1. Why Tariff Hikes won't Protect Domestic Manufacturers

Context:

- The FY21 Budget announced tariff increases on a range of household products and appliances as part of a trade policy to restrict 'unnecessary' imports.

Background:

- Many of the imports are from China; India's widening trade deficit with which has caused the government concern. The rationale given is to protect local manufacturers, and give a boost to Make in India.
- This comes after the cutting of corporate tax rates to make them globally competitive, especially with ASEAN countries like Vietnam, with which India is competing for investments.
- Despite a range of policy initiatives, the manufacturing share of India's GDP remains at around 15%.
- While India is not alone in imposing higher trade barriers post the 2008 financial crisis, it is one of the most aggressive users of anti-trade notifications. WTO estimates that India's average MFN tariff is the highest among major economies.

Why Tariffs Hike is Not Helpful for Industry:

- Most of the 'unnecessary' imports, like toys, small plastic parts, small furniture, etc, are made by private Chinese SMEs, which operate in a hyper-competitive environment in a country with rapid increase in wages, and not by subsidised, large state firms.
- Indian SME suppliers are unable to compete with them, despite the additional cost of transportation from China.
- Despite the tax cuts to make India a more attractive manufacturing investment destination, Vietnam is attracting a major share of the large capacities shifting out of China, despite India's much larger domestic market as an attraction. As a result, Vietnam's manufacturing exports are growing rapidly while India's are stagnating or declining.

Lack of competitiveness of the Indian Industry:

- Indian SMEs in local market are being out priced by their Chinese competitors, and large scale manufacturers find themselves out priced in the global market by plants in Vietnam (and several other countries, e.g., Bangladesh for textiles).

- Unless we address this essential poor global competitiveness, we face the danger of falling into the high tariff protected, import substitution, high-cost manufacturing mindset of the 1960s and 70s.

Way Forward to increase the competitiveness of the Industry:

- Trade policy favouring local manufacturers is a legitimate policy lever (if allowed within WTO rules) as long as there is clear understanding within the industry that these tariff increases are temporary and they have to improve their cost competitiveness during this period of high tariff imposition.
- From past experience, we can see that this strategy has helped build the only two globally competitive manufacturing sectors we have in India—automotive, and pharma.
- Government has initiated several major policy reforms—GST, focus on EoDB, infrastructure development, setting up a logistics department, etc—to support the manufacturing sector.
- We have to put **Global Competitiveness at the centre of our Industrial Policymaking** to ensure that our trade, investment, and industrial policies are synchronised, with one overarching objective—global cost competitiveness of the Indian industry
- The only measure to bring competitiveness is Cost of Doing Business (CoDB), which has to be built on
    i. Factor costs,
    ii. Cost of, and access to capital (especially for SMEs),
    iii. Regulatory compliance costs, and
    iv. Other factors of global competitiveness that go beyond EoDB.
- Only by developing such a measure that brings together the comprehensive set of factors that drives CoDB, and then using this metric to inform our policymaking, can we improve our global cost competitiveness.