

Import the domestic availability problem further denied

[Business](#), [Industries](#)



Import substitution is an international trade policy which patronizes replacing foreign imports with domestic production.

It follows the presumption that a nation should attempt to reduce its reliance on foreign products through the domestic production of industrialized products. In the post WWII era, following the then consensus view, most of the independent and then developing countries decided to choose the path of import substitution in trading to achieve and excel in industrialization. India chose to follow the same path, accentuating import substitution yet further. The imports in India as a proportion of the Gross Domestic Product (GDP) dropped to just 4% in 1969-1970 from a high of 10% in 1957-1958. By mid-1960s India had banned the imports of consumer goods, which took away the freight on domestic producers to supply good quality products. The domestic availability problem further denied the producers' access to best quality raw materials and machinery whenever equivalent domestic products, no matter how worse in quality, were available. Quality of Indian products dipped and failed to compete in the global marketplace.

Bad performance of exports in created deficits of foreign exchange, which led to the more tightening of import laws. This ferocious cycle affected the growth, with per capita income rising at the minimal annual rate of 1.5% during 1951-1981.

India had adopted the policy of import substitution post-independence till Economic reforms in 1991 by imposing heavy tariffs on import. The only solution to this problem and to break this cycle of import controls heading to poor export performance and poor export performance forcing yet tighter

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import controls was to do away with import controls and let the value of INR depreciate sufficiently to incentivize exporters and producers of import-competing products. That was exactly what India did beginning in 1991. With world class products beginning to flow into the country, consumers became more differentiating and producers could get top quality raw materials, machinery and technology. This sudden reform eventually brought vast advancement in the quality of domestic products allowing both imports and exports to grow. Indian goods and services exports multiplied almost six times from just \$75 billion in 2002-03 to peak of \$450 billion in 2011-12.

India is now a \$2.3 trillion-dollar economy with imports at \$450 billion.

Unfortunately, however, the launch of Make in India initiative has created a temptation to return to import substitution policy. The argument goes, won't it be a great to replace the heavy imports with domestic production. It is our market, so shouldn't we be the one handling all its production? Sadly, this argument may take us back to the time of ruin. We are consistently just thinking about Make in India and its success while making the above argument of replacing the foreign imports with domestic production.

Reduction in exports will come accompanied by equivalent reduction in imports. The reason is Reserve Bank of India (RBI) need to maintain the exchange rate at a sufficient level that keeps the current account deficit (total imports minus total exports) to around 2% of gross domestic production.

RBI has stucked to this policy since India adopted flexible exchange rates. If the flow of foreign good will cease or decline, India will lose the revenues

that it got on imports. If we cut back on their goods, they will have to cut back on ours. Even the large decline in our oil import bill during 2015-16 was accompanied by a near equivalent decline in our exports. The recent example of the above was in 2015-16 when there was a large dip in the oil import bill.

What is added to Make in India through import substitution will get subtracted by losses in exports. The key to the gains from international trade is that we export products that we produce at the lowest cost and import those that our trading partners produce at the lowest cost. In this way, we maximise the gains from trade. Import substitution, which relies on raising barriers against imports or subsidising our products, undermines these gains. Only if import substitution is the result of increased efficiency of our producers does it add to the gains from trade. If politics compels us to intervene to help producers, the least damaging course is to do so on behalf of those able to export to world markets. In doing so, we are likely to assist producers on the verge of becoming competitive against the best in the world.

In contrast, the risk in import substitution is that we may end up propelling sectors in which we are among the costliest producers. Before Make in India, India used to allocate about 1.8% of its GDP towards defence spending, of which 40% was allocated to capital acquisitions and only about 30% of India's equipment was manufactured in India, mainly by public sector undertakings. Even when defence products were manufactured domestically, there was a large import component. All these factors made the Indian

defence market one of the most attractive globally and provided an immense opportunity for both domestic and foreign players in the defence sector. The Centre is attempting to boost MSME sector's contribution towards indigenous manufacturing in defence from the present 20-30 to 70 per cent in the next five years under its ambitious ' Make in India' programme. Make in India initiative has helped the defence ministry save more than Rs 1 lakh crore worth of foreign exchange. In the past two years, as many as six air defence and anti-tank missile projects have been built indigenously by the DRDO.

In keeping with the ' Make in India' initiative, the defence ministry has asked the Defence Research & Development Organisation to create a " master list" of its technologies that can be commercialised and given to private Indian industries for manufacturing and export, besides looking at tax concessions for domestic producers. Many Senior Defence Officials believe that Make in India is also going to help the development of the indigenous defence industry as the money which would have been transferred to foreign vendors would now be spent within the country and will also develop the capabilities of the indigenous players. The projects where the government has decided against the foreign vendors and gone for DRDO's Made in India products include some of the missiles which will substitute imports have been under development for the last several decades. The Government of India has treated the electronics sector as a priority under its " Make in India" program. This scheme promotes manufacturing in India to boost job creation and skill enhancement, facilitate investment, foster innovation, protect

intellectual property, and build best-in-class manufacturing infrastructure. In line with this, it has announced several policy initiatives.

It has also taken steps for creating a business-friendly and governance-oriented financial and economic environment. This has resulted in various Indian and global manufacturers announcing their expansion plans. While Make In India Campaign is in the full swing, especially in Defence, Electronics, Automobiles sectors etc., experts have varied opinion on how successful the campaign has been. A majority believes that the policy has not been able to achieve the desired results with FDI not been directed in the focus areas.

Make in India campaign was launched to create employment and self-employment opportunities for the youth. And the way to do this, according to Make in India, is to increase the share of manufacturing in India's GDP to 25% by 2022, which is expected to generate approximately 100 million jobs for Indian workers. Responding to the lifting of foreign direct investment (FDI) caps in several sectors, efforts to improve the ease of doing business and of course Prime Minister Modi's frenetic wooing of investment in foreign travels, gross FDI flows to India jumped 27% to \$45 billion in 2015-16, an all-time high. Even the Finance Ministry's usually measured Economic Survey 2015-16 touted the FDI increase as a success for Make in India.

Make in India specifically concerns manufacturing. After an encouraging jump to a record \$9.6 billion in 2014-15, FDI in manufacturing actually fell to \$8.

4 billion in 2015-16. Furthermore, the percentage of FDI flowing to manufacturing, which has been in the range of 35-40% for the past four years, dropped to 23% in 2015-16.