● POLICIES TAILOR-MADE FOR DOMESTIC VALUE CREATION SOUGHT

Tariff barriers, but for how long?

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IN LATE JANUARY this year, the government reduced the customs duties on assorted parts of mobile phones from 15% to 10% via a notification; it didn't wait for the interim Budget that was to be presented shortly. Many thought the move heralded a policy decision to trim tariffs across the board, reversing the sweeping increases of these trade barriers for roughly a decade. However, that was not to be; the interim Budget did not alter the import duties much.

Apple and Foxconn have been the key beneficiaries of the tariff cuts on cell phone components. The American tech giant exported iPhones worth $10 billion from India in FY24, twice the level in the previous fiscal, as it found it cheaper to assemble parts in India. Reportedly, Apple is on track to shift more than a quarter of the production of its flagship product to India by 2026, up from about 15% now.

While it is proof that low tariffs for inputs and subsidies help boost domestic manufacturing, the fact is assembling accounts for just a little over 5% of the cell phone value. Net domestic value creation is only a small fraction of the surging phone exports.

This begs the question: Won't it be a more prudent policy to encourage upstream value creation by keeping import tariffs on components high? Needless to say, such a policy would yield results only if it is complemented by a more competitive domestic economy, with overall cost advantages.

With another Union Budget around the corner, the clamour for reduction in India's "high" import tariffs, especially those on industrial raw materials and intermediates has, become louder. What is being sought is a reversal of the tariff increases seen since 2014, and the "escalation" of the trend since 2017-18. As many as 4,300 of the 12,000 tariff lines, defined by the HS code, have seen tariff cuts since 2014 (see chart).

Niti Aayog in a report last week said India needs to significantly overhaul the import tariffs, and use fiscal incentives for being a major player in global value chains (GVCs) for electronics, and set a target of $500 billion for the sector by 2030 from a little over $100 billion at present.

Trade economists would say rising tariff and non-tariff barriers are contrary to the policy of progressive external trade liberalistion pursued over the previous decades, particularly since the 1990s. The tariff cuts, they say, were the logical extension of the dismantling of the quantitative restrictions on imports, and trended towards the ASEAN levels.

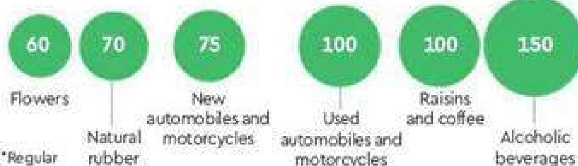
At the current juncture, with China-Plus-One strategy being adopted by major economies, low tariffs are seen to be a prerequisite for faster integration of the Indian economy with the GVCs that are fast rearranging themselves.

THE BIG PICTURE

THE RIGHT POLICY WOULD BE TO HAVE A CALIBRATED APPROACH TO TARIFFS, TAKING INTO ACCOUNT THE CURRENT LEVELS OF THE DOMESTIC INDUSTRY IN KEY SECTORS

TOO HIGH FOR COMFORT

A few items on which India still keeps high MFN* tariffs (%)



*Regular

Lower would be better?

	Year	Total	Agriculture	Non-agriculture
Bound		50.8	113.1	36.0
MFN Applied	2007	14.5	34.4	11.5
	2009	13.0	31.8	10.1
	2014	13.5	33.4	10.2
	2017	13.8	32.8	10.7
	2022	18.1	39.6	14.7

Source: World Tariff Profiles

Tariff range: 0-150%

The right policy, however, would be to have a calibrated approach to tariffs, taking into consideration the current level of the domestic industry in key sectors. Wholesale tariff increases are clearly avoidable, indiscriminate lowering of tariffs might not help either.

"The refrain is that lower import tariffs and FTAs help the country's integration with the global value chains. But just bringing the tariffs down without reducing costs to the businesses and improving the business conditions might result in an influx of imports, undermining domestic manufacturing," says trade expert Ajay Srivasatava.

It may also be noted that India is not the only country to have resorted to tariff hikes in recent years. Donald Trump's presidency in the US saw the world's largest economy undertaking biggest tariff increases since the Great Depression. That also led to considerable retaliatory measures, including by India. As presidential candidate, Trump is now threatening to put in place "universal baseline tariffs on most foreign products" and tariffs of 60% or more on Chinese goods.

That said, there is still scope for India to reduce tariffs in hundreds for items without causing any significant revenue loss to the exchequer or problems for domestic units, given that over 80% of the customs revenue is generated from just about 10% of the tariff lines.

Ahead of the Budget FY25, industry executives are hopeful that the finance ministry would reduce basic customs duty (BCD) on several items, and correct instances of "inverted duty structure. According to sources, the government is mulling the correction of the inverted duty structures in textiles, apparels, leather among other items.

This is because at present manufacturers have to pay import duties on several raw materials and intermediate goods, which are higher than the levies on finished goods.

Typically, this scenario exists because the government encourages firms to source input items locally rather than externally, but manufacturers are heavily reliant on imported inputs and thus have to pay a high price.

The Apple example is a case in point. Inverted duty structures currently exist in automotive parts, healthcare apparatus, telecommunications, electronics, and toys. This is where reductions are needed on an urgent basis, say experts.

"Lowering of duties on components can incentivise further investments in manufacturing of the final products concerned. This is in line with the aim of the PLI scheme," Gautam Khattar, principal, Price Waterhouse & Co, opines.

Yogesh Kale, executive director, Nangia Andersen India also notes that strengthening manufacturing (by lowering BCD) leads to the development of more efficient local supply chains. Kale expects the government to reduce the rates in a few sectors, such as electronics and technology, healthcare, renewable energy, and automobiles.

Gaura Sen Gupta, chief economist, IDFC FIRST Bank says "The share of custom duties in gross tax revenues has been declining over the years, which partly reflects reduction in duties."