Trade in an increasingly protectionist world

The rhetoric against globalization is disturbingly shifting away from strengthening domestic industry through necessary economic reforms to shielding it from global competition. This is not a good sign.

The US' department of commerce has recently recommended a review of the policy on imports of steel and aluminium products. It has suggested a global tariff of at least 24% on all steel imports from all countries and a tariff of at least 53% from 12 countries, including India. Similarly, a global tariff of at least 7.7% on all aluminium imports from all countries has been endorsed. The import restrictions have been made under the "national security" provision of US trade laws and are intended to increase domestic production. Jean-Claude Juncker, president of the European Commission, has reportedly stated that the European Union would react "within a few days" in response to any action taken to protect the US steel industry.

In its latest Union budget, the government of India has proposed to almost double its import duties on inter alia labour-intensive sectors, such as beauty aids, watches, toys, among others, to 20%. The move came as a surprise as India has been progressively reducing tariffs from an average of almost 81% in 1990 to 13% till recently. The suggestion that India needs protection in these entry-level industries after 25 years of domestic reforms does not inspire confidence in a country staking its claim at the global high table and wanting to double its economy to $5 trillion in the near future.

The role of high tariffs in promoting domestic industries is not impressive. It can have several unintended consequences. For instance, a report by the World Bank, titled "Automotive In South Asia: From Fringe To Global", argues that high tariff and non-tariff barriers in the automotive sector in India and Pakistan might be reducing international competitiveness and slowing down the spread of world-class good practices in the value chain. The local original equipment makers (OEMs) in both countries do not face adequate competition due to high import tariffs of 60% and 80% on completely built units of passenger cars. This makes imports of cars prohibitively expensive, thus encouraging local OEMs to focus on the domestic market at the expense of exports. This is remarkable since both countries have excess plant capacity (by 30-40%) and no explicit barriers to exporting. As a result, despite being the world's sixth largest auto producer by volume, India has less than 1% of global export markets compared with more than 3% for China. Not surprisingly, productivity levels in India are one-third the levels in China. The resistance to becoming globally competitive and a heavy reliance on the domestic market might not be advisable in a country like India, which has "a hole where its middle class should be", as recently pointed out by *The Economist*. It has been reported that high tariffs have been tried for key industries in Malaysia, Indonesia, Singapore and Hong Kong, with unconvincing results.

The World Bank report also highlights an interesting contrasting case of the Indian auto parts sector, which has witnessed a gradual reduction in import tariffs since the 1990s (from 60% to an average of 12.5%). Far from leading to the debilitation of an industry, this has been a powerful catalyst to its global success, with increased production and exports. Exports now comprise more than 40% of production, imports have grown, and firms are able to trade with mature end-markets in global value chains (GVCs). Local jobs were created. GVCs across sectors have been key for economic growth in developing countries, and have kept the world increasingly interconnected.

Although tariffs play an important role in the competitiveness of countries, they are not the sole determinants. Kartik Roy, Hans Blomqvist and Cal Clark in their book *Economic Development In China, India And East Asia* have argued that despite imposing high import tariffs, several Asian countries successfully raised export incomes and economic growth rates, whereas some countries in other regions achieved less success on both fronts despite lowering considerably their import

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tariff levels in the 1990s. They posit that the right kind of "policy mix" matters most in a country's "outward orientation". State monopolies on the export of major items, regulatory burdens, bureaucratic costs and red tape, uncompetitive factor markets particularly for labour and credit, are some of the indicators of suboptimal outward orientation in the trade policy mix of a country.

To tackle the challenge of increasingly protectionist tendencies across the globe, and design right policies for promoting domestic industries, this author has repeatedly argued for convergence between trade and industrial policy. The recent inept bureaucracy-led short-sighted action of prioritizing a tariff hike above difficult domestic policy reforms, without taking into account potential costs, points to the urgency of such convergence. This can be achieved by introducing process reforms in the formulation of trade and industrial policies through a whole-of-government approach. Meritorious and comprehensively thought-out policy prescriptions designed after rigorous cost-benefit analysis and expert consultation must find favour rather than the knee-jerk reactions suggested by senior officers. Capacity building and administrative reforms within the government should be high priority.

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