# When Protection Ends: Evidence from Differentiated Product Markets

Governments often protect small businesses to preserve jobs and encourage entrepreneurship. In India, one such policy reserved the production of hundreds of products exclusively for small firms, preventing larger firms from entering these markets. While the policy aimed to support small-scale industry, it also limited competition and constrained firms from expanding and investing in better technologies. Between 2000 and 2007, India gradually removed these restrictions, creating an opportunity to examine how greater competition affected firms and consumers. This paper studies the consequences of ending this protection using detailed manufacturing data covering thousands of Indian factories. By comparing products that became open to competition with those that remained unaffected, we estimate the causal impact of the reform on product quality, prices, product variety, and consumer welfare.

We find that removing production restrictions significantly changed the way firms competed. Rather than simply lowering prices, firms increasingly competed by improving the quality of their products, particularly in industries where consumers value quality differences. The reform also encouraged more firms to enter previously protected markets, expanding the range of products available to consumers. While average prices did not fall, consumers received substantially better value because products became higher quality and the choice available in the market increased. The gains were driven primarily by larger and more productive firms, which responded to greater competition by investing in better machinery, employing more skilled workers, and upgrading production processes. At the same time, firms that had previously remained just below the size limits imposed by the policy were also able to expand and improve their products once those constraints were removed.

Overall, we find that the benefits of the reform came less from lower prices and more from better products and greater consumer choice. These improvements translated into substantial gains in consumer welfare. The findings suggest that industrial policies based on firm size, while intended to protect small businesses, can unintentionally discourage investment, innovation, and quality upgrading. Removing such restrictions can strengthen competition, encourage firms to become more productive, and ultimately deliver better outcomes for consumers.