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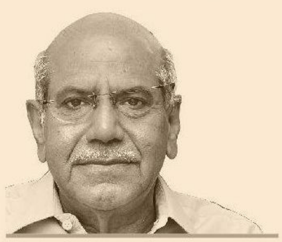
Budget's flawed swadeshi objective

Only a more globalised Indian economy can deliver GDP of $5 trillion by 2024, not a protectionist one

It is good to have high ambition and the goal of a $5-trillion Indian economy by 2024 is welcome. What is more, it is achievable. The key ingredients are in place. India is still in its most productive demographic phase, although not for long. It has a comprehensive and relatively sophisticated industrial base and dynamic entrepreneurship. It has sectors such as space and IT, which are world standard. India is advancing rapidly in the use of digital technologies and has large and expanding data resources that could enable rapid progress in new areas such as Artificial Intelligence (AI) and Machine Learning. The sheer size of the Indian market may be leveraged not only to attract significant foreign capital and technology flows, but to also seek advantageous terms of trade and investment. India is in a sweet spot in its growth trajectory. We need a bold economic strategy to leverage these assets while recognising that this is a window of opportunity which will close sooner rather than later.



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The recent Budget has several positive features. There is an emphasis on revival of investment, including foreign investment, building of infrastructure, promotion of exports, deepening of financial markets and job creation. What is worrying is the reappearance of import substitution as a policy objective. The latest Budget has followed two earlier ones in raising tariffs on a range of imports. This has now become a trend. We are in danger of slipping back to the pre-1991 sub-optimal strategy of growth based implicitly on import substitution and protected domestic production. There are other worrying signs. After several free trade agreements were concluded in the first decade of the current millennium, sentiment has veered against them. While these may have led to an increase in the overall volume of India's trade, they have also resulted in higher trade deficits. There is criticism that our trade partners have benefited more than we have from these agreements. This is behind India's reluctance to sign on to the proposed Regional Comprehensive Economic Partnership(RCEP), which would make India a partner in a large trading arrangement composed of Japan, China and the Republic of Korea, the 10 ASEAN countries and Australia and New Zealand. It is right for India to seek reciprocal market access and a level playing field for its companies, and this may need a review of the terms of some of the free trade agreements. Switching to an import substitution strategy is not the answer.

The problem with raising tariffs selectively on some products is that it creates vested interests, which are difficult to unknot once they are in place. It may be better to decrease the exchange rate of the Indian rupee, which would achieve the same impact as higher tariff but without sectoral effects favouring some industries over others. Some economists have argued that the rupee is overvalued.

With respect to existing free trade agreements, studies carried out by my colleague V S Seshadri have shown that the Indian industry has looked upon them chiefly to preserve market access for their existing exports rather than instruments for seeking expanded and more diversified market access. Provisions in the agreements, which could be used by Indian exporters to overcome non-tariff barriers or to raise value addition, were not taken advantage of. The agreement with Japan contains a commitment to help India's pharmaceutical industry navigate the complex registration process without which Indian drugs could not enter the Japanese market despite being competitive. It was never used. The overall impression is that Indian industry treated the free trade agreements defensively rather than as opportunities for market expansion. Import substitution is unlikely to change this mindset.

Pursuit of protectionist policies will make Indian industry less, not more competitive. This would go against the declared policy of promoting exports. Our experience of the pre-1991 period provides ample evidence that protectionism breeds low-quality and inferior service because consumer choices are limited. The argument that high tariffs would give Indian industry some time and space to become more competitive is patently false. Even a foreign investor is happy to be able to sell sub-standard and low-quality goods in the Indian market because of a lack of competition. There is less incentive to bring in high technology goods and services. India would be unable to leverage the size of its market to get high-quality investment. That would be a lost opportunity. A word of caution is also required on the proposal for foreign borrowing through sovereign bonds. These could create expanding liabilities if, as expected, the rupee's value declines over time. Exports have remained stagnant over the past five years and, if they remain sluggish, we could face a balance of payments challenge once again. Since exports today are also dependent on imports of crucial components and intermediates, import substitution may under-cut export promotion.

I served in the Prime Minister's Office during the first two years of Narasimha Rao's government in 1991-92 and witnessed sharp debates over whether it was prudent on India's part to jettison the import substitution and self-reliance strategy pursued since independence. Prominent industrialists warned of the hollowing out of Indian industry, given its inability to compete in international markets. They were proved wrong and India embarked on a high-growth trajectory, thanks to the bold reforms and liberalisation measures that were adopted. Indian industry became more not less competitive and proved more than capable of taking on more established international rivals. It would be a pity if these lessons of the past are unlearned and we regress into an autarkic "swadeshi" mode. This is a recipe for slower, not accelerated growth. This will neither deliver a $5-trillion economy nor sustain India's greater geopolitical salience. India cannot pursue an expanded geopolitical role as a leading power while moving to the margins of the global economy. Globalisation is driven by technology and will advance irrespective of our preferences. The future will lie with countries that stay ahead of the globalisation curve and pursue excellence in all aspects. The hedging of bets that characterises the Budget falls short of expectations.

The writer is a former Foreign Secretary and is Senior Fellow CPR