

# China-India Brief

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*Guest Column*

## Will India Replace China as the New Global Manufacturing Hub?

By Ying Chen

As a result of the COVID-19 pandemic and US-China tensions, global manufacturers have been actively seeking strategies to diversify their supply chains and reduce their reliance on China as the major manufacturing supplier. **Thailand, Malaysia and Vietnam** were among the initial sought-after destinations for global capital, and recently, India has also started to attract interest.

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The *China-India Brief* is a bi-monthly digest focusing on the relationship between Asia's two biggest powers. The Brief provides readers with a key summary of current news articles, reports, analyses, commentaries, and journal articles published in English on the China-India relationship. It features a Guest Column weighing in on key current issues in China-India relations.

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Companies that have started production in India or are in the process of sealing the deal include **Apple, Boeing, Nokia, Ericsson, Samsung, and LG**. Samsung took the trouble to clarify that “products manufactured in India are mainly sold in the Indian market, with some exported to African countries.” This comment from Samsung exemplifies the dilemma facing global capital considering a shift to manufacturing sites to India. On the one hand, the shift is urgently needed given the labour cost and geopolitical advantages India can bring, yet on the other hand there are concerns about India’s possible unpreparedness and the resulting problems of short-run risks and long-term sustainability.

### **Weighing Pros and Cons**

To start, moving some manufacturing capacity to India has several advantages for global manufacturers. As was revealed by the pandemic, the current global supply chain relies heavily on China’s manufacturing capacity, and once the country went into lockdown, transnational corporations (TNCs) were immediately affected. Even without the pandemic shock on the global supply chain, tensions between US and China, starting with the trade war but now intensified by conflicting positions on the Russia-Ukraine war and Taiwan sovereignty, constantly alerts global capital to the need to find back-ups. India has emerged as a top candidate, with its

Western-friendly parliamentary democracy, a much younger population, and growing **policy supports** including **tax cuts for corporations, the establishment of the special economic zones, and a \$26 billion incentive plan to promote investment in local industry**.

However, these advantages sometimes prove to be the source of TNCs’ hesitance. One of the biggest ironies is that business analysts have cast doubt on the efficiency of India’s decision-making precisely because of its status as the **“largest democracy,” since there are “too many stakeholders to satisfy.”** The challenges and risks awaiting such business decision-making can be summed up in the **World Bank’s Doing Business 2020 report**, in which India was ranked at 63rd among 190 countries for “ease of doing business,” much lower than China (31st).

Aside from the perspective of global capital, there is a more pertinent labour question at hand. For businesses, a rational economic decision is to lower the cost of labour to reap as much profit as possible. However, China did not become the world manufacturing center just because it had ‘cheap labour.’ True, wages were extremely low in China when it first joined the World Trade Organisation (WTO) in 2001. The official statistics suggest that the average annual wage in the manufacturing sector was only **RMB 9,774** (USD\$100) at that time. Yet at the same time, life expectancy had



already reached **72.61 years** and adult literacy was over **90 percent** by 2001, a rare human development achievement for the level of economic development at that time as measured by standard GDP. That achievement was due to the **radical policies** of redirecting public health and education resources to the rural sector and the less privileged in the urban sector, which **largely took place during the pre-reform period**. What is at stake is not the absolute level of labour costs but rather the cost-effectiveness of labour, or the cost of labour for a given output level. In other words, businesses do not just compare nominal wages across countries and choose the lowest wages, they also take account of the productivity of labour, which, along with the wage, determine the labour cost per unit of output value. Productivity can be affected by many factors, including labour

quality, physical infrastructure, economies of agglomeration, and technology, in all of which India is currently lagging behind China.

The quality of labour, which can be roughly estimated by health and education indicators, contributes significantly to labour productivity and cost-effectiveness, which matters to businesses. Historical data suggest that the gap between India and China started decades prior to the reform era and has widened until today. India's starting life expectancy at the time of independence was comparable to China's in 1950 (around 30 years), but China's life expectancy surpassed that of India as early as the 1960s, and by the time China entered the economic reform period in the 1980s, it had achieved a life expectancy of **64 years**—10 years more than what India had achieved

at that time (54 years). Similarly, for adult literacy rate, the gap between India and China started in the pre-reform period and has continued until the present (77.7 percent versus 97.2 percent in 2022). India's life expectancy and literacy rate today has not even reached China's 2001 figures.

This persistent gap largely explains why cellphone production in India right now still has a **high defect rate** of around 50 percent, much higher than in Chinese factories, and higher than what global capital can accept. It also explains why, despite its annual manufacturing wage experiencing an **eight-fold increase** from 2001 to 2021, and the hourly wage a **three-fold increase** from 2005 to 2016—making wages in China far higher than manufacturing competitors in Latin America and Southeast Asia—China is still the largest manufacturing country in the world, taking a total share of **28.7 percent** of global manufacturing output.

In addition to cost-effective labour, a potential manufacturing hub must also have well-maintained physical infrastructure such as highways and railroads to ensure materials can be transported safely, cost-effectively, and in a timely manner. Today **only 5 percent of India's roads are highways**, and road congestion is a major problem. Although the railroad infrastructure building in India can be traced back to colonial times, much of it is outdated and cannot satisfy the needs of expanding industries.

Another disadvantage for India is the lack of a comprehensive industrial system which prevents India from achieving economies of agglomeration, a term used by economists to describe cross-industry economies of scale. This means that smart phone manufacturers do not have access to components cost-effectively from nearby locations, but instead might have to import those intermediate inputs from abroad. This lack of the backward linkages adds additional uncertainty as well as costs for businesses.

All of the abovementioned disadvantages will take great effort to address, and India still has a long way to go.

### Economic versus Political Considerations

The above analysis points to one conclusion: if it is a purely economic decision, one should expect TNCs to continue manufacturing in China to take advantage of its labour cost-effectiveness, instead of bearing the risks of a premature shift to India. Nevertheless, Apple recently **announced** that it is moving production away from mainland China—where currently 95 percent of all iPhone products are manufactured—with plans to expand operations in India, where 25 percent of iPhones will be assembled by 2025.

It appears that this is a move based on political considerations. Market forces alone cannot make such a shift work, and instead, many non-market interventions will be

required to rapidly prepare India for this role. This will include not only policies to directly support the manufacturing industry, but also policies to improve labour productivity, such as investment in public health, education, and physical infrastructure. Investment of this kind, as argued by the renowned Indian economist and philosopher Amartya Sen, would require strong state participation and should not be left solely to the ‘invisible hand’ of the market.

Based on historical experience, such a big shift could potentially enable India to rapidly transform its economy towards industrialisation, a path that was used by South Korea and Taiwan during the Cold War. There is striking similarity in terms of their motivations. During the Cold War, the aim was to compete with socialist North Korea and socialist mainland China. The West supported that approach by supplying South Korea and Taiwan with capital and technology and integrated them into the global trade arrangement, starting with the two economies engaging in low value-added manufacturing activities. Land reform was even tolerated by the West in South Korea and Taiwan at that time to enhance incentives and improve productivity. It was a rare time when countries in geopolitically strategic positions had a remarkably wide domestic policy space, as well as material support from the developed countries to launch industrialisation. Later South Korea

proactively “defied” its comparative advantage, as described by economist Ha-Joon Chang, upgrading to producing higher value-added electronic products and climbing up the ladder of the global value chain.

If India wants to follow the East Asian development path, that is an opportunity it can seize. Acknowledging that shifting to India is driven by geopolitical considerations, India should use its strategic position to bargain for more capital and technological support to enhance its manufacturing capacity as well as to collaborate with other countries to invest in its human capital development. However, the temptation for India is to passively follow the Western doctrine of comparative advantage and stay at the lower position of the global value chain. What India should do in the intermediate term is to proactively implement industrial policies to achieve industrial upgrading as quickly as possible.

### **Prospect for Labour**

Most analyses of India’s rise as a potential manufacturing hub have focused on the interest of capital as a priority, weighing whether it makes sense for businesses to shift production and endure short-run risks and possible losses. At the other end of the spectrum, it should be noted that once the TNCs are able to diversify their manufacturing sites, they will have even higher leverage to bargain down wages for

workers in any specific site. India's status as the most populous country with a much younger labour force attracts foreign capital precisely because the very existence of a large reserve army of labourers (i.e., the majority unemployed or underemployed who are willing to jump to a position for a subsistence wage) weakens labour's bargaining power. In 2021, India's **average monthly wage amounted to \$422 while its average minimum wage was \$95, much lower than in Southeast Asian markets.** Not surprisingly, women's wage compensation, if they earn wages at all, is even less. For instance, a female industrial worker made **INR 382 per day** on average in 2019, which was only 87 percent of what her male counterparts earned.

As long as capitalism remains the dominant operating economic system, the race-to-the-bottom strategy domestically and internationally will tend to be prevalent, and the textbook issues of labour exploitation and ecological destruction can be expected to persist for a long time, despite the aggregate employment potential and GDP growth potential being attractive for a while. The most recent **legislation reforms** in favour of Apple and Foxconn over the claims of Indian labour in the state of Karnataka allows the two companies to legally extend work-shifts from 9 hours to 12 hours and allows overtime hours to rise

from 75 to 145 hours over a three-month period, suggesting that a new wave of labour struggles in India is just beginning.

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## News Reports

### Bilateral relations

#### **India and China spar over visas for their journalists**

Reuters, April 6

India and China broke into fresh diplomatic sparring on Thursday (April 6), accusing each other of creating visa hassles for their journalists posted in New Delhi and Beijing.

#### **Normalcy in ties with China will require restoration of peace and tranquility in border areas: India**

The Economic Times, April 6

The Indian and Chinese troops are locked in a standoff for three years at certain friction points in eastern Ladakh even as the two sides completed disengagement from several areas following extensive diplomatic and military talks.

#### **China's moves to assert control along disputed border risk further tensions with India**

South China Morning Post, April 5

China is planning to upgrade two Tibetan towns along the disputed border with India to city status, in a move that may help consolidate its hold over the region but risks further inflaming tensions.

#### **Arunachal Pradesh: India rejects China's attempt to rename disputed places**

BBC, April 4

China has renamed 11 places along a disputed Himalayan border region in the state.

### China and India in the Region

#### **India confronts Myanmar about China spy post on remote Coco Islands**

The Straits Times, April 7

India has confronted Myanmar with intelligence showing that China is providing assistance in building a surveillance post on a remote island in the Bay of Bengal.

#### **India courts Southeast Asia with affordable missiles amid South China Sea rows, Russia-Ukraine war**

South China Morning Post, April 4

India's move to boost its defence sector could undermine Chinese efforts 'to establish military superiority in the region', analysts say.

#### **China Says Plans To Boost Ties With "Emerging Powers" Russia And India**

NDTV, April 4

China and Russia are dedicated to growing a new type of major-country relations featuring mutual respect, peaceful coexistence and win-win cooperation, Chinese Foreign Ministry said.

#### **India keeps close watch as EU leaders make beeline for China**

The Economic Times, March 31

India is keeping a close watch as European leaders make a beeline to China amid apprehension that any closer EU-Beijing economic ties may increase EU investments in China and dilute their Indo-Pacific outreach.

## Trade and Economy

### **Exec sees China-India ties as economic win-win**

China Daily, April 7

"There's a win-win when we trade more, invest in each other and our economies are more connected to each other," said Atul Dalakoti, Executive Director of the Federation of Indian Chambers of Commerce and Industry at the Boao Forum.

### **Embraer sets sights on China and India with latest jets**

Nikkei Asia, April 5

Embraer, the world's third-largest aircraft supplier, plans to expand its footprint in the narrow-body passenger jet market in Asia, where demand is expected to take off.

### **Made-in-India iPhones surge as Apple moves production away from China**

South China Morning Post, April 5

India-made iPhones surged in volume and value last year, as Apple moved to shift some production away from China in a bid to diversify its supply chain.

### **ADB forecasts China, India to power strong growth in 2023**

The Hindu, April 4

China's recovery from the pandemic and strong demand in India will drive strong economic growth in Asia this year, the Asian Development Bank (ADB) said in a report issued on April 4.

## Energy and Environment

### **Almost all new coal projects announced last year came from China, says a new report**

Fortune, April 6

The coal fleet grew by 19.5 gigawatts last year, with nearly all newly commissioned coal projects in China, according to a report by Global Energy Monitor.

### **India Set to Surpass China in Need for Oil as Growth Paths Diverge**

Bloomberg, March 24

A change is on the horizon for oil demand, with India set to eclipse China as the most important driver of global growth—and potentially the last, as the world shifts to a greener future.

### **Russia overtakes Saudi Arabia as China's top oil supplier**

Al Jazeera, March 20

Chinese imports of Russian oil rise by nearly one-quarter from the same period in 2022.



## Analyses

### **Russia and China's plan is to divide and rule the West**

Indian Express, April 5

*By C. Raja Mohan, Senior Fellow with the Asia Society Policy Institute in Delhi*

New Delhi can see that their overreach has cemented broad western unity rather than separating Europe from the US.

### **NATO expansion will end up shaping India's policy**

Hindustan Times, April 5

*By Harsh V. Pant is Vice President—Studies and Foreign Policy at Observer Research Foundation, New Delhi*

India will do its best to keep ties with Russia on an even keel, but underlying realities are changing rapidly.

### **Why India Downplays China's Border Threat**

Foreign Policy, April 4

*By Happymon Jacob, Associate Professor at the School of International Studies at JNU.*

Responding to Beijing's aggression is more than a military question.

### **India must evaluate EU's 'de-risking' with China**

Deccan Herald, April 4

*By Gulshan Sachdeva, Professor at the Centre for European Studies and Coordinator, Jean Monnet Centre of Excellence, Jawaharlal Nehru University*

As China is India's major trading partner as well as a key strategic challenge, New Delhi needs to carefully study the evolving European approach towards China.

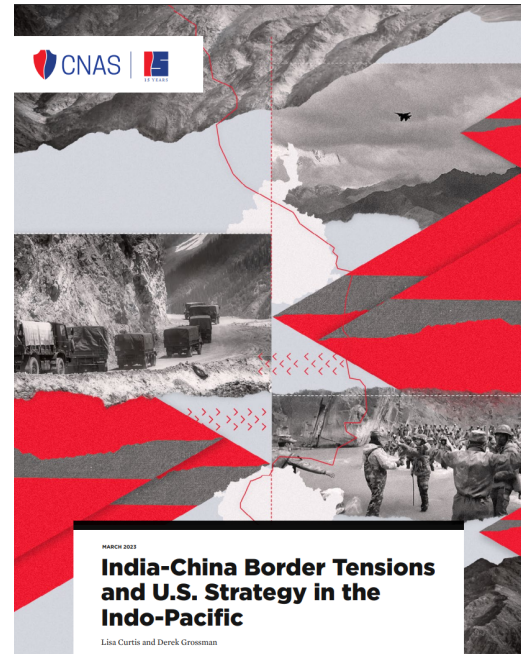
## Books and Journals

### India-China Border Tensions and U.S. Strategy in the Indo-Pacific

Center for New American Security, March 30

*By Lisa Curtis, Senior Fellow and Director of the Indo-Pacific Security Program at CNAS; and Derek Grossman, Senior Defence Analyst at the RAND Corporation*

While the Chinese and Indian militaries have since pulled back forces from the most contentious standoff sites where the 2020 buildup occurred and established temporary buffer zones, both sides retain high numbers of troops forward deployed along the disputed frontier, and there are several flashpoints that could erupt into another border crisis at any time. The most recent clash that took place near Tawang is a reminder that, even though recent attention has been focused on the Ladakh region, there are multiple trigger points along the 2,100-mile-long Line of Actual Control (LAC) that bear monitoring. With both China and India enhancing infrastructure and introducing new and advanced weapons systems on their sides of the disputed border, combined with forward deployments and heightened lack of trust, the chances for continued standoffs that could erupt into local or even full-blown conflict remain high.



## Our team



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## THE CENTRE ON ASIA AND GLOBALISATION

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## OTHER CAG PUBLICATIONS

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- *Deterring Conflict and Preserving Peace in Asia* edited by Drew Thompson and Byron Chong (Centre on Asia and Globalisation, 2022)
- *What Can the United States Learn from China about Infrastructure?* by Selina Ho in *The China Questions 2* (Harvard University Press, 2022)
- *Failure to launch? Indonesia against China's Grey Zone Tactics* by Evan Laksmana (IDSS Paper No.37)
- *India-Australia-Indonesia Maritime Partnership: Shared Challenges, Compelling Opportunities* by Premesha Saha, Natalie Sambhi, and Evan Laksmana (ORF, 2022)
- *India Versus China : Why they are Not Friends* by Kanti Bajpai (Juggernaut Books, 2021)
- *Winning the Fight Taiwan Cannot Afford to Lose* by Drew Thompson (Strategic Forum, 2021)
- *Routledge Handbook of China-India Relations* edited by Kanti Bajpai, Selina Ho and Manjari Chatterjee Miller (Routledge, 2020)



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