International Growth Centre

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# Reinvigorating India's manufacturing sector: Integrating the services value chain with Southeast Asia

**Fostering connectivity through stronger regional trading relationships may hold the key to unlocking growth in India's manufacturing sector. Opening up regional trade networks will not only reduce the costs of trading but also accelerate the development of manufacturing, production networks, and value chains in the region. Successful market integration requires a foundation of cooperation and knowledge sharing across borders.**

The Bharatiya Janata Party (BJP) led National Democratic Alliance (NDA) government has recently completed its first anniversary with a yearbook of reform agendas for India. Several international policies of the previous government have been rechristened. For instance, the erstwhile 'Look East Policy' is now 'Look West, Act East' policy with renewed emphasis on Eastern neighbours. There is focus on uplifting the laggard manufacturing sector with greater integration with countries in East and Southeast Asia. All of these are wrapped in the attractive 'Make in India' package, with a global growth strategy for India, linking the country with global value chains.

In the past two decades, India and Southeast Asian countries have signed several comprehensive free trade agreements (FTAs) and they are in the process of negotiating regional trade agreements known as Regional Comprehensive Economic Partnership Agreements (RCEP). The recent trade agreements are comprehensive, covering goods, services, investments, electronic commerce and trade facilitation, among others to ensure easier movement of goods and services and to facilitate the creation of a value chain.

### Constructing global value chains

Within Southeast Asia, India is now negotiating a comprehensive trade agreement with Thailand, a key trading partner in the region. Services sector reforms in both countries have enhanced the role of services in their respective global value chains and production networks. Trade agreements including services facilitate creation of value chain through global production networks, enabling different trading partners to add distinct value to exportable goods. The OECD gives data on value added by other countries in the exports of a particular country. In 2009, countries in East and Southeast Asia contributed to about 4.6 percent of the value added embodied in India's exports. Among ASEAN countries, Thailand is the third largest in terms of value addition, with about $24.41 million or 20 percent of the value added by ASEAN member states. Thailand's value added in India's exports has been the highest in wholesale and retail trade, hotels and restaurant services and the manufacturing sector. This suggests the possibility of creating a global value chain in services sectors between India and Thailand. Creation of value chain can be nurtured by **three kinds of connectivity** – physical connectivity, institutional connectivity and people-to-people connectivity.

### Connecting places

Transport connectivity is an important component of physical connectivity. It is crucial for establishing production networks. It is worth mentioning that the land route from India to Association of South East Asian Nations (ASEAN) is through Thailand where Myanmar plays an important role. Despite their close proximity transport connectivity between India and Thailand is poor. The two main links connecting India and Thailand are a) the India–Myanmar–Thailand Trilateral Highway (IMTTH) and b) the Mekong–India Economic Corridor (MIEC). India and Thailand need to cooperate at an institutional level to develop these corridors, along with support from the private sector in both the countries. This will enable better physical linkages between the two countries that will benefit the entire ASEAN region and support the development of production networks. It will also reduce transportation time and cost.

### Connecting institutions

Other important infrastructure services that support manufacturing sector and strengthen physical connectivity are telecommunications and financial services. These are enabling services for establishing manufacturing linkages and production networks. At present, both of these are restricted for foreign investors in the two markets. Business-facilitating instruments such as banks have a limited presence in each other's market. Telecommunications in India have an oligopolistic setup while it is nearly a monopoly in Thailand (which is now moving towards an oligopoly). Lower call charges and better telecommunication and broadband connectivity will be beneficial for businesses of the two countries.

### Connecting People

As regards movement of people, both India and Thailand have abundance of manpower. However, while India's export interest lies in high-skilled, professional services, Thailand has comparative advantage in terms of certain specialised skills such as nursing, midwifery, spa specialists, etc. India is keen to export professionals in sectors like business services and information technology to Thailand while Thai companies and associations are interested in establishing a foothold in spa services in India. While Thailand has interest in exporting specialised skills, India being a labour abundant country has reservations. It imposes a minimum salary condition, which is tough for the Thai spa workers, nurses and midwiferies to meet. Indian service providers are also facing visa and work permit related issues in Thailand. The regulatory bodies for related issues in Thailand. The regulatory bodies for professionals in the two countries do not recognise each other's qualifications.

### Current barriers to regional market integration

India and Thailand have a fairly restrictive FDI regime in services and the regulations in this sector are evolving. The current operating environment for Foreign Service providers is non-transparent offering limited cooperation and knowledge sharing among regulators of the two countries. All these factors impede bilateral flow of trade and investment thereby restricting market integration and development of services value chains.

An analysis of the existing trade agreements of India and Thailand reflect that the two countries have undertaken liberal commitments with their trading partners. They are both proponents of liberalising the movement of people in their WTO and bilateral/regional trade agreements. India's commitments in different services sectors in the bilateral agreements are similar to or lower than their domestic regime. However, Thailand is willing to go beyond its domestic regime in trade agreements. Ideally, a bilateral trade agreement should aim to facilitate market integration. Nevertheless, if it even binds the existing regime it provides operational certainty to businesses, since both countries will find it difficult to roll back the existing regime. Such operational certainty is important in countries such as India and Thailand that frequently change their regulatory regime. Since both India and Thailand continue to negotiate trade agreements such as the RECP, market integration will enable them to leverage each other's strengths. It will also enhance their joint bargaining power in RCEP *vis-à-vis* countries such as China.

### Integrating services may facilitate growth in India's manufacturing sector

For the trade agreements and market integration to be successful, the two countries have to develop a sound institutional and regulatory framework. There is a need for greater co-operation at three levels—government to government, among industry associations and among businesses. Co-operation and sharing of information and knowledge will facilitate market integration. Companies from India and Thailand can leverage their mutual strength to access third country markets. Overall, for services market integration and the development of services value chains, countries in this region have to speed up their domestic reforms process, remove market access barriers and implement a sound regulatory framework that enables foreign companies to operate in a transparent and non-discriminatory environment. Moreover, services have a key role in supporting the manufacturing sector, which has so far depicted slow growth in India. By opening the services sector to foreign markets and in this case with Thailand, India can secure its place in global production networks and participate in services value chain in the ASEAN region, rather than being left out in the hands of protectionism.