Fallout from Covid-19: Japanese, S. Korean & US Companies Likely to Relocate Production Bases from China to India

Author Rajaram Panda

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Introduction

The outbreak of Covid-19 has dramatically altered the social, political and economic lives of millions around the world. While a worldwide recession is feared, economic readjustments by countries in Asia have already begun. The Covid-19 pandemic could overhaul the Asian production value chain. This change began even before the pandemic due to rising labor costs in China. This had already encouraged Japan and other developed nations' production subsidiaries in China to move to South Asia. This time, with the disruption of production supply chains in China caused by the virus at the beginning of the pandemic when China's mishandling of infections became widely known, there seems to be a greater driving force behind those nations' subsidiaries in China moving to other parts of Asia. These countries are now even planning to relocate their production bases to back home.

In the process of resetting ties, the governments of Japan, South Korea and the United States seem to be also encouraging companies with production bases in China to relocate their businesses either back home or to other neighboring countries, such as in Southeast Asia and India.

In simple terms, this production shift would be a gain for Southeast Asia and India. Given the huge potential, large domestic market and increased purchasing power capacity of the more than 350 million middle-class population, India enjoys a comparative advantage *vis-à-vis* the countries of Southeast Asia in this restructuring process. Creating a new hub for global supply chains in India seems to be the new economic mantra for the US, Japan and South Korea.

Why India?

India enjoys many advantages as a manufacturing base for Japan, South Korea and the US. It has huge manpower, skilled and semi-skilled, available at relatively low cost. The Indian government too is laying out a roadmap and putting a strategy in place that removes potential roadblocks in export manufacturing. Apart from the auto sector, other sectors where Japan and South Korea are likely to focus are pharmaceuticals and electronics which have both achieved sophistication and produce quality products at competitive prices. Mobile phone manufacturing has already made its presence felt. The focus will be to attract major companies like Apple and Samsung.

Potential for India to Become Center of Supply Chains

Prime Minister Narendra Modi has stressed that post-Covid-19, India can emerge as the nerve center of modern supply chains. He said that the novel coronavirus outbreak has significantly changed the contours of professional life and these days home is the new office and the Internet is the new meeting room. Underlying the new business and lifestyle models, he said, "India, with the right blend of the physical and the virtual, can emerge as the global nerve center of complex modern multinational supply chains in the post-Covid-19 world." Modi's emphasis that "technology demolishes bureaucratic hierarchies, eliminates middlemen and accelerates welfare measures" will give Japanese and Korean partners added confidence to do business in India.

Indeed, Covid-19 is both a crisis and an opportunity. India has a great opportunity to emerge as an alternative sourcing destination. For decades now, China has remained as central to the global supply chain but with foreign firms withdrawing now, it has lost that advantage. While China's export specialization is concentrated on products such as electrical machinery, appliances and equipment, India's exports are dominated by mineral products, chemicals and precious metals. The current disruption in China could reshape global supply chains. That provides an opportunity for India to capitalize on other nations' search for alternative supply options.

Changes in FDI Norms

Given China's aggressive economic drive overseas with the long-term goal of taking a controlling stake in many enterprises, the Modi government announced a decision on April 18, 2020 with geopolitical economic ramifications, amending its FDI policy to put a blanket ban on investment through the automatic route by entities from countries that share a border with India. The move is seen as an attempt to ward off the threat of "opportunistic" Chinese takeovers of Indian companies.

The trigger came when stock and other asset prices started crashing following the Covid-19 fear. The government had to intervene in order to protect its interests, especially in sensitive sectors such as fintech, digital infrastructure, e-commerce, pharma and specialty chemicals from predatory acquisitions. The government had to strike a balance between economic openness and national security, and hence the tweaking of these FDI norms. When the People's Bank of China acquired 1% of India's HDFC Bank Ltd. on behalf of China's sovereign wealth fund SAFE through the FPI route, alarm bells started ringing and the government had to intervene to protect its national economic and security interests.

The Case of Japan

While announcing a state of emergency in Japan on April 7, Prime Minister Shinzo Abe also announced an economic stimulus package worth a whopping 108.2 trillion yen ($993 billion), equal to 20% of Japan's economic output, to cushion the impact of the epidemic on the country's economy. The Japanese government will use part of this package to support Japanese manufacturing companies shifting their overseas production bases back to Japan, as well as to the other Asian nations rather than China.

The impact of this changed business strategy supported by public policy is going to be huge. Japan's decision could result in the loss of numerous jobs in China and the creation of new jobs in South Asia. This decision to transfer factories and shops to South Asia will thus open up opportunities for India, Bangladesh, and other countries in Southeast Asia like Vietnam and Thailand. These countries are now hoping to attract Japan to their shores. India looks like the best bet for Japan, given its cheap labor, a democratic system and a robust manufacturing ecosystem of which Japan already is a part.

India has a large middle-class population and thus provides a huge market. It also enjoys comparative demographic advantage as 65% of its population are below 35 years of age. There are nearly 1,500 Japanese companies registered in India. These companies have 5,102 business establishments spread across states like Karnataka, Tamil Nadu, West Bengal, Delhi and Gujarat. The news of the Japan International Cooperation Agency's role in the development of metros in Indian cities and the Mumbai-Ahmedabad shinkansen project are path-breaking initiatives that could define future India-Japan economic relations.

Modi and Abe already enjoy a close bonhomie having met several times in summits and in third countries, and Abe is attracted to Modi's new ideas, such as Make in India, Digital India, Skill India, Clean Mission Initiatives and several others.

The Case of South Korea

South Korea has also started thinking on similar lines. Unlike Japan and even without government initiatives, South Korean companies have started planning to move units from China to India. Hyundai Steel and Posco are already in talks with the Indian government. South Korean companies are also wary of the ongoing China-US trade frictions. Requests from Korean steel majors, some start-ups and one from the hospitality sector are already with the Indian government. The state of Andhra Pradesh has been identified as the ideal location to set up units. India is all set to become a manufacturing base for Korean companies for their global markets.

When Japan's Suzuki Motor Corp. decided to set up its first car manufacturing plant in Gurugram in the 1980s, South Korea preferred to focus on China, thereby making the mistake of putting all its eggs in one basket. That mistake is now being corrected. India's capacity to invest in the two Korean companies will depend on how soon the economy restarts.

On its side, India needs to adopt the right strategy and build a consensus among states, and focus on important legislation to welcome Japanese and Korean firms. It needs to remove red tape, give one window clearances, ease land acquisition norms and revamp labor laws. These have been seen to be the bottlenecks by potential investors for a long time and India needs to do its homework fast. Many Indian lobbyists and industrialists are excitedly looking forward to attracting other such companies that want to move from the Chinese market into India. States should be ready to offer overseas companies 2,000 to 5,000 acres in some special zone where they do not have to look for land or building approvals.

The Case of the US

As with Japan and South Korea, India is also seeking to attract US businesses, including medical devices giant Abbott Laboratories, to relocate from China as President Donald Trump's administration steps up efforts to have Beijing take responsibility for Covid-19. In April, the US government reached out to more than 1,000 companies in the US and through overseas missions to offer incentives for manufacturers seeking to move out of China. India is prioritizing medical equipment suppliers, food processing units, textiles, leather and auto part makers among more than 550 products covered in the discussions.

Concluding Observations

There is a clear message now that for India welcoming Japanese and Korean enterprises to partner with Indian enterprises takes precedence over Chinese companies. Modi has already spoken to Abe and South Korean President Moon Jae-in on the phone and all three nations are on the same page. With the support of the Indian government, Indian enterprises and other stakeholders should work together to create the right environment in making India the new manufacturing hub and center of global supply chains. This will be a win-win proposition for the US and the three Asian countries. JS

Prof. Rajaram Panda is Lok Sabha research fellow at the Parliament of India and member of the Governing Council of the Indian Council of World Affairs, and the Centre for Security and Strategic Studies, both in New Delhi.