

# Two Apples Of Our Eye

*Manufacturing vs services is a false binary for India. We need both.  
But why we need them is not properly understood*

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The India visit of Apple boss Tim Cook and two recent data points have re-ignited a simmering debate on manufacturing vs services.

Not only have exports of electronics finished products, driven by mobile phones, have seen a dramatic 55% increase this year. But Apple has become the largest blue-collar jobs creator in Indian electronics industry.

But there's also been a spectacular rise in export of services (up 24% in fiscal 2023 over 2022) – remarkably, not from the storied IT services, but from other services verticals (legal, medical, MNC back-offices). Raghuram Rajan wrote in these pages about how the services export data point is validation of the fact that India should focus more on services.

So, what's the answer? The answer is not to declare a winner. It's always tricky to derive grand sweeping narratives out of singular data points. And it's important not to create false binaries. Policymaking has to grapple with greys, not blacks & whites.

India needs both manufacturing and services. Here's why.

## **Services create more jobs than manufacturing**

For starters, don't think manufacturing is not about jobs. Not in India, not anywhere else. China, the largest factory of the world, with a manufacturing output of \$5 trillion, employs around 83 million workers in manufacturing. As a contrast, India, with manufacturing output of around \$500 billion, employs between 27 million and 62 million (depending on the survey you believe) workers.

Ergo, manufacturing is not a massive job-creator. As Indian manufacturing approaches Chinese levels of productivity, chances are it will need fewer workers than more. With increased automation, employment intensity of



manufacturing is on a secular decline.

At least one study, by CMIE and Ashoka University, finds that manufacturing employment declined from 51 million in 2016-17 to 27 million in 2020-21. While absence of formal large sample employment surveys makes such conclusions debatable, the trend is quite clear. Enrico Moretti of University of California in Berkeley, in a seminal study found that hi-end jobs, especially in the hi-tech sectors, have a much bigger multiplier effect on jobs created than low-tech jobs.

Moratti found a multiplier of 3.5 jobs (2 hi-skilled and 1 low-skilled) for every science and technology job created in an American city. In effect, services industries would tend to create a lot more jobs than relatively low-tech, low-skilled manufacturing assemblies.

No wonder the bulk of the population even in highly industrialised countries of Asia, including China, are employed in services. In China, despite its monster manufacturing capacities, half of its

workers are employed in services.

## **Manufacturing is crucial to keep trade deficit low**

The real issue with high performing services and limited manufacturing is trade deficit. Most services are non-tradable in nature – a barber or a chef, eg, cannot deliver his services remotely across the oceans. An economy that has limited tradables – goods and services that can be exported across large distances – typically ends up with large imports that need to be financed.

While some services can be traded – India's a storied case study of exporting IT services – their scalability is limited. Global services trade is about one-fourth of global goods trade. So, countries that have limited manufacturing capacities (relative to their economic size) also tend to have structural current account deficits (CAD).

The UK and US are examples from the developed world. But access to a

reserve currency affords developed countries more policy options to deal with structural CAD compared to emerging markets (EM) like India, which has non-convertible, non-reserve currencies.

India's CAD has been a perpetual policy constraint for the country since independence. While the country now has wider pools of capital flows to finance CAD, it still has an overbearing impact on efficiency in policymaking. Whether entering into FTAs, or deciding on a monetary policy stance, CAD forces a trade-off between economic stability and income growth.

Ergo, as a long-term strategy, India needs to have larger manufacturing capacities with market access in order to chip away at our CAD constraint.

Second, and recent years have reinforced that point somewhat violently, we should consider the political risk of supply chains. High dependence on China for API (a key ingredient in pharmaceutical manufacturing) or rare earth minerals (critical for a range of industries) or industrial intermediates for strategic electronic products presents large, un-diversifiable risks.

Recent experiences with Covid vaccines, where countries ringfenced vaccine supplies (as well as supplies of vaccine raw materials) for their own use, illustrate this point even more sharply. As the world gets buffeted by new geopolitical winds after three decades of a "relative pause of history" (paraphrasing Francis Fukuyama), India cannot afford to leave itself economically vulnerable – it needs a much larger manufacturing base.

Interestingly, despite the record growth in service exports and the spectacular emergence of electronics exports, India ended 2022-23 with a CAD of around 2% of GDP. That's just another way of saying we need to focus on both manufacturing and services. And we need them for reasons that policymakers must appreciate.

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