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COVID-19's Lessons in Self-Reliance and India's Recent Trade Policies

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Abstract

The outbreak of a deadly coronavirus followed by a worldwide lockdown led to a complete shutdown of global economic activity. This led to both demand and supply side shocks to the world economy, thereby adversely affecting economic and trade operations. It has severely impacted economic operations in India and pushed the economy into a deep economic downturn. In view of challenges posed by the pandemic, the Government of India introduced the Self-Reliant India Mission to promote the domestic manufacturing industry to bring the economy back on track. Under the Self-Reliant India Mission, India is bringing significant changes in its trade policy regime to augment the domestic manufacturing sector. This opinion paper analyses the contemporary changes in India's trade policy, particularly with reference to mandatory standards for electric and machinery products

Keywords: trade policy, non-tariff measures, tariffs, global value chains and WTO



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Introduction

The outbreak of the coronavirus in Wuhan, China and its global diffusion has stalled the wheels of the world economy. International trade in goods and services cannot be an exception in today's world of global value chains in which economies are interdependent and inter-networked (Singh, 2020). The pandemic-led global economic crisis has attributed to both demand and supply side shocks with a sharp fall in global aggregate demand, consumption, investment and disruption in the functioning global supply chains.

One of the greatest challenges for countries is to respond to supply side shocks that originated from disruption in global supply chains. China, being a center of the pandemic and a global supplier of intermediate parts and finished goods, has severely impacted downstream manufacturing activities worldwide. The pandemic-led disruption in global supply chains has exposed the over-reliance of firms and economies on China. Challenges are further compounded by a widespread use of traditional trade policy instruments such as export restriction. This problem is particularly recognized in medical devices and the pharmaceutical sector. Extensive use of trade policy instruments and over-reliance received considerable policy attention both in developed and developing countries. It has created the need and urgency for countries such as India, Japan and the United States to make their supply chains more resilient to mitigate the adverse economic and trade implications.

It has been noted that many countries across the world are extensively using industrial policy measures to reorient their supply chain linkages. This is well recognised in the recent economic stimulus packages announced by countries. For example, Japan has announced a stimulus package of US\$2 billion to help Japanese companies move their production out of China and develop alternative sources of global trade supply chains¹. The Government of India's call for a Self-Reliant India (Atmanirbhar Bharat) categorically focuses on promoting the domestic manufacturing industry to address the looming economic crisis. India also recognizes that the expansion and development of the domestic manufacturing sector is critical to providing

1. Coronavirus Impact: Japan to offer \$2.2 billion to firms shifting production out of China, Business Today, 10 April 2020 <https://www.businesstoday.in/current/world/coronavirus-impact-japan-to-offer-22-billion-to-firms-shifting-production-out-of-china/story/400721.html>

productive employment, reduce poverty and regional inequalities.

The Self-Reliant India Mission has received considerable attention globally. Economists, trade analysts and research scholars are arguing that India is moving back to import substitution of the 1980s. However, the Government has made it very clear that the Self-Reliant India need not be interpreted in the context of the import substitution strategy. It is an effort to create an ecosystem that promotes the domestic manufacturing industry. Against this backdrop, this opinion paper is segregated into four parts. Section 1 provides a brief overview of Self-Reliant India Mission and its key elements in shaping the future of the economy. Section 2 discusses the dynamics and direction of India's foreign trade with the world. Section 3 maps recent changes in India's trade policy in specific areas to regulate imports and its potential implications to the domestic and export manufacturing industry. Section 4 concludes the main findings.

1. The Self-Reliant India Mission

In his historic speech on 12 May 2020, Prime Minister Narendra Modi made a clarion call for Self-Reliant India to unleash the path of sustainable economic development. He emphasized five pillars: a) Economy, b) Infrastructure, c) System, d) Vibrant Demography, e) Demand. The Government has introduced an economic package of US\$ 265 billion (INR 20 lakh) to undertake bold reforms to reduce the cost of factor of production (land, labor, liquidity) and address legal and regulatory impediments.

The Self-Reliant India Mission clearly outlines key priorities to revive the economy with a focus on expanding the capacity of domestic manufacturing. The overarching goal of these five pillars is to make India Self-Reliant in key economic sectors by augmenting the capacity of domestic manufacturing and shifting the economy at a higher growth trajectory. This will ultimately lead to greater economic activities, thereby creating employment opportunities for millions of young people.

These five pillars of Self-Reliant India complement each other. The first pillar focuses on the heart and vein of the economy and underpins the importance of a strong and diversified economy, reflected not just in domestic and external macroeconomic fundamentals but in addressing distortive elements of demand and supply. India's development challenges of providing livelihoods and quality employment requires a greater focus on addressing key economic sectors. The second pillar focuses on developing

the critical infrastructure and contains many initiatives for infrastructure and development projects. Key areas of infrastructure development include boosting connectivity within the country as well as with regional markets, development of dedicated freight corridors and upgradation of industrial infrastructure and developing indigenous capabilities for Aircraft Maintenance, Repair, and Overhaul (MRO), among others.

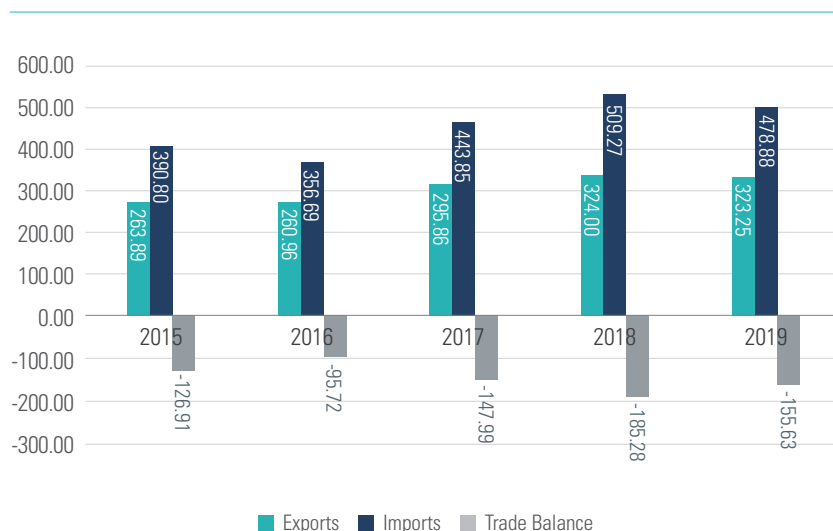
The third pillar underlines the importance of creating a robust technology-driven system that encompasses governance, economic and social management in rendering public and private services. These include digital payments and digital transfers in most government programs to fix issues related to rent-seeking and inadequate utilization of resources. The value of a favourable demographic structure in sustainable economic development is placed in the fourth pillar of Self-Reliant India. Various international estimates suggest that India is likely to exhibit a relatively young population profile for the next several decades as compared to many countries. India has the unique advantage of large numbers of young people who can play an important role in fuelling the growth of the economy, provided this demographic dividend is utilized through appropriate skill development and enhancement which are marketable. The final pillar focuses on demand creation and this is well reflected in the economic package. Given the fact that the Self-Reliant India mission focuses on improving domestic manufacturing capabilities to reduce imports of manufactured products, this creates the need to analyse India's foreign trade in this reference.

2. Dynamics and Direction of India's Trade with the World

India's foreign trade with the world has witnessed significant growth over the past two decades. Exports and imports have increased both in terms of values and volume. Figure 1 analyses the trend of India's trade with the world in last five years. It demonstrates that India's exports to the world were US\$ 263.89 billion in 2015 and increased to US\$ 323 billion in 2019. On the other hand, India's imports from the world were US\$ 390.80 billion in 2015 and reached US\$ 478.88 billion in 2019.

Figure 1.

India's Foreign Trade with World(US\$ billion)



Source: ITC trade map, accessed on August 2020.

This demonstrates that the growth of India's imports from the world were higher than the growth of exports that led to a massive rise in India's total trade deficit over the concerned years. India's trade deficit was US\$ 126.91 billion in 2015 and reached US\$ 155.63 billion in 2019. India's trade with the top five major trading partners provides important insights regarding its trade deficit. India's top five export markets are the United States, the UAE, China, Hong Kong and Singapore while its top five import sources are China, the United States, the UAE, Saudi Arabia and Iraq. It is important to mention India has a significant trade deficit with China, which contributes almost one third to its total trade deficit. This is mainly in electric machinery equipment, machinery and mechanical appliances and organic chemicals.

Table 1 shows the composition of India's foreign trade. It is worth noting that India's exports to the world are dominated by resource-based products. India's top five exports include mineral fuels and oils, natural or cultured pearls, organic chemicals, machinery, mechanical appliances, and vehicles other than railway. India's top five exports contribute 42.74 percent to the total exports and concentrated in few products categories. On the contrary, India's imports from world include a combination of raw material,

intermediate and finished products. India's top five imports include mineral fuels, mineral oils, natural or cultured pearls, electrical machinery and equipment, machinery and mechanical appliances and organic chemicals. They constitute 68.39 percent of total imports from world.

Table 1.

India's Top Five Traded Products with World in 2019 (US\$ billion)

HSN	Products	Exports	Share
27	Mineral fuels, mineral oils	44.53	13.77
71	Natural or cultured pearls	36.73	11.36
84	Machinery, mechanical appliances	21.26	6.58
29	Organic chemicals	18.25	5.64
87	Vehicles other than railway	17.41	5.39
India's Total Exports		323.25	

HSN	Products	Imports	Share
27	Mineral fuels, mineral oils	152.67	31.89
71	Natural or cultured pearls	58.90	12.30
85	Electrical machinery and equipment	50.85	10.62
84	Machinery, mechanical appliances	44.48	9.29
29	Organic chemicals	20.53	4.29
India's Total Imports		478.88	

Source: ITC Trade map, 2020

A close analysis of India's exported and imported products shows key product groups that contribute to India's trade deficit. India's trade deficit emanates from key product items such as animal and vegetable oil, mineral fuels, fertilizers, plastics and articles, natural or cultured pearls, electrical equipment, machinery equipment and optical and photographic instruments. Mineral fuels contribute 69 percent to India's total trade deficit, followed by electrical machinery and equipment at 23.07 percent, machinery, mechanical appliances at 14.91 percent and so on. India's concerns with respect to the rising trade deficit lies in product categories such as electrical machinery, equipment and machinery, mechanical appliances, fertilizers, plastic articles and optical and photographic instruments rather than

mineral oil, mineral fuels and natural or cultured pearls. This is because mineral oils and fuels, natural or cultured pearls are natural resources available in a few specific countries of the world. Moreover, imports of these products add value in domestic industrial activities and exports.

3. Shifting Paradigm of India's Trade Policy: A Case of Mandatory Standards

Under the Self-Reliant India Mission, the Government of India is focusing on boosting domestic manufacturing capabilities to make India a hub of the global manufacturing sector. It is important to state here that the Government of India has categorically stated that Self-Reliant India focuses on augmenting and utilizing domestic production capacity to expand the role of the manufacturing sector in the economy.

The Department of Commerce under the Ministry of Commerce and Industry is working with relevant ministries to introduce a number of trade policy measures that would help India regulate imports of those products that can be manufactured domestically. In this context, a comprehensive mapping of products has been conducted to identify the potential tariff lines (HSN Eight Digit) in which India's imports from the world are significant. It is important to state that a number of products under Chapter 84 (machinery and mechanical appliances) and Chapter 85 (electrical machinery and equipment and parts thereof) were identified as those of which India's imports from the world are substantial. There are 756 tariff lines falling under Chapter 84, 85 and 29 in which India's imports from the world are significant. A high volume of low-cost imports in these tariff lines adversely impacts the domestic manufacturing industry. In order to curb imports in these tariff lines, the Government has two possible options. First, import tariffs may be increased in those tariffs in which imports are significant, but it is not possible to increase import tariffs on all tariff lines given the fact that affected countries will also retaliate against increased import tariffs. The possible option to use traditional trade policy instruments such as tariffs is limited. Second, India may introduce technical and quality standards to monitor imports of sub-standard and spurious products in the country. This option has a legal base and is relatively less conflictive. Keeping this in mind, the Government is in the process of introducing a number of mandatory technical standards to regulate the imports. The Department of Heavy Industries (DHI) and Bureau of India Standards (BIS) are working on the Omnibus Technical Regulations (OTR) on machinery and electrical

safety standards to regulate imports of spurious machinery and electrical products in the country². The objective is to ensure that machinery and electrical products manufactured in India or imported from any country in the world must comply with the prescribed safety standards of BIS to protect users of the machines and electrical equipment and reduce the risks of environment. It is equally important to state that India's approach for formulating mandatory standards for imports under the Self-Reliant India Mission for machinery and electrical products is consistent with the World Trade Organization's Agreement on Technical Barriers (TBT), as the proposed mandatory standards do not discriminate between domestic and imported products.

However, the proposed mandatory standards for machinery products will have some implications for the domestic and export manufacturing industry. They can be broadly summed up in three points. First, the mandatory standards for machinery and electrical equipment will increase the cost of imported goods, thereby making final products expensive for Indian consumers. This essentially means that consumers have to pay a higher price if they are to buy similar or the same products from the domestic market. This line of thought may be challenged on the ground that if a country wants to develop its manufacturing capabilities, the government needs to provide import protection for a certain period of time so that it could beef up domestic manufacturing capabilities to compete with foreign producers. But, this has some drawbacks. It is stated that the Government support to the domestic industry is generally taken as granted by the industry and its demands for import protection become a permanent feature of policy. At a later stage, it becomes very challenging for the government to withdraw the support and create a market-driven system. This is primarily because of the state of the domestic political economy which creates an unviable dilemma for the Government to adopt competitive policies. They also discourage the private sector to invest in research and development to enhance their productivity to become more competitive.

Secondly, the proposed standards for machinery and electrical equipment will bring additional costs on the domestic manufacturing industry, especially Micro Small Medium Enterprises (MSME) to adhere to mandatory standards. This will increase the cost of manufacturing,

2. India - Draft Omnibus Technical Regulation for Safety of Machinery, <https://www.tuv.com/regulations-and-standards/en/india-draft-omnibus-technical-regulation-for-safety-of-machinery.html>

thereby affecting domestic and export competitiveness. This is vital in the context of MSMEs, which contribute a significant portion to the total manufacturing output of machinery and electrical equipment. Moreover, it will also increase procedural and operational hassles for MSMEs to comply with mandatory safety standards.

Finally, the potential implications of mandatory standards for machinery and electrical products may be far more serious for firms operating in value chain-led trade. Exporting firms relying on competitive imported machinery and electrical products will find it difficult to import machinery as the cost of compliance with mandatory standards for machinery and electrical equipment will magnify the cost of imported products. An increased cost of machinery and electrical products due to mandatory standards will increase the cost of exported products in value chain-led trade, thereby affecting the cost of competitiveness of final products. It will also affect their participation in value chain-led trade. It is pertinent to note that lead firms in GVCs are price-sensitive and tend to change their suppliers if the cost of any intermediate inputs at any stage of the value chain escalates the price of final products (World Bank 2020). This creates the potential risk for Indian machinery and electrical manufacturers to move out of value chain networks.

However, the likely implications of mandatory standards for machinery and electrical equipment will largely depend how the contemporary policy changes shape the cost dynamics in domestic and export manufacturing. In addition, it is equally important to bear in mind that the introduction of mandatory standards for machinery and electrical equipment may have cost implications for domestic machinery and electrical equipment manufacturers in the short run, but it may benefit them in the long run in terms of improving the quality of products. This hinges on other factors such as the ability of the Government to undertake reforms in those areas (product market and ease of doing business) which are far more critical for boosting productivity and competitiveness.

4. Conclusion

This short opinion piece gives a brief overview of the Self-Reliant India Mission and its key pillars to understand how it will contribute to the transformation of the manufacturing sector through various reforms. It analyses the dynamics of India's foreign trade and its evolving trade strategy

under Self-Reliant India. It argues that India's approach to boost the domestic manufacturing industry by regulating imports of sub-standard products may have economic ramifications in the short run. It highlights that the introduction of mandatory standards for machinery and electrical equipment will increase the cost of manufacturing for domestic MSMEs as they need to comply with standards. They will also increase the cost of imported intermediate inputs and finished products, which may or may not be produced at equally competitive prices. This will have a significant impact on the consumers, who use imported finished products. Finally, firms that rely on competitive imports for their manufacturing exports are likely to suffer due to higher standards-induced compliance costs. On the other hand, they can also gain from improved quality standards as they are important determinants to participate in global value chains.

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