Trade reforms: Global Competition or Domestic Protection?

Pradeep Mehta's article has mentioned, very rightly, the imperative to coordinate trade and industry policies more effectively (than India has been doing since liberalisation in the 1990s). Let us look at India's own history to understand what policies will produce the required results, which are more production of goods and services in India, to create more employment in the country. With the necessary condition that the products made in India should be of International Standards, so that they can be exported, and also so that Indian customers of products made in India get best value for money.

A good case study is the 'automobile' industry, which Pradeep has mentioned. This industry includes Passenger Cars, Commercial Vehicles, Two-Wheelers, and components for these vehicles. It is a 'success' story.

These industries have been growing well. Indian consumers have a variety of products to choose from. Large employment has been created by these industries—skilled employment in manufacturing units, and employment in ancillary services around the country to sell, finance, and service the products.

There is 'depth' in production chains—complex components required for the vehicles are produced within the country. Some companies have been designing new products, and some have been exporting products for many decades. Foreign companies are welcome to participate in the Indian industry, on India's terms. Many have come to the country and some have done very well.

Policies in this sector were designed since the 1950s to build competitive capabilities within the country. Producers were 'licensed' to produce. With the privilege of the license came permission to import technology, raw materials, equipment, and parts. Local producers were 'protected' by high import duties.

However, the privileges came with a demand to build capabilities within the country, in a 'phased manufacturing program', so that the components required for the final products would also be produced in the country. The licensees and their foreign partners were compelled to bring in foreign parts' suppliers to produce in the country. The parts' suppliers gained a privileged access to growing Indian demand, supplying to both the product assemblers and also to the growing after-sales spares market. Domestic value chains have grown within India in these industries with many small enterprises in them.

Many component producers, including SMEs, who established capabilities in India have exported their products profitably and become connected into global supply chains. Thus, the policy instruments of 'import duties for protection' and a 'phased manufacturing program' have successfully stimulated the growth of a large, vibrant industry in India.

However, these very-same instruments of 'import duties' and a 'phased manufacturing program' have become anathema in the WTO regime. In fact, when the Indian government proposed such instruments recently to grow its electronics hardware industry, it was warned that it cannot since it is a signatory to WTO. Meanwhile China, using similar policies to nurture producers, became the 'factory of the world' in electronics and many other products.

Trade theories cannot fully explain how industrial capabilities are developed. One must look deeper. Indian auto components' producers have been successful exporters, whereas producers of vehicles have not exported much.

Some economists have attributed this difference to the higher import duties that continue to be levied on vehicles whereas the duties on components are much lower. They cite this as proof that high duties produce non-competitive industries. Whereas, the reason for the differences in export levels is that finished vehicles are not as easily exportable as components.

Vehicles for export must suit the importing countries' customers' requirements. Generally, vehicles for export must be altered to suit operating conditions in other countries. Moreover, they must be certified to operate in the foreign country which is a costly and complicated process. Besides, the vehicle seller has to establish its brand and set up a sales and service network too. These 'set-ups' require large investments. On the other hand, components are easier to export. Their designs are more fungible. They are generally sold 'business to business', to vehicle assemblers and to spare parts' sales chains. Component producers do not require to make large investments in marketing and distribution which vehicle exporters must.

The story of the growth of the Indian automobile industry since the 1950s provides several insights into how enterprises learn to produce what they could not before and also learn to compete in international markets.

Tata Motors (formerly known as TELCO) was producing trucks in India, with its collaborator Daimler-Benz, by the 1970s, with 99% Indian content, to Daimler-Benz's quality standards. A large network of component suppliers had grown in India, and Daimler Benz was exporting these Made in India trucks to other countries as its own trucks with its star on the bonnet.

By the 1990s, Bajaj Auto and Hero (with Honda) had grown very capable two-wheeler industries: and Bajaj was exporting its products. Since the 1980s, Maruti with Suzuki has grown a strong passenger car industry. And M&M has grown strong capabilities in utility vehicles and tractors—and is exporting its products.

An entrepreneur's desire to learn and compete with the best is essential for a successful Make in India strategy. Builders of successful enterprises in the Indian auto sector were driven by an urge to learn and make complex products and compete with the best in the world. They were supported by so-called 'protection' policies in the early stages. On the other hand, others, with a traders' mentality, who took advantage of high import duties on automobile products merely to make profits, and did not build their technological capabilities, have not grown; and some have disappeared.

Foreign companies are not shut out by policies to nurture Make in India. Those who participate can have access to a growing Indian market and they can also build a competitive base for exports to their markets abroad, as Hyundai and many component manufacturers have.

P.S. I think a very valuable analysis can be made about how policies are developed: what ideas influence policies and who has greater influence over policy makers. The Indian automobile industry, and the Indian IT industry, were 'success' stories by 2000. Thus the two industries had become strong lobbies.

The automobile industry has been able to maintain high import duties on finished products as Pradeep points out. And the IT industry advocated reduction of import duties and free imports of hardware, to maintain its costs and quality. Since the 1990s, ideas of 'free trade' have acquired huge power, displacing previous ideas.

However, the benefits of untrammelled free trade are not unambiguous, as Dani Rodrik has eloquently explained in his book, 'Straight Talk on Trade'. He also discusses the power of 'ideas'—right or wrong—in shaping policies.

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