

Industrial Policy Redux

Rohit Lamba

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Ideas of India Conference, Chennai

Licensing for laptops and PCs

government order

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Laptop imports will require licence; Govt keen to boost local industry

The move seems to be aimed at promoting domestic manufacturing, and probably targeted at China since more than 75 per cent of India's total \$ 5.33 billion imports of laptops and personal computers in 2022-23 was from the neighbouring country.

Written by Anchal Magazine, Souravendra Barik

the history of it

- In 1981, Prof V Rajaraman (IISc) committee suggested concessions for import of computers against software exports.
- These had been imposed to protect state-owned Electronics Corporation of India Ltd.
- Affordable computers played key role in India's IT revolution.

The Theory

what is industrial policy?

Government policies that explicitly target the transformation of the structure of economic activity in pursuit of some public goal.

—Juhász, Lane and Rodrik (2023)

what is industrial policy?

For education, health, infra, safety nets, and stabilization policies:

- typically ask how and not why **government intervention**.

For manufacturing, we often ask why and not how industrial policy:

- the bar for why is much higher...

rationale for industrial policy

broadly creating or enabling markets.

specifically...

- externalities: knowledge spillovers, jobs, national security;
- coordination failures: information asymmetries, creating a network or supply chain;
- specific inputs: training labor force, building ports.

instruments of industrial policy

The instruments of industrial policy:

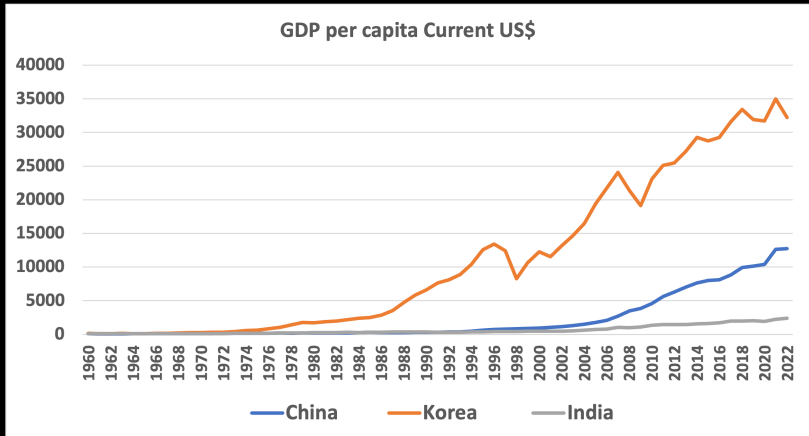
- tariffs and other trade policy,
- tax incentives for investment,
- direct and directed lending,
- labor market incentives and skill development,
- subsidizing R&D and tech transfers,
- cheap land and special economic zones,
- signalling a "skin in the game".

critiques of industrial policy

- Hayekian: information is dispersed, you "cannot pick winners"
 - ▶ response: the key is to "let go of losers".
- Political capture
 - ▶ response: competent bureaucrats and local competition.
- Externalities: eg. laptops tariff hurts service industry
 - ▶ response: keep it for a short period.

The success of IP

east asian miracles



But...

east asian miracles

- Korea:
 - ▶ export oriented with remarkable bureaucratic efficiency
 - ▶ time bound and sector targeted policies,
- China:
 - ▶ large number of moderately skilled workforce,
 - ▶ decentralization and competitive cronyism:

"What is obvious for anyone who travels around the country is how much of the economy is driven by... a kind of Darwinian internal competition that pits localities against each other ... each Chinese province, city, county, and village furiously compete to gulp down any economic advantage..."

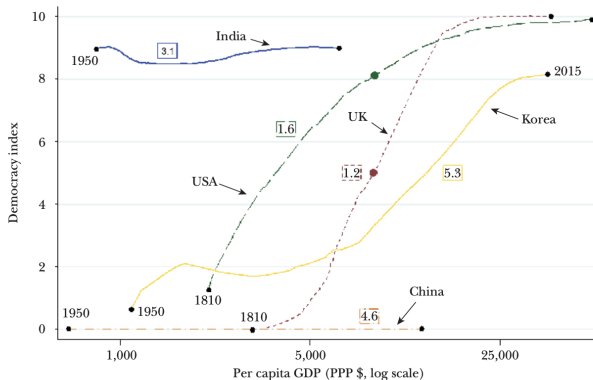
- India: what aspects of the IP successes do we satisfy?

Politics

does politics matter?

Figure 2

Patterns of Sequencing of Economic and Political Development



Source: Lamba and Subramanian (JEP, 2020)

does politics matter?

Sequencing of economics and politics:

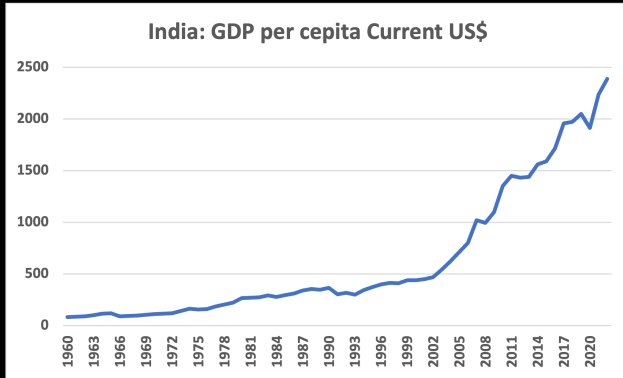
- Developed world gradually grew and democratized.
- Korea did initial growth spurt under dictator then demo.
- China is autocracy, was able to push initial reforms ruthlessly.
- India democratized while still being poor.

Is some amount of autocracy essential for directed structural transformation of the 20th century?

- are Germany and Japan counterexamples?

Our past experience

trauma of license-raj



trauma of license-raj

"I want the corruptions of the Permit/Licence Raj to go... I want real, equal opportunities for all and no private monopolies created by the Permit/Licence Raj." — C. Rajagopalachari, Swantantra Party.

"There was also such a strict licensing regime to import a computer that it took me three years and I went about 50 times to Delhi." —Narayan Murthy, founder of Infosys.

— — — — — the break — — — — —

"My motto is- trade not aid." —PM Narasimha Rao, July 09 1991.

The return of IP

why is it making a comeback?

Developed countries: eg. CHIPS Act in the US

- geopolitics and strategic considerations,
- jobs for the hollowed out middle,
- rise in inequality: de-legitimization of economic liberalism,
- lack of ideas.

why is it making a comeback?

India: why?

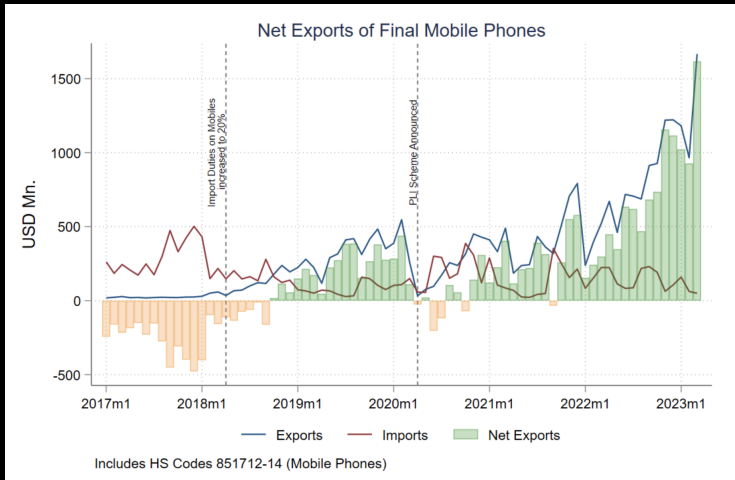
- China fetish,
- a gigantic jobs crisis,
- some amnesia of past attempts,
- plausible hypothesis: state capacity is better at attempting IP,
- lack of ideas?

Mobile phones: A case study

joint with Rahul Chauhan and Raghuram Rajan

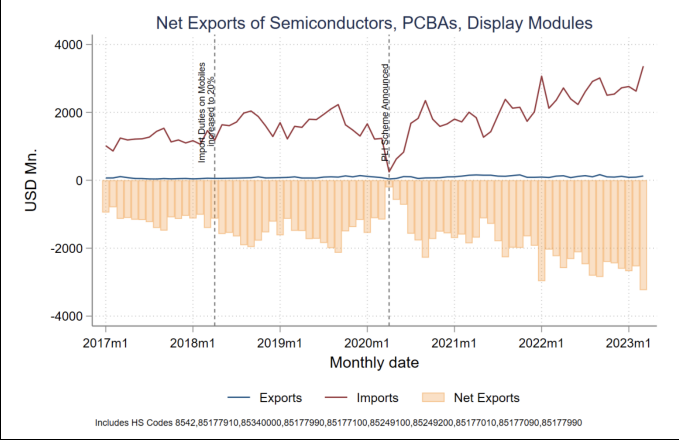
net exports of mobile phones

massive rise on the back of tariff and then PLI:



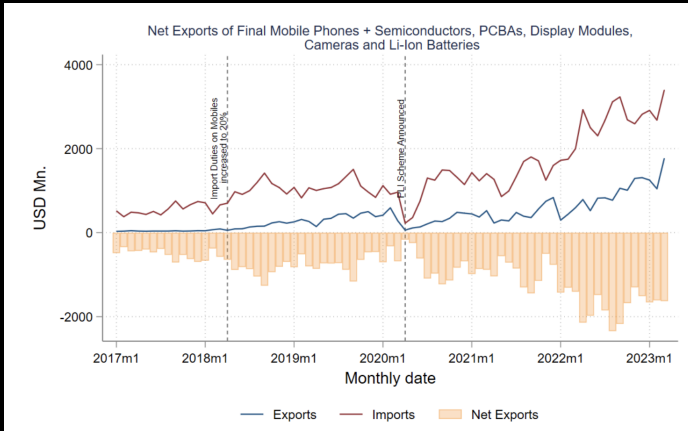
a granular look

however massive rise in imports of components:



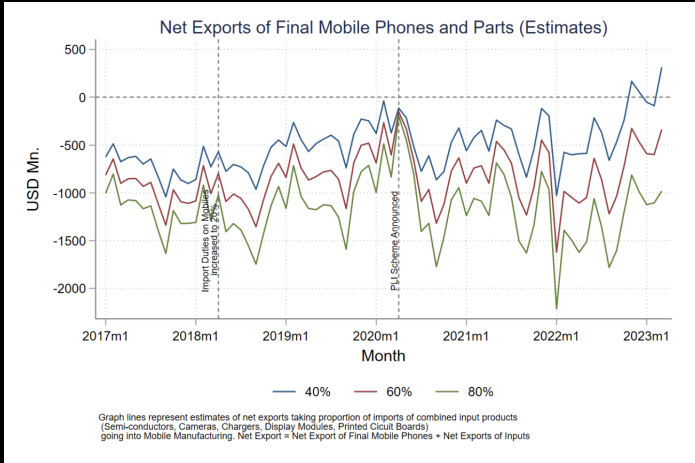
is india "manufacturing" mobile phones?

total net imports risen substantially:



net exports under varying assumptions

government estimates 65% of components going into mobile phone:



interpreting facts

- It is clear India hasn't become a net exporter mobile phones.
 - ▶ moreover, the value added is quite low.
- PLI is paying multi-nationals 6 percent to produce in India
 - ▶ potentially fine to justify as a jobs generator,
 - ▶ but is it the best use of our resources?
- If the objective is to aspire to higher ends of the value chain...
 - ▶ what is the game plan to achieve that?
 - ▶ structure and incentives of global supply chains have changed since China attempted this route to development.
 - ▶ how much time do we give ourselves with current policies?

objective?

More broadly, what is the objective of IP in India:

- Reduce trade deficits: imports have to go up with increase in exports—>global value chains.
- Jobs: are subsidies for assembly the best way to plan for jobs of the future?
- Crowding in higher value: is the traditional path to higher value from the bottom still open?
- Make India a manufacturing powerhouse: given state capacity, infra, laws, and skills, is it possible or desirable?

Lack of clarity also on how and why sectors are chosen for IP.

Everyone wants chips

Three steps: design \mapsto fabrication \mapsto assembly.

- Max value is captured in design, then fab, and then assembly.
- We are already doing design but not owning it.
 - ▶ 20% of global design by foreign firms in India.
- Should we do fab and/or assembly?
 - ▶ do we have a comparative advantage?
- Assembly is typically a route to fab.
 - ▶ but fab requires massive investments & constant upgrades.
- Will the world be flooded with chips?

micron plant

Proposal for the Micron plant

- Pure assembly, expected to create 5000 jobs.
- \$2.75 billion or Rs 16.5k crores: 70% from Indian state.
- That's a subsidy of \$400k or Rs 3.2 crore per job!

Perhaps unfair, missing other multiplier effects....?

- But they better be huge.
- For context: central government's entire higher ed contribution is Rs 44k crores.

Growth composition: Manufacturing vs Services

Key facets

Three ideas to move the lens on how we traditionally think about structural transformation:

- ladder from low to high value add manufacturing is shrinking,
- divisions b/w services and manufacturing is blurring,
- notions of tradability of services is changing.

Enabling structures vs interventionist policies

structures

- India stack and GST are enabling structures.
- Tariff is an interventionist policy.

Other examples of enabling structures:

- data privacy laws,
- health stack,
- improving numeracy and literacy,
- investing big in research and higher education,
- fixing labor laws and contracts,
- even backing firms or sectors with a light touch where have some core strength: eg. Tejas networks.

Some promising home-grown examples

service exports

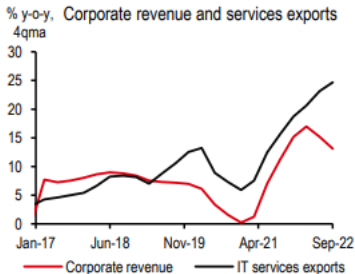
India's service exports rising steadily:

Chart 3: India's IT services continue to gain global market share, even as the share of goods seems to have flat lined



Source: ITC trademap, UNCTAD, CEIC, HSBC

Chart 4: "Other" IT services exports are rising faster than the revenues of the major IT firms



Source: Company reports, CEIC, HSBC. Note: We include the revenues of seven prominent IT services firms

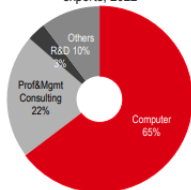
Source: HSBC India

global capability centers

Doing well in new service exports, esp global capability centers:
India houses 40 percent of world's GCCs and getting more...

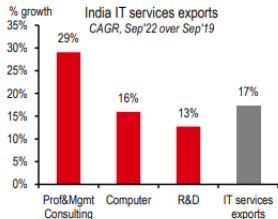
Chart 5: Breakdown of IT services exports

Breakdown of India's IT services exports, 2022



Source: CEIC, HSBC

Chart 6: Over the last three years, professional and management consulting exports have grown the fastest



Source: CEIC, HSBC

Source: HSBC India

lenskart

- Sells glasses and lenses and manufactures them:
 - ▶ a story of services driving manufacturing.
- Custom made glasses manufactured and delivered in two days.
 - ▶ started services online, moved to physical stores,
 - ▶ started manufacturing in China, moved most to India.
- Also selling in the Middle-East and East Asia.
- Turnover of Rs 5k crores.
- Key insight: India does manufacturing with incremental innovation or greater in-house engineering requirement better.

- B2B supply platform
 - ▶ story of a services intermediary in manufacturing,
 - ▶ eg., a factory in Coimbatore wants a machine part and Moglix has it in its catalogue, finds in Thane, and delivers it,
 - ▶ still only one percent of market share, most of sourcing is relational, not organized,
 - ▶ most active in tier 2 and 3 towns.
- 40 warehouses, 200 trucks, numerous bikers, growing further.
- Revenue of Rs 2.5k crores in 2022-23.
- Key insight: enabling structures like the GST have allowed for value creation.

In Conclusion

final remarks

Use IP sparingly and wisely, and when you do...

- have a vision and clear objectives,
- be constantly on the ball,
- invest in monitoring and evaluation,
- be transparent: share data widely,
- be prepared to cut losses.
- have a plan for how to go up the value chain.

But mostly...

- use window to push on enabling structures and other reforms.

Thank you