Covid -19 Impact on World Economy: An Opportunity for India?

Dr T.K. Jayaraman

The trade war between the United States of America (USA) and China, the world's the first and second largest economies began as a 'cold war' much before President Trump assumed office in 2017. China, which was accused of manipulating its currency to make its exports cheap, became a central issue during the American election campaign from an economic point of view. Once President Trump took over in January 2017, the cold war became a tit-for tat affair as he started implementing the campaign promise of bringing back jobs from China by reducing the one-billion-dollar-a-day trade deficit with China. Tariffs and counter tariffs were levied by the US and China on their imports from each other. That made the American manufacturing units operating in China jittery. They began to look for countries to move out of China.

Poverty Reduction in China

"It doesn't matter whether it's a black cat or a white cat, if it catches mice it's a good cat." The doctrine of Deng Xiaoping has worked well for China. The communist country embraced capitalism but did not give up totalitarianism. Adopting the capitalist tools of production and exchange, China heavily exploited the liberal world trade environment since the 1990s. Without any hesitation, China welcomed Foreign Direct Investment (FDI) in manufacturing cheap consumer goods for exports to the US and the rest of the world. Over the last three decades, the US and the European companies, making semi-durables such as refrigerators and a host of other goods contributed to growth of supply chains and ancillary industries such as transportation in China. In the old terminology of development economics, they were known as backward and forward linkages.

Once economic development resulting in the emergence of vibrant new sectors and rapid economic growth led to increase in per capita incomes, the overseas manufacturing units in the export sector of China started experiencing rise in labour costs. The advantage of cheap Chinese labour of the 1990s was seen to be melting away. That duly reflected in China's very impressive poverty reduction record since the 1990s. In simple comparative terms, China's per capita annual income soared from $ 348 in 1990 to $ 8,338 in 2017. The corresponding figures for India were $ 364 in 1990 and $ 1940 in 2017. As a result, today only 3.3% of China's total population is below the poverty line (defined as income being $1.25 per day per person), compared to India's 21.9% of its population.

The general wage rise in the Chinese urban sector supplying labour to all industries was visible. To offset the rise in the industrial wage level, rural labour was forcibly brought to factory areas to keep the wage rate down. It did not work for long. Additionally, in early 2017, China began to switch to 'rebalancing the economy' - by shifting attention on raising domestic consumption, as it knew the emerging countries with low wage levels would eventually become its competitors. With the end of the trade war not in sight in the short run, a fresh trade treaty nowhere near finalisation and continuously rising labour costs, most of the companies (Chinese as well as foreign-owned) were working out strategies in two phases - 'China plus one' and 'A place away from China'.

Moving out of China

The first phase began in 2018 with rise in the flow of FDI - mainly by diverting them from China to nearby emerging economies. The term FDI would normally refer to substantial equity stake and effective ownership and control of enterprises. However, in the context of the growing service sector in developing countries, a broader definition is now more acceptable. This now also refers to non-equity participation by foreigners by way of licensing, franchising, joint ventures with limited equity participation and R&D cooperation. Most of the beneficiaries happened to be member countries of the Association of Southeast Asian Nations (ASEAN).

Before examining in detail, the nature of companies and the countries benefitted by the shift, let us have a quick review of FDI flows (Table 1). The year 2018 was the third consecutive year of declining FDI inflows. They decreased by 13% to reach $1.41 trillion. For the fourth year in succession, the global FDI flows fell further to $1.39 trillion in 2019, down marginally by 1%. India was among the top 10 recipients of FDI, attracting $49 billion in inflows, a 16% increase from the previous year figure of $42. A major proportion went into the service sector, including information technology. It is to be noted that there were no flows into any manufacturing industries.

World's top ten FDI recipient countries

2018			2019		
Rank	**Country**	**US$ bn**	**Rank**	**Country**	**US$ bn**
1	USA	252	1	USA	251
2	China	139	2	China	140
3	Hong Kong	116	3	Singapore	110
4	Singapore	78	4	Brazil	75
5	Netherland	70	5	UK	61
6	UK	64	6	Hong Kong	55
7	Brazil	61	7	France	52
8	Australia	60	8	India	49
9	Spain	44	9	Canada	47
10	India	42	10	Germany	40

Source : UNCTAD (2019) : Handbook of Statistics, Fact Sheet No: 9 , FDI

That brings us back into the discussion on the 'China plus one' strategy adopted by investors with a view to complement their Chinese operations with additional ones in other countries. The objectives were lowering costs, diversifying risks, and accessing new markets. They were eminently achieved by moving to any of the ASEAN countries including Vietnam, Cambodia and Thailand - which have large available labour pools. While the monthly average wage in China was $326, the corresponding wage rates in Indonesia, Cambodia, and Vietnam were 280, 182 and 180 (in dollar terms) respectively. Other than wages, there were additional incentives as well. Thailand announced a 50% corporate tax break for companies relocating production from China. Indonesia too announced plans to streamline its FDI regulations and improved its business environment.

Thus, the ASEAN region was the preferred destination for shifting manufacturing units as they were low wage countries with capacities to accommodate large shifts of production from China. A State Bank of India's (SBI's) recent research states that Vietnam has been the highest gainer. The benefitting sub-sectors were electrical machinery, furniture, clothing, footwear and leather industries. India was benefitted only in organic chemicals and iron and steel. Bangladesh benefitted in the garments sector as its monthly wage rate was the lowest ($95) among all South Asian countries.

The latest statistics, released by Nomura, a Japanese financial group show that between April 2018 and August 2019, out of 56 companies that shifted their production units out of China only three came to India and two went to Indonesia. The remaining 51 went to Vietnam (22), Taiwan (11) and Thailand (8).

The second stage

The SBI research acknowledges that 2020 is "a lost year in terms of trade". India's strength lays only in ICT and services exports. Our merchandise trade has been poor. China exports are seven times higher than India. The SBI research finding states that India can look in the range of incremental exports growing by $20 billion in the least favorable outcome to a significant $193 billion jump in the five-year horizon only if and when its capabilities capture a significant portion of the Chinese market.

That determines the second stage. Though in recent years, India has moved up to reach the 63rd rank among 190 countries in the World Bank's Ease of Doing Business Index and also reached the 68th rank among 141 countries in the World Economic Forum's Global Competiveness Index, it is still has a long way to go for inspiring confidence among overseas investors.

Asian Developing Economies:World Competitiveness Index

Asian Rank	World Rank	Country	Scores
1	27	Malaysia	74.6
2	40	Thailand	68.1
3	50	Indonesia	64.6
4	64	Philippines	61.9
5	67	Vietnam	61.5
6	68	India	61.4
7	84	Sri Lanka	57.1
8	105	Bangladesh	52.1
9	106	Cambodia	52.1
10	108	Nepal	51.6

Source : World Economic Forum (2019) : The Global Competitiveness Report 2019

Need for reforms

India needs reforms in several areas. Labour markets, taxation, availability of land and of course control of corruption at all levels are some of the important areas. In regard to labour, which is in the concurrent list, states have their own laws. At the federal level, the government has planned to reduce multiplicity of laws by identifying four labour codes namely wages, industrial disputes, occupational safety and health and social security. The first has been cleared by the parliament and the three other codes are at various stages of clearance.

What is now required is to deal with the state laws. Two states have decided to suspend them for the sake of attracting industry and creating jobs. In fact, these laws, central and state, have been responsible for the absence of large enterprises in the country. It is reported that most of the work force in India is employed in the informal sector, which prevents them from being benefitted by the protection and the safety net enjoyed by those in the formal sector. The state laws are the reason behind large companies employing workers on a contract basis.

Another area is the tax policy. Much has been done by the government to attract FDI by way of favourable treatment to foreign investors. What is bothering them is the possibility of the government's power to introduce retrospective tax amendments.

Rightly, the Director General and CEO of Federation of Exporters have drawn the government's attention to this power, acting as a disincentive. The FDI policy has always been a sensitive subject though India has moved away from the earlier stand of a mixed regulated economy.

India is not China. India has a well-tested democratic regime. Governments are regularly replaced by periodical elections. It would, therefore, be better for the government now in power to evolve a consensus, similar to the efforts that the government undertook to get an acceptable set of guidelines for reducing the spread of the Covid-19 virus. That would bind the political parties to a common FDI policy to be followed by future governments. ■

Dr T K Jayaraman is a Research Professor, Faculty of Business, Accounting, Finance and Economics, University of Tunku Abdul Rahman, Kampar Campus, Perak State, Malaysia and Honorary Visiting Adjunct Professor, Amrita School of Business, Bengaluru Campus.