TERRY FRIEL

India's Factories Booming, But Not Enough

India's booming manufacturing sector is a major engine of growth for one of the world's fastest growing economies, but still has to pick up dramatically to hit the country's 10 percent growth target and take on rival China.

Unless manufacturing grows faster, economists say, economic growth will be stuck at about 8 percent, a rate to be envied by many but not fast enough to create jobs for a workforce growing by three percent or 12 million people a year or to fight poverty.

"I think this current pattern is unsustainable," says D. Joshi, an economist with the CRISIL ratings agency in New Delhi.

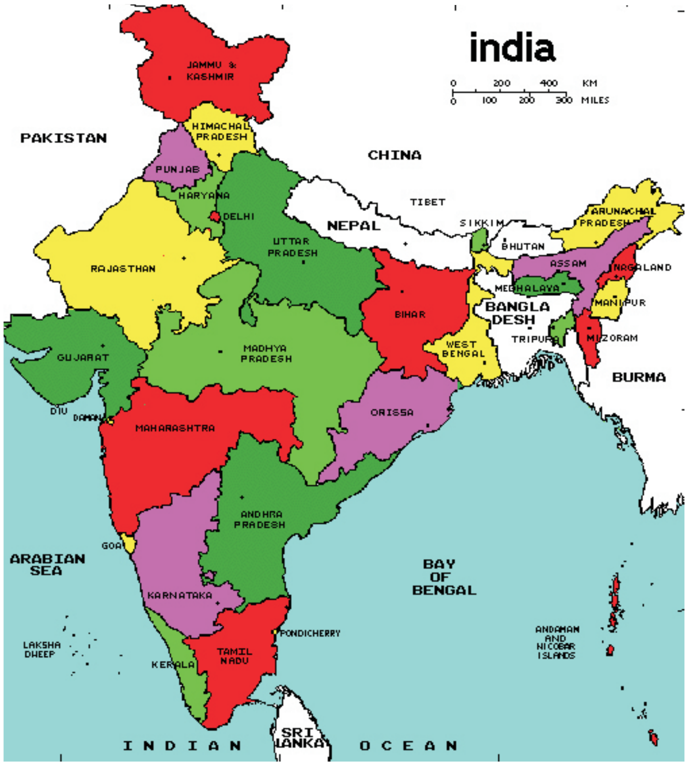
“You can't rely totally on services. You have to move into the manufacturing areas because otherwise there's no way you can absorb the low-skilled labour that comes out of agriculture and which is becoming an issue now.

"It is turning into a political issue also.”

Manufacturing accounts for about 16-17 percent of Asia's third-largest economy, not far behind the developed nation average of 20 percent, but less than half of China's 40 percent.

In South Korea, Thailand and Malaysia, manufacturing accounts for about a third of gross domestic product.

The sector employs about 6 million workers in India, plus maybe another 50 million in small-scale units with fewer than



10 workers -- compared with China's 100 million -- and exports just over $60 billion a year to China's $500 billion.

Manufacturing output is growing about 9 percent or more annually.

In the past few years, strong growth has been spurred by cheap credit for consumers and manufacturers alike and slow but steady economic reforms, including tax and tariff cuts.

But a study by the Federation of Indian Chambers of Commerce and Industry estimates the sector must grow at least 11 percent a year to support 8 percent GDP growth, let alone the 10 percent Prime Minister Manmohan Singh wants within two to three years.

Manufacturing expansion is being driven by surging domestic demand as consumers enjoy higher incomes and cheaper credit, as well as exports, which have been increasing by 20 percent a year over the past three years.

Consumption spending, growing by 7 to 8 percent, has become the economy's biggest driving force, economists say.

But analysts and industry experts say growth is being constrained by government policy and slow reforms, appalling infrastructure, restrictive labour laws and higher costs for raw materials and utilities.

Manufacturers say their industry is also too regulated and taxes are too high.

"The inspector Raj must end," says G. Vivekanand, managing director of Vishaka Industries in Chennai, which makes textiles, cement and asbestos sheeting, using the term for the licences and red tape that dog industry.

Indian industry is also more fragmented into small-scale operations than China's.

“Our problem with catching up with China is that we will never be a supplier of such a large volumes as China, because China, apart from high-technology, has also been able to use its massive labour force," the FICCI economist adds.

As India's economy develops, agriculture is becoming less important as a contributor to growth. Its share of GDP has fallen from half in the 1950s to barely 20 percent.

But more than 60 percent of Indians still rely on farming, "trapped" as former government economic adviser Shankar Acharya puts it, "in low-productivity agriculture, severely compounding the massive problems of poverty and regional disparities".

As more workers move off farms without the skills and education to join the information technology boom, factories and production lines become increasingly important to soak up the excess as well as the 12 million new job-seekers every year.

Creaking national infrastructure needs to be upgraded. Many companies, for example, supply their own power.

"If the economy were to grow at 8, 9 percent for a sustained period of time the current infrastructure will not support it, it will become a binding constraint,”

"Unless we improve the infrastructure, unless the roads are improved, unless the ports become efficient, I think we can't go too far, says CRISIL's Joshi. "We'll move as we are moving, which is not too bad, but it's not replicating the China story. No way.”

Prime Minister Singh is regarded as the father of reform, opening up what was then a heavily centralized economy in the early 1990s when he was finance minister.

But his Congress party-led coalition government relies on Communist support to stay in power, which has slowed change in areas such as making it easier for companies to hire and fire workers and easing foreign investment controls.

In its latest survey of foreign direct investment, A.T. Kearney found India had overtaken the United States as the most popular destination after China ($5.3 billion vs China's $60.6 billion) and was on the verge of an investment explosion.