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India's New Protectionism Threatens Gains from Economic Reform

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EXECUTIVE SUMMARY

Indian prime minister Narendra Modi has been hailed as an economic liberalizer, having sharply criticized rising U.S. protectionism under the Trump administration. Yet Modi too has embarked on measures to protect and support manufacturing jobs in India. The latest Indian budget in February 2018 raised import duties on more than 40 items, ranging from auto parts and toys to candles and furniture, in order to protect uncompetitive small businesses and create jobs in labor-intensive industries. Earlier, India had raised import duties on several electronic items, from phone components to TVs and microwave ovens. This was in pursuance of a Phased Manufacturing Program aiming to check massive imports from China and ensure that cellphone assembly and the manufacture of components are done mostly in India. An official task force has been appointed to look into ways of reducing import dependence.

Modi's Bharatiya Janata Party (BJP) is not a conventional right-wing party. It rejects both socialism and Western capitalism and seeks a homegrown solution called Integral Humanism. It supports private enterprise

but also runs India's biggest trade union and believes in a wide-ranging welfare state. It has highly protectionist affiliates that have always been wary of multinational corporations and international institutions. It believes in government intervention to create national champions, increase employment, and protect small businesses. The party also contains many liberalizers who succeeded in opening up the economy when the party ruled from 1998 to 2004, overcoming objections from BJP affiliates.

When Modi came to power in 2014, he was seen as a liberalizer, bearing the slogan, "Minimum government, maximum governance." In fact, he expanded the role of government in welfare even while liberalizing the economy incrementally. He now faces the same global headwinds that Trump does: fear of China, automation, and lack of good jobs. These pressures are driving India's new protectionism, just as they have done in the United States. Optimists hope the new import tariffs are only temporary. The risk is that the new protectionism will get entrenched and reverse the major gains India has made since economic reforms began in 1991.

“The new protectionist approach means India is going back to the bad old days.”

INTRODUCTION

At the 2018 Davos meeting of the World Economic Forum, Indian prime minister Narendra Modi made a stirring plea for globalization and open trade, implicitly attacking the “America First” policies of the Trump administration. He said, “Many countries are becoming inward focused and globalization is shrinking, and such tendencies can’t be considered lesser risks than terrorism or climate change.”¹

Modi’s speech was widely welcomed by economic liberals across the globe. It echoed similar pro-globalization statements made by Chinese president Xi Jinping. Some theorists began to speculate on the possibility that India and China would keep the world open and globalized in the 21st century even as the United States turned inward.²

Alas, such theorizing was revealed as wishful thinking a few weeks later when India’s budget for 2018–2019 was presented. It raised import duties on 40-odd items “to provide adequate protection to domestic industry” and “promote creation of more jobs.”³ The language of the budget speech was not cloaked by any subterfuge: it was nakedly protectionist. One columnist remarked that Modi’s slogan of “Make in India” was becoming “Protect in India.”⁴ Duties were raised by 15–20 percent on items as varied as auto parts, candles, kites, sunglasses, lamps, cigarette lighters, toiletries, toys, watches, footwear, and furniture. The duty on fruit juices and miscellaneous processed foods went up to the range of 25–50 percent. India itself is a substantial exporter of some of these items—auto parts, textiles, and footwear—and that made the selection of protected items puzzling. One World Bank expert examined the list of items and said he could find no coherent or logical thread connecting them.⁵

In July 2018, the government increased the import duties on 76 textile items⁶ and followed up with increased duties on 328 textile items the next month.⁷ It also appointed a task force under the cabinet secretary, the senior-most civil servant, to look into ways of reducing import dependence. The stated aim is brazenly protectionist.⁸

The new protectionist approach also means India is going back to the bad old days when it had dozens of different tariff rates for different items. This encouraged misdeclaration of imports (to pay relatively low rates of import duty) in cahoots with corrupt customs officers. Worse, it encouraged lobbying by different industry groups for special tariff protection, creating an inequitable form of crony capitalism. In the 2000s, successive governments began trying to reduce the dispersion of rates to discourage lobbying, misdeclaration, and corruption. By 2008, the peak import duty on nonagricultural items was reduced and unified at 10 percent, with limited exceptions. The latest budget raises fears of a return to the old protectionism and cronyism, marked by widely varying import duties on different items, that India followed for decades after independence, with disastrous economic consequences.⁹

THE HISTORICAL BACKGROUND

After India gained independence in 1947, the Congress Party, cashing in on its advantage of having spearheaded the independence struggle, ruled for more than four decades. It was a socialist party seeking economic self-sufficiency over globalization, aiming for state control of the commanding heights of the economy, and making Five-Year Plans inspired by what at the time looked like the successful economic model of the Soviet Union. During the independence movement, the party strongly campaigned for Indians to buy only domestically produced goods and burn imports from Britain, the colonial power.

That bias remained after independence. Leaders of all political parties sought “economic independence” to buttress political independence. This took the form of discouraging international trade and foreign investment and relying on import substitution at almost any cost. This was motivated by the theory that infant-industry protection would ultimately make India a great, competitive industrial power. Industrial licenses were used to tightly regulate all production, and imports

competing with newly licensed items were banned or taxed at high rates often exceeding 100 percent. This approach failed to create world champions and instead created uncompetitive high-cost industries that harmed consumers and investors alike. This approach also reduced India's share in global trade from 2.2 percent in 1950 to 0.45 percent by 1985, yet many socialists cheered this as a success rather than deploring it as a disaster. Such inward-looking policies yielded GDP growth of just 3.5 percent per year for three decades after independence, half the rate achieved by the trade-friendly "tiger" economies of Asia. Some GDP acceleration in India occurred in the 1980s, partly because of limited economic liberalization but mostly because of a fiscal spending spree.¹⁰

This came to a sorry end in 1990, when India ran out of foreign exchange reserves and went hat in hand to the International Monetary Fund (IMF) in 1991. That set the scene for much-needed economic reforms that gradually liberalized the economy, reducing the dominance of the public sector and encouraging foreign trade and investment. Gradual liberalization eventually helped India achieve a record 8 percent growth per year in the 2000s. Growth slowed after the Great Recession, but even today.

India is growing at around 7 percent per year and has overtaken China as the fastest-growing major economy in the world. Gradual success in liberalization and record growth in the 2000s helped tame India's instinctive protectionist tendencies built up over decades. But those tendencies always triumphed in some areas (like agriculture) and remained just beneath the surface in other areas. They are now rearing their heads again.¹¹

Various unstable coalitions ruled India after 1991. Different parties came to power, often using left-wing rhetoric, but liberalization continued regardless of who ruled—including the once-socialist Congress Party—with occasional steps backward and sideways. From 1998 to 2004, the Bharatiya Janata Party (BJP), a Hindu nationalist party, ruled India at the

head of a coalition called the National Democratic Alliance. It significantly liberalized the economy in these six years. Subsequently, a Congress Party-led coalition returned to power in 2004 and remained until 2014, an era marked by high growth but also a high level of corruption.¹²

The BJP swept back into power in the 2014 election under Modi. He subsequently led the party to victory in 20 state assemblies, making the BJP the major political force in India.

THE ETHOS OF THE BJP AND ITS AFFILIATES

Right-wing parties in most countries are pro-business, wary of trade unions, and gung ho about privatization, foreign trade and investment, and globalization in general. The BJP is right-wing but does not follow this pattern at all. It strongly favors the small-business owners and traders who have always been its core supporters, and it wants to give them special protection rather than risk their failure in open competition with large companies. It is wary of global institutions, such as the World Trade Organization (WTO), the IMF, and multinational corporations (MNCs), whom it suspects of being political tools of Western powers. The party thinks MNCs have unfair advantages because of global networks and cheap capital. It is pro-business but also believes strongly in a caring welfare state. It espouses *antodaya*, which means the uplifting of the very poorest in every habitation.

The BJP aims to create national champions in both the public and private sectors, providing them with government support against foreign rivals. The party philosophy rejects both communism and Western-style capitalism and promotes a fuzzy concept called Integral Humanism. It does not view capital and labor as fundamentally opposed but as elements that must be combined to produce a strong state. And so, even while being pro-business, the BJP also operates the largest trade union in India, the Bharatiya Mazdoor Sangh. This is one reason the party has failed

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to liberalize restrictive labor laws that make it difficult to fire workers.¹³

The BJP does not think free enterprise will work for the millions of Indian farmers owning tiny plots of a hectare or two, and views them as handicapped people who deserve subsidies, freedom from plant patents, and other forms of government support. This agenda is pushed by a BJP farmers' affiliate called the Bharatiya Kisan Sangh (BKS). The party is not very keen on privatization and is happy to reform public-sector enterprises and run them efficiently rather than privatize them en masse. (This was in fact Modi's model when he was chief minister of Gujarat for 12 years.) It views a strong, well-run public sector and a strong indigenous private sector as tools to keep MNCs at bay and promote a powerful Hindu state. The BJP favors slashing red tape and reducing the power of sundry inspectors to fine or close offending units (a power widely misused to extract bribes). This mix of policies makes the BJP very different from the typical right-wing party in the West.¹⁴

The Party's Origins

The party's origins lie in the formation of the Rashtriya Swayamsevak Sangh (RSS) in 1925 as a nongovernment organization propagating the values and culture of traditional Hinduism. It deplored the modern secular values of other parties that opposed a Hindu state and felt that Muslims and other minorities should respect and absorb Hindu culture and values. The RSS was associated with many anti-Muslim riots. One of its members, Nathuram Godse, assassinated Mahatma Gandhi in 1948 for being too pro-Muslim during the Hindu-Muslims riots that wracked India at the time of its partition into India and Pakistan. The RSS aimed for a Hindu state that would make India as great a power as it had been in ancient times. It deplored tendencies to ape Western culture and values.¹⁵

The RSS and its economic wing, the Swadeshi Jagran Manch (SJM), were historically protectionist. They feared that foreign trade and investment could be the thin end

of the wedge for foreign economic and cultural domination. They were at one time very worried about Indian culture being undercut by economic liberalization. When Kentucky Fried Chicken first entered India in the mid-1990s, the SJM attacked its outlets and campaigned for banning fast food MNCs that would threaten the traditional Hindu way of life. They grossly underestimated consumer loyalty to India's many cuisines. Indian consumers disliked KFC's standard international menu, so the company had to close temporarily and relaunch later with items tailored to Indian tastes.

McDonald's never had a hope of bringing its standard beef burgers into India because Hindus view the cow as sacred and do not eat beef. McDonald's considered introducing a lamburger instead, but that idea failed. Many years of experimentation led it to settle on a menu dominated by chicken and vegetable burgers, spiced to suit Indian palates. Initially the SJM campaigned against McDonald's too, saying hamburgers and potato chips (known in the United States as french fries) were junk foods that India did not need. Indeed, the election campaign of the BJP in 1998 had the slogan, "Computer chips yes, potato chips no!" However, Indian fast foods (and slow foods) soon showed that they could more than hold their own against foreign chains, which had to alter their menus drastically to suit Indian tastes. The fear that McDonald's would change India's culture proved groundless. Rather, India changed the culture of McDonald's, prompting the company to depart from a standardized menu.¹⁶

From 1998 to 2004, the BJP ruled for the first time in New Delhi at the head of a disparate coalition under Atal Behari Vajpayee. He was far more liberal in outlook than the RSS or SJM. So were his two finance ministers, Yeshwant Sinha and Jaswant Singh. They were able to liberalize the economy much faster than the RSS and SJM would have liked. Contrary to RSS fears, liberalization helped increase GDP and Indian companies (including food chains) proved they could stand up to foreign competition. This

reduced RSS resistance to foreign investment and helped liberalizers within the party. Indeed, in the 2000s many Indian companies began to acquire companies across the globe and become multinationals. LN Mittal acquired Arcelor to form the biggest steel company in the world. The Tata group acquired Britain's Jaguar and made it a great success. This showed that globalization was not a recipe for foreign domination and could in fact assist the rise of Indian dominance abroad, bringing back memories of glorious past centuries when India was one of the world's most powerful and prosperous trading nations.¹⁷

Current Fears

While the RSS and SJM are now willing to accept many more forms of foreign investment, they remain paranoid that global giants like Walmart will kill millions of small Indian shopkeepers. Indian trader outfits fought the entry of foreign retail chains, garnering support from all political parties. India became the only country in the world to have different policies for single-brand and multi-brand retail. Single-brand chains like Apple and Puma were not seen as killers of small shopkeepers, and their entry was allowed. But multibrand chains like Walmart were seen as threats and were limited to holding minority stakes in joint ventures headed by an Indian partner. They could, however, open wholesale stores (along the lines of Sam's Club). Onerous conditions on local sourcing were placed on foreign retailers: the RSS worried that foreign chains would flood India with cheap items from China, hitting Indian manufacturers. These onerous sourcing conditions were gradually eased, but they delayed the entry of companies like Ikea by years. Walmart entered into a joint venture with the Bharti group for retail stores, but these failed and Walmart exited the venture. It did continue with wholesale stores modeled on its Sam's Club chain.¹⁸

Meanwhile, the e-commerce revolution threatened brick-and-mortar stores, regardless of ownership. Modi always saw "Digital India" as part of his vision for India's future and

told the RSS and all shopkeepers they would have to adapt to this phenomenon. But as a measure to protect shopkeepers, e-commerce companies had to restrict themselves to being "marketplaces" that brought together consumers with third-party sellers. Amazon could not sell anything produced by its own subsidiaries. In May 2018, Walmart acquired Flipkart, which meant Indian e-commerce would be dominated by the two American giants. The SJM has bitterly protested, but the takeover will almost certainly go through, since it has taken place with the full knowledge of (and without resistance from) Modi.¹⁹

The RSS and SJM, as Hindu nationalists, are today more worried about China than about Western MNCs. Politically, they view China as Pakistan's greatest supporter and as wanting to grab control of the Indian Ocean through a string of naval bases. This explains why India is one of the few countries to oppose China's Belt and Road Initiative. The BJP fears China will try to grab Indian territory in the Himalayan region. Economically, it is paranoid about the ability of China, with its massive subsidies, to dump enormous quantities of cheap goods on the Indian market. Indian big business shares these fears. Small labor-intensive industries are even more at risk. In 2017, China exported \$68 billion of industrial goods to India while importing only \$16 billion (mostly raw materials like iron ore and cotton).²⁰

The SJM has run campaigns against cheap Chinese imports and helped launch antidumping suits on items such as electronics, steel, pharmaceuticals, chemicals, fishing nets, and electrical equipment. Of the 370 antidumping suits ending with the Indian authorities, 220 relate to Chinese goods. The SJM has influenced the government's decisions to oppose new rules on e-commerce and insist on the right to high agricultural tariffs in the WTO. The SJM disagreed strongly with two of Modi's star economic appointees, central bank governor Raghuram Rajan (formerly chief economist of the IMF) and Columbia University economist Arvind Panagariya (appointed chief of a government think tank called Niti Aayog).

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It viewed them as excessively favoring free trade and foreign investment and had a role in their exit. The SJM was critical of the few free trade agreements that India had signed, claiming that these helped foreign exporters much more than Indian ones, and has so far succeeded in thwarting new free trade agreements. The SJM and BKS (the farmers’ affiliate of the party) have succeeded in preventing trials for genetically modified crops. The RSS has influenced the government’s decision to greatly expand price controls on medicines and medical appliances, and on hospital fees. Many such illiberal ideas coexist uneasily with liberal reforms in Modi’s government.²¹

EVOLUTION OF POLICY IN THE MODI ERA

Narendra Modi came to power in 2014 promising “minimum government, maximum governance.” This misled optimists to believe he was a liberal free trader. In fact, he was only an incremental liberalizer, as became evident in the measured pace of his reforms. He was willing to reverse gears when it seemed likely to pay political dividends.

By “minimum government” he merely meant a reduction in red tape and harassment by corrupt bureaucrats, not a reduced role for the government in the economy. His most important reforms include a Goods and Services Tax to unify and rationalize the vast jungle of indirect tax rates previously levied by state and central governments on different goods and services. His Insolvency and Bankruptcy Code promises to end the old practice of industrial cronies ever-greening loans (i.e., constantly rolling over loans that could not be serviced) from public-sector banks. His *jan dhan yojana* (a plan to provide personal bank accounts for every household) has succeeded in opening bank accounts for almost the whole population, making it feasible for government entitlements to be deposited directly in individual bank accounts, avoiding the corruption and delays of earlier schemes. He has ended subsidies on gasoline and diesel fuel, as well as price controls on most petroleum

products. Voters believe he is the only politician at all serious about tackling black money, which is why they did not penalize him in subsequent state elections for the disruption caused by his demonetization of high-value notes in November 2016. High-value notes were deemed not to be legal tender and had to be exchanged for new currency notes at banks, the aim being to identify and indict people with large amounts of black money in the form of hoarded cash.

However, Modi has moved only slowly on liberalizing the markets for land, labor, and capital. India’s quasi-bankrupt state electricity sector remains deep in the red. No privatization has taken place, and a proposal to privatize Air India was linked to so many conditions that no bids were received.²²

Modi’s election campaign in 2014 promised good jobs for all, with special emphasis on jobs in manufacturing. His industrial policy coined the slogan, “Make in India.” He emphasized the need to promote and nurture small-business owners, who also happen to constitute the BJP’s core support. He created a new government agency called the Mudra Bank to refinance loans to micro, small, and medium-sized enterprises (MSMEs). He also created a new Ministry of MSMEs to advocate their cause more strongly than the Ministry of Industry, which tends to focus on big business.

Economic growth in Modi’s first four years in office has been around 7 percent per year, which looks good by international standards yet is well below the rate India achieved in the 2000s. The great computer software boom of the 2000s has run its course, and no new growth champions are in sight. Industrial growth has been tepid, barely 5 percent per year in Modi’s four years, though it is now picking up. Industrial woes have led to massive nonperforming loans that threaten to drown public-sector banks. Exports have fared poorly, and the 2017–2018 level (\$302.8 billion) was below the peak (\$312 billion) achieved in 2013–2014.²³

Agriculture has been a problem area, with the media highlighting many farmer suicides. Under Modi, India suffered major droughts in 2015–2016 and 2016–2017. The rains then

returned, but global agricultural prices started falling, hitting Indian farmers, most of whom farm just one or two hectares (2.5–5 acres) and have a limited ability to absorb shocks.

India has always viewed agricultural protection as essential to assuage rural distress; other safety nets are so riddled with corruption, sloth, and delay as to be ineffective. For this reason, India has always opposed agricultural opening up in the WTO, even while liberalizing other fields since 1991. Modi has followed the same policy. After world agricultural prices fell in 2017, he increased import duties on a wide range of agricultural goods. The import duty on wheat was doubled to 20 percent. An import duty of 30 percent was imposed on chickpeas and other lentils in 2017 and was raised to 40 percent in 2018. The duty on edible oils was raised to the 25–40-percent range, and sugar duties doubled to 100 percent in February 2018.

Agrarian distress, lackluster industrial growth, export stagnation, and automation have combined to create stress in the Indian labor market. Good formal-sector jobs are growing but not fast enough to quickly absorb millions of educated unemployed. This has disappointed many who had looked to Modi as a champion job creator. In his home state of Gujarat, the Patels—the dominant rural caste—have launched a massive campaign for getting a quota in government jobs. The law already provides for job quotas for Dalits (a caste once called “untouchables”), tribes folk, and backward classes. Patels cannot by any stretch of the imagination be called backward; they include the largest landowners and businessmen. Historically, they graduated from agriculture to industry and trade and have shown little desire to enter government service.

The situation has now changed dramatically. In 2015, Hardik Patel, a 20 year old with no political backing or experience, attracted record crowds when he started campaigning for a job quota for Patels. His associates say that the old path from farming to small business ownership has been blocked because cheap Chinese imports of a wide range of goods have decimated small businesses. Similar agitations

by dominant rural castes have occurred in several other states: by Jats in the state of Haryana, by Marathas in Maharashtra, and by Ahoms in Assam. These are clear signs of massive disgruntlement among the aspiring classes that voted Modi into power.²⁴

When Indian Railways, India’s national railway system, advertised 90,000 posts being vacated by retiring staff, it received no less than 25 million applications.²⁵ Amroha district in the state of Uttar Pradesh advertised job vacancies for 114 posts for sweepers, who keep the streets, drains, and other infrastructure clean. These jobs traditionally have been considered too filthy to be done by any but the lowest Dalit caste. The district received a whopping 119,000 applications, some from MBAs and engineers. More than 500,000 people, including college graduates, applied for 3,250 sweeper posts in Kanpur municipality.

The formal sector accounts for only 15 percent of all jobs, while informal jobs lack decent pay or security, and so even the lowliest government jobs are eagerly sought. Some recent employment indicators suggest that job growth in the formal sector has indeed improved, and real wages have been rising. But the shortage of quality jobs remains a major issue, especially among the educated unemployed.²⁶

PILLARS OF THE NEW PROTECTIONISM

India is the largest importer of defense equipment in the world. One of Modi’s aims on coming into office was to boost defense production and accompanying jobs. This is typically done for national security reasons and is not usually viewed as a form of protectionism, though it could be called that. Earlier, almost all defense production was done by the public sector. Modi has greatly increased the role of private-sector companies. These have partnered with foreign arms manufacturers to gain expertise in how to make everything from ammunition to sophisticated fighter planes, missiles, and submarines. However, defense contracts continue to be awarded at a sluggish pace.²⁷

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“The new protectionism arises from fear of China.”

Thanks to its historically inward-looking policies, red tape, and high corporate tax rates, India has failed to become part of the global value chains that today are spread across Asia (the one exception being the auto industry). India has become a massive importer of electronics, especially cellphones and computers. The Modi government wants to get into such value chains and has offered a capital subsidy of up to 40 percent for setting up silicon semiconductor wafer fabrication plants. Even this has proved insufficient to attract investment.²⁸

The government has levied import duties on a wide range of electronic items to encourage domestic electronics production. The vast majority of cellphones used to be imported, but now most are assembled locally. To increase value addition, the Modi government has decreed what it calls a phased manufacturing program (PMP). This seeks to use import duties and informal political pressure to get top electronics firms to find local vendors to make components. A start was made in 2016–2017, with local subassembly of the charger, adapter battery pack, and headset. This was followed the next year by die-cut parts, microphones and receivers, keypads, and USB cables. In 2018–2019, the items incentivized by higher import duties include printed circuit boards, camera modules, connectors, and antennae. In 2019–2020, the list will include touch panels, cover glass, vibrator motors, and ringers. The protective duties have increased by up to 25 percent. The Indian Cellular Association, which includes companies like Samsung, Apple, and Micromax, estimates that the three-year scheme will increase local value addition to the 39–50-percent range.²⁹

Some experts in the earlier Congress Party government preceding the Modi era were also in favor of selective protection and PMPs to ensure that India got into global value chains.³⁰ Optimists believe that the PMPs will help create scale economies that will eventually bring down the cost of production dramatically, make import protection unnecessary, and so create a competitive world-class industry, exactly the way China has. However, this approach looks dangerously similar to the

infant-industry protection that India followed for four decades in its socialist phase, with disastrous results—including the creation of a high-cost, uncompetitive economy. The new policy lacks any sunset clauses to ensure that protection will be temporary.

In pursuance of PMP, the government in December 2017 raised import duties by up to 20 percent on a variety of electronic items. These extended well beyond cellphone components, to TVs, microwave ovens, and digital cameras.³¹

As previously noted, Modi created the Mudra bank to refinance loans to small businesses, whose owners form the core of his voter support. But large bad debts in the banking system have discouraged lending to the smallest businesses. Modi has also attempted to help small businesses by cutting red tape and improving the ease of doing business. In the World Bank’s rankings for ease of doing business, India has moved up from 142nd position (out of 190 countries) in 2014 to 100th position in 2018. It is still a long way from the 50th position Modi is aiming for.³²

Blows to Small Business

Many small businesses and retailers used to evade excise and sales taxes and do business largely in cash to avoid getting noticed by the taxman. But this dubious form of competitiveness was hit hard by three Modi reforms. The first is the demonetization in November 2016, which aimed to catch hoarders of black money, make future tax evasion difficult, and move the economy from cash payments to digital payments, increasing tax compliance and government revenues. Demonetization devastated cash-based businesses because currency notes disappeared from circulation for months. It accelerated the shift toward digital payments, which was laudable for modernizing the economy but harmed the small businesses that had long flourished on cash payments and tax evasion. Many small businesses that went bust during demonetization will never come back.³³

The second blow to small businesses was the launching of the aforementioned Goods and Services Tax in July 2017. This was a

much-needed reform, debated for over a decade. It replaced the old jungle of innumerable different central and state tax rates for different items, helped eliminate check posts at state and city borders (which were notorious for corruption and delays), helped create a unified all-India market, and created a paper trail that greatly reduced the scope for tax evasion. The new system was inevitably accompanied by many glitches but will gradually settle down into a much improved (though still flawed) tax system. However, it hit the same small businesses that were earlier hit by demonetization, a double whammy for Modi's core supporters.³⁴

They suffered a third blow, in gradual fashion, with the rise of e-commerce. While still modest in volume compared with traditional commerce, e-commerce threatens the future of small retailers. Modi simply had to do something to relieve the suffering of small businesses that were so important to him politically.³⁵

Slippery Slope

His solution is the new protectionism, exemplified by import duties on 40-odd items in the budget. On a TV program, a Finance Ministry official said the duties were levied on "simple" items that could easily be manufactured in India by small manufacturers. Another official in the prime minister's office argued that India gained nothing by letting the Chinese dump simple items like plastic toys, kites, candles, clocks, and the like onto the Indian market, and protecting their domestic manufacture would not affect India's overall competitiveness or productivity. The problem with this approach is that it has no cut-off point: notions of what are "simple" or "can easily be made in India" are highly subjective and can be stretched very far.³⁶ Instead of creating world-class champions, it may simply create high-cost, uncompetitive products that hit consumers and investors. The same is true of the increase in textile import duties in July and August 2018. Even more worrisome is the appointment of a task force to reduce import dependence.

The new protectionism is not identical to the old protectionism of the socialist era. First, the old protectionism arose from fear of

Western multinationals, whereas the new protectionism arises from fear of China. Second, the old protectionism focused on creating national champions in the public sector, whereas the new protectionism mostly protects private-sector players. Third, the old protectionism aimed for self-sufficiency, while the new protectionism claims it wants India to gain a foothold in global value chains. Fourth, the old protectionism claimed to be protecting infant industries till they matured. Modi's new protectionism goes beyond global value chains to blanket protection of relatively simple manufactures, ranging from electronic components to a wide range of consumer goods. He does this simply to save jobs and small businesses, with no pretense of protecting only infant industries. This approach has something in common with the old socialist era's reservation of 800 items for production only by small-scale industries. That list was whittled down in stages in the era of economic reform and disappeared in the 2000s. It now shows signs of coming back in a new tariff-based avatar.³⁷

Optimists point out that the new areas protected by Modi amount to only a small fraction of India's imports. India's pattern of liberalization has often been two steps forward and one step back, so optimists hope the recent import duty hikes will turn out to be a blip, not a trend. They suggest it may be premature to ring alarm bells on protectionism.³⁸

That would be a mistake. Modi is on a slippery slope that could take him much farther down the protectionist path. The problems he faces are deep seated and global. They are the same as those faced by President Trump in the United States and by politicians across the globe. As in the United States, the unemployment rate in India looks okay, and GDP growth is pretty good. But the combination of three things—fear of China, automation, and lack of good jobs—that is driving Trump's populist protectionism is also driving Modi's. These strong roots carry the risk that the new protectionism will worsen over time. That could reverse the huge economic gains India has made since 1991.

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