Clothes and Shoes: Can India Reclaim Low Skill Manufacturing?

Creating jobs is India's central challenge. Generating rapid economic growth is one critical element of the policy response India needs to generate jobs that are formal and productive, provide bang-for-buck in terms of jobs created relative to investment. Labour intensive manufacturing have the potential for broader social transformation, and can generate exports and growth.

The apparel and leather and footwear sectors meet many or all of these criteria and hence it makes sense to strive towards giving a boost to these sectors. Recognizing this, the government has announced important steps to incentivize the production and exports of apparel while the policy initiatives for leather products is a subject of discussion.

Why Clothes and Shoes?

Nearly every successful economic growth take-off in post-war history in East Asia has been associated with rapid expansion in clothing and footwear exports in the early stages.

Jobs, especially for women

Apparels and Leather sectors offer tremendous opportunities for creation of jobs, especially for women. The opportunity created for women implies that these sectors could be vehicles for social transformation. Women in apparel factories emphasize that they have gained financial independence.

In Bangladesh, female education, total fertility rates, and women's labour force participation moved positively due to the expansion of the apparel sector

A historic opportunity – China vacating; space filled by others and not India!

India has an opportunity to promote apparel, leather and footwear sectors because of rising wage levels in China. India is well positioned to take advantage of China's deteriorating competitiveness because wage costs in India are significantly lower than in China.

The space vacated by China is fast being taken over by Bangladesh and Vietnam in case of apparels; Vietnam and Indonesia in case of leather and footwear. India needs to act fast if it is to regain competitiveness and market share in these sectors. Hence, the urgency.

Common Challenges to both Apparel and Lather Industry

Logistics

On logistics, India is handicapped relative to competitors in a number of ways.

- The costs and time involved in getting goods from factory to destination are greater than our competitors.
- Lack of very large capacity containers (VLCC) at Indian ports to move cargo so that exports have to be transhipped through Colombo which adds to travel.

Labor regulations

Issues in labor market

- Minimum Wages Act 1948 mandates payment of overtime wages at twice the rate of ordinary rates of wages. This makes it burdensome for firms to hire workers overtime.

- Large mandatory contributions from the salary (for retirement fund/ insurance) for low-paid workers in small firms' results in a 45 per cent lower disposable salary.

- Lack of flexibility in part-time work and high minimum wages in for some sectors.

One symptom of labour market problems is that Indian apparel and leather firms are smaller compared to firms in say China, Bangladesh and Vietnam.

Tax and Tariff Policies

In both apparel and footwear sectors, tax and tariff policies put exporters at a disadvantage.
In the case of apparels, there are two sets of policies both of which hamper competitiveness in man-made fibres and favour instead cotton-based exports. This is not beneficial to India because internationally, world demand is shifting strongly towards manmade fibers and against cotton-based exports.

On the one hand, high tariffs on yarn and fiber increase the cost of producing clothing. India imposes a 10 percent tariff on man-made fibers vis a vis 6 percent on cotton fibres. To some extent this need not affect export competitiveness because drawback for tariffs paid on inputs is available. But drawbacks are not provided for purchases of domestically produced yarn that will reflect the high tariffs, adding to clothing costs. Also domestic sales of clothing will not benefit from duty drawback which could also affect overall export competitiveness.

On the other hand, domestic taxes also favour cotton-based production rather than production based on man-made fibers with 7.5 per cent tax on the former and 8.4 per cent on the latter. A similar problem also afflicts footwear production with taxes of 20.5 per cent on leather and 27 per cent on non-leather footwear. The global demand for footwear is shifting away from leather footwear and towards non leather footwear. This shift can be attributed to a host of factors like physical comfort, aesthetics and price affordability which work in favor of non-leather shoes as opposed to leather shoes.

India traditionally has been an exporter of leather footwear. Its share of leather footwear exports in the world market is more than double the share of non-leather footwear. Efforts are required to promote non-leather footwear to be able to effectively capture world market share particularly in view of China's slowdown of exports. Hence there is a need to undertake rationalization of domestic policies which are inconsistent with global demand patterns.

Discrimination in export markets

India's competitor exporting nations for apparels and leather and footwear enjoy better market access by way of zero or at least lower tariffs in the two major importing markets, namely, the United States of America (USA) and European Union (EU).

In the EU, Bangladesh exports enter mostly duty free (being a Less Developed Country (LDC). Vietnam could also attract zero tariffs once the EU – Vietnam Free Trade Agreement (FTA) comes into effect. Ethiopia, which is an emerging new competitor in apparels and leather, enjoys duty free access in US, EU and Canada.

Indian leather exports also face high tariffs in partner country markets in exports of leather goods and non-leather footwear, with considerable added disadvantage in Japan. An FTA with EU and UK will help. In the case of apparels, it will offset an existing disadvantage for India relative to competitors- Bangladesh, Vietnam and Ethiopia which already enjoy better market access.

In the case of leather, the FTA might give India an advantage relative to competitors. In both cases, the incremental impact would be positive.

<u>Sector Specific Challenge –leather and Footwear Sector</u>

Comparative advantage in cattle

The leather and footwear industry uses raw hides and skins of a number of animals like cattle, buffalo, goat, sheep and other smaller animals as its chief raw material.

Amongst these, leather made from cattle hides has greater global demand owing to its strength, durability and superior quality. It is estimated that cattle-based global exports dominate buffalo-based exports by a factor. However, despite having a large cattle population, India's share of global cattle population and exports of cattle hides is low and declining. This trend can be attributed to the limited availability of cattle for slaughter in India, thereby leading to loss of a potential comparative advantage due to underutilization of the abundantly available natural resource.

Policy response and Conclusions

Several measures have been taken by the government to address these concerns

- Apparel exporters will be provided relief to offset the impact of state taxes embedded in exports to improve competitiveness. Similar provisions for leather exporters would be useful.

- Textile and apparel firms will be provided a subsidy for increasing employment. This will take the form of government contributing the employers' 12 per cent contribution to the Employee Provident Fund (EPF)

But these need to be complemented by further actions. So what needs to be done?

India should make sure that new Free Trade Agreements, such as, with the European Union (EU) and the United Kingdom (UK) provide conducive market environment to export-and job-creating sectors such as apparels and maybe also leather products

GST is likely to rationalize domestic indirect taxes so that they do not discriminate in the case of apparels against the production of clothing that uses man-made fibers; and in the case of footwear against the production of non-leather based footwear (if there is such a discrimination).

A number of labor law reforms would overcome obstacles to employment creation in these sectors, some of which include the following:

• Low Wage Employees (people with less than Rs 20,000 salary per month) only receive 55 percent of their salary because 45 per cent goes to statutory deductions for retirement funds, insurance etc. Low wage employees do not have a 45 per cent savings rate and therefore they may prefer to receive these contributions today than benefit from them tomorrow.

Formal employment could increase by offering employees choices when they start employment: to decide whether they want such a high employee contribution to be deducted or decide whether their health insurance premiums go to ESI (Employee State Insurance) or a private health insurance of the employee’s choice.

The key point is to offer choice to employees, which will also result in competition for service providers which are government owned. This will result in better service at affordable rates.