectives has remained daunting from the outset. It will continue to be challenging, given the serious structural and policy-reform deficits that remain to be addressed. In addition, the campaign – which relies too heavily on marketing and not enough on policy-product development -- has created expectations that cannot be met easily.

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