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High interest & labour cost, not rupee, are the problem

At a time when both global growth and trade are perking up, India’s exports aren’t seeing any traction. In fact, disconcertingly, the growth in exports has lagged those from Asian peers. Global growth is expected to clock 3.6% in 2017 up from 3.2% in 2016, according to estimates by the International Monetary Fund (IMF), while global merchandise trade is expected to grow at a more robust pace of 4.2%. However, the momentum in markets overseas doesn’t appear to have helped accelerate exports from India. Between April and October, they grew at sub-10%—just 9.5% year-on-year. In contrast, competing economies such as Vietnam and South Korea reported increases that were much higher at 23.8% and 18.4%, respectively. Usually, a strengthening currency is identified as the chief culprit. But this time around, the currency must be absolved of any crime since, after some steep appreciation till March, it has been relatively stable.

In fact, a broader indicator, the real effective exchange rate (REER), has remained stable since April, dipping slightly in August. Economists at CRISIL believe domestic policy changes, such as the roll-out of GST, could have impacted exports, slowing them down. Small and medium enterprises, they say, have been adversely impacted by the problems related to GST. Sectors such as leather, textiles and gems & jewellery, which are labour-intensive, appear to have been among the worst hit. Had the loss of momentum in exports from these sectors been entirely due to GST, the trend would have reversed once the disruption due to GST was addressed. However, CRISIL’s economists believe the problem is a much more deep-rooted one, stemming from structural issues.

The lack of competitiveness of these labour-intensive sectors, they believe, had begun to erode even before GST. In their words, the revealed comparative advantage (RCA), or generally speaking, competitiveness of these labour-intensive sectors, was already on the decline. In the decade between 2006 and 2016, the RCA declined for three of the sectors; demonetisation and GST exacerbated the problem. The RCA for gems & jewellery fell to 3.96 in 2016 from 6.38 in 2006. Given how crucial it is to generate exports and employment, these labour-intensive sectors must regain their competitiveness.

In an analysis some time ago, economists at HSBC had observed that the biggest reason for India’s poor export performance was domestic bottlenecks—just around a third of the problem, they noted, was related to global growth. With the rebound in global growth, it would appear now the hurdles to better exports have more to do with poor infrastructure and cost and price disadvantages—these include high real rates of interest as well as high wages, especially after being adjusted for productivity. The government needs to study these problems closely and come up with a solution, else exports could falter further.