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TRADE REFORMS IN INDIA

Trade Reforms in India

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TRADE REFORMS IN INDIA

Introduction

After several decades of controls and restrictions on imports and exports, comprehensive reforms to open up the Indian economy were initiated in the early nineties. Trade reforms were accompanied by reforms in the industrial sector, lifting of exchange controls, liberalization of foreign investment policy, removal of restrictions on the current account, opening up of financial markets and other measures.

The changes in policy were primarily due to the serious balance of payments crisis in 1991. Earlier coalition governments did not have the mandate to take difficult economic decisions, but in 1991, after a gap of three years, a new political leadership came into power, that could address these issues. Further, the Uruguay round of trade negotiations had been going on for some time, and was nearing completion, and would necessitate the unraveling of several trade restrictive measures.

The political environment at that time enabled this. The former Prime Minister Mr. Rajiv Gandhi had been assassinated, and though the Congress Government that came to power in 1991 did not have an absolute majority, they had the sympathy and support of the public. The new Prime Minister Mr. Narasimha Rao brought in Dr Manmohan Singh, a renowned economist, as Finance Minister, and Mr. Pranab Mukherjee, a veteran at negotiations, as Commerce Minister. India lost an important ally in the collapse of the Soviet Union, and had urgently to find fresh trading partners. The new government realized the importance of making friends with the United States and of globalizing trade. The reforms that led to the opening up of the Indian economy from 1991, were thus both a political as well as an economic necessity.

To be sure, there are still critics on the political spectrum and among intelligentsia who are vociferously inimical to the word 'globalization' and all that it connotes. But even these recognize the benefits in terms of growth and incomes that have accrued to a majority of the population in the last decade and a half.

Trade reforms implemented since 1991 have done away with import licensing on all goods but a few which are disallowed on environmental, health or safety grounds and a few which are 'canalized' (imported by government agencies only). In the case of agricultural goods, all border measures have been replaced by tariffs, as required under the Uruguay Round Agreement on Agriculture. Procedures have been simplified to reduce transaction costs. The top tariff rate on non-agricultural goods is being brought down to 10% which is comparable with that of East Asian nations. Most of the export controls have also been removed. Export prohibition now applies only to a small number of items on health, environment or moral grounds. Similarly export restrictions apply only to cattle, camels, fertilizers, cereals, groundnut oil and pulses.

Several foreign exchange restrictions were removed so that the Rupee is officially convertible on current account. Many capital account transactions were also freed from restrictions.

Liberalization of trade in services has also taken place. Insurance, banking, telecommunications, e-commerce and other infrastructure sectors have been thrown open for foreign direct investment. Foreign investment policy continues to be liberalized.

Both exports and imports of goods and services have increased substantially in the last 15 years. India's share in world exports of goods and services which was 0.8% in 2002 is targeted to rise to 1.5% by 2009.

Before we discuss in detail the reforms in the last 15 years, it is necessary to look at what happened in the preceding four decades. There were efforts, from time to time, to liberalize imports even from the First Five Year Plan, though they were ad hoc and on a smaller scale. However, events of economic and political importance intervened too often which made it difficult to adopt initiatives to substantially liberalize India's international trade.

The next section gives a summary of post-1991 reforms followed by a brief discussion of developments in the industrial and trade sectors since independence up to mid-seventies which forms the background for subsequent measures of liberalization, and then moderate reform measures during the period 1976-91. The post-1991 reforms and their impact are then discussed in the next two sections. This is followed by an overview of trade negotiations and regional arrangements. Prospects and problems of further reforms are briefly touched upon in the following section and the chapter ends with some concluding observations.

The Background

After attaining independence in 1947, India adopted a democratic political system based on universal franchise and a federal structure. The Indian National Congress was the dominant political party which ruled without interruption for about three decades after independence. When planning for economic development was launched in 1951, the objective was stated to be establishment of a 'socialistic pattern of society' which envisaged, among other things, a dominant role for the Public Sector in industrial development and a strategy based on import substitution necessitated by scarce foreign exchange resources.. The Congress party which had a clear mandate from the people could implement the public sector-dominated and import substitution-based policy without much resistance from other parties.

In the years preceding India's independence, import controls were in force mainly to conserve foreign exchange and prioritize shipping during World War II. In the post-war years, the scope of Open General Licenses was widened considerably, but following the adverse balance of payments position of 1947, the trade restrictions were revived and exchange control was extended to cover all countries. Thus the main objective of import controls was conservation and regulation of scarce foreign exchange. The next few years alternately witnessed periods of liberalization and tighter controls as dictated by balance of payments position.

The national leadership, to whom the British handed over power in 1947, had to cope with recurring foreign exchange shortages and when planning for development commenced, the strategy for industrialization came to be based on import substitution. The pattern of industrial licensing, was sensitive to political issues such as the concentration of economic power and wealth. The leftist parties and many economists had kept this issue in the forefront of parliamentary debates and influenced the licensing system towards greater reliance on the public sector.

During the five year period (1951-56) of India's First Plan, certain progressive measures for liberalization of imports were introduced, particularly the India Tariff (Second Amendment) Act of 1954 which changed the tariff rates for 32 items, permitting the Government to increase import quota and issue additional licenses over and above normal entitlements. However, this modest attempt to ease import controls was halted by yet another exchange crisis at the beginning of India's Second Five Year Plan (1956-57). After this, the import control regime became tighter. Conservation of foreign exchange and its allocation for various activities became the central objective of trade and foreign exchange policy. Allocation of scarce foreign exchange to a large number of industries – large and small enterprises – for importing capital and intermediate goods, all of them vying for priority consideration, was a difficult job and the bureaucracy charged with this job had to rely on *ad hoc* rules like *pro rata* allocations with reference to installed capacity, employment etc. The Government, at the same time, denied foreign exchange to import a product if domestic substitutes were available in sufficient quantity. The application of this 'indigenous availability' principle was not, however, done in an efficient way since the quality of the domestic substitute, the price at which it was supplied and delay in delivery were often not given much attention. These administrative controls were in place till 1965-66.

The import control regime must also be seen in the context of India's industrial policy during this period. Industrial development was also closely regulated since 1956. Investments in public sector enterprises were, in any case, subject to direct planning. Physical capacity controls extended to private sector investments as well. This was achieved through an exhaustive licensing system along with a detailed setting of targets by Planning Commission while formulating the Five Year Plans. Industrial targets were relatively few in the First Plan and were largely projection of industrial capacities based on rough estimates of demand and supply possibilities. In the Second Five Year Plan, the system of targets and licensing of investment was continued, but with the Second Plan's emphasis on expanding the capital goods sector, target setting assumed greater importance. However, neither the extent of shift to capital goods industries nor the overall levels of investment in consumer goods industries was based on any sound empirical basis.. Consequently investments in public sector enterprises for heavy industry were based on estimates of demand and supply that, at the very least, were inefficient. Private sector investments were constrained and regulated. In the Third Five Year Plan {1961-66} the strategy of sizeable investments in heavy industries and licensing system for private sector continued, but greater attention was given to inter-industry balances and phasing of investment.

Despite regulation and investment controls, industrial production recorded a growth rate of 5.75 % per annum in the period 1951-56 and of nearly 7.5% since the beginning of Second Plan. In the first three years of the Third Plan (1961-64}, the rate of growth has been about 8% per annum. Growth of output of the organized industrial sector accelerated through the three Plans and the share in investment, output and value added shifted decidedly in favour of metals, machinery and chemicals. Thus the shift in investment strategy in the Second Plan resulted in rapid growth of output and value added in these 'basic' industries during this period.

Export performance during the first decade of Planning shows stagnation in both average prices and volumes. Economic policy of the Government during this period was rather indifferent to the need for promoting exports. As a result, India's share in world exports came down from 2.1% in 1951 to 1.2% in 1960. Steps to remedy the situation were taken only towards the beginning of Third Plan (1961-66), with some limited success.

Notwithstanding the tight import control regime, import of goods and services in the decade 1951-61 and thereafter showed a generally increasing trend while exports more or less stagnated as shown in the following table. Imports of capital goods, machinery and equipment for the developing heavy industry base accounted for the increases in imports.

Table 1

($ million)

Year	Imports		Exports	
	Goods	Services	Goods	Services
1951	1852	185	1574	270
1952	1622	153	1363	295
1953	1241	146	1126	282
1954	1343	145	1150	285
1955	1566	169	1370	267
1956	2124	152	1323	278
1957	2625	156	1463	287
1958	2219	178	1185	279
1959	1969	188	1325	302

1960	2259	294	1315	357
1961	2139	358	1388	317
1962	2288	406	1412	337
1963	2493	424	1623	404
1964	2946	462	1714	430
1965	2932	516	1678	352
1966	2600	501	1531	423

[Source: 'Industry and Trade in some developing countries'—Ian Little, Tibor Scitovsky and Maurice Scott –1970] – Goods are valued at market prices, imports and exports are valued f.o.b., freight and insurance entered as service payments (p.395).

The 1960s and 1970s was a period beset with tumultuous events, political and economic. The political scene in India changed radically after the death of Prime Minister L.B.Shastri in January 1966. The Congress party was engulfed by an internal struggle and after a few weeks during which time an acting Prime Minister was in office, when Mrs. Indira Gandhi took over as P.M. Mrs. Gandhi had an uneasy relationship with some senior leaders of the Congress Party which ultimately led to a split in the party. The later part of 1960s also witnessed several non-Congress Governments coming into power in several States. Mrs. Gandhi came to power at a time when the economy was in distress. She was initially persuaded by liberal economists to move towards a freer system of exchange controls, and to move the rupee to reflect its value. The rupee was devalued by about 37% in 1966.. Along with devaluation of rupee, the Government took steps toward liberalization of import licensing, tariff and export subsidies. Import liberalization measures were extended to 59 industries covering 80% of the organized sector's output. The industries were given freedom to import their raw materials and components. However, since the necessity to obtain licenses remained due to continued application of the principle of indigenous availability, the scope of import liberalization was limited.

Unfortunately, the devaluation of rupee coincided with a second consecutive drought in the country which led to an industrial recession. At the same time, much of the aid package of $900 million promised by the World Bank, who had urged the Government of India to go in for devaluation, could not be utilized in 1966-67 due to the recession. It was impossible to consider dismantling of protection of all industries when there was lack of effective demand for output in several industries. The continuation of the principle of indigenous availability was partly to be attributed to the industrial recession. Food shortages, high prices and shrinking employment opportunities contributed to a negative public perception of rupee devaluation. The widely held belief was that the devaluation forced by World Bank was not the correct prescription. Severe domestic criticism, a political leadership that was keen to distribute export subsidies and an industrial sector that had learned to profit from protection came together to reverse the import liberalization measures in less than two years after 1966-67. For Mrs. Gandhi, this was a set back, and she remained wedded to the end of her days to the principles and advantages of a closed economy, tightly controlled by the state. She was persuaded that direct public expenditure was the only means of alleviating poverty, and that, for this, means of production should be tightly regulated by the state, or remain I the hands of the state.

Thus the late 1960s and early 1970s saw a further tightening of import controls.. At the same time, Mrs. Gandhi had to face political challenges that made it imperative to project a new pro poor socialist image. She sought to identify with the poor and underprivileged with new schemes to help them. Nationalization of banks, removal of privileges of erstwhile rules of princely states, and nationalization of coal and oil followed in rapid succession. The war with Pakistan in 1971, that led to the creation of Bangladesh paid political dividends leading to a resounding victory in the elections which followed. Mrs. Gandhi was convinced that state controls over the economy were right path for the nation. But the opposition parties were not amused. A combination of splinter group of Congress (known as Congress-O), the Bharatiya Janata Party (erstwhile Jan Sangh) and certain other parties was agitating against the policies (economic as well as political) of Mrs. Gandhi. By mid-1975, the combined agitation of opposition parties reached a climax leading to imposition of internal emergency by the President on the advice of Mrs. Gandhi.

The U.S. was not favorably inclined towards the political leadership in India under Prime Minister Indira Gandhi and the hostile U.S. policy immediately before and after the Bangladesh war in 1971 was partly responsible for the kind of economic isolationism in the early Seventies. In the years after rupee devaluation, the World Bank had also gone back on its promise of $900 million in annual aid under pressure from United States which further strengthened the hands of protectionist forces. By 1975-76, the import control regime had become so restrictive that the share of non-oil, non-cereals imports in GDP fell from an already low 7% in 1957-58 to 3% in 1975-76.

The tight import restrictions adversely affected the profitability of industrial units since essential raw materials and machinery could not be imported in required quantities and in time. Industrialists therefore started lobbying for liberalization of import of raw materials and machinery for which there was no domestically produced substitutes. At the same time, an improvement in export performance and remittances from overseas workers in Middle East led to accumulation of a healthy foreign exchange reserve. Policy makers were ready to consider some liberalization of trade controls.

The trade liberalization measures initiated in 1976 progressed gradually (as discussed in the following section), more or less unaffected by political developments and regime changes in the next fifteen years. In 1977, when the emergency was lifted and elections were held, Mrs. Gandhi's party lost to a coalition of opposition parties (except communists and other leftists) but this Government could last only about three years due to internal dissensions in the coalition and in the elections held in 1980 Mrs. Gandhi came back to power. After her death in October1984, her son Rajiv Gandhi was elected leader of the party, sworn in as Prime Minister, won the General elections and was in office till 1989. During this period several controversies arose which weakened the party and as a result, the party could not muster enough strength to form a Government. In the next one and half years, two minority Governments, with support from BJP in the first case and from Congress in the second case, were in office and ultimately elections were called again in May 1991. However, as mentioned above, the trade reform measures initiated earlier were not halted or hampered by these political developments. In fact, the Congress regime during the 1980s was comparatively more favorably inclined to continue with trade reform measures, but the circumstances were not conducive to introduce comprehensive reforms in industrial and trade policies.

Reforms – 1976-91

With the reintroduction of Open General License (OGL) list in 1976 a new phase of liberalization commenced. The OGL was in existence since pre-independence days but had become defunct after import controls were tightened in the late Sixties. The new OGL system operated on a positive list basis. Items included in the list could be imported without license if the importer was actual user (AU). In the case of machinery imports, clearance from licensing authority may be required if the sector in which the machinery was to be employed was subject to industrial licensing. In 1976, the OGL list contained only 79 capital goods items. By April 1990 the number of items in the list increased to 1170 capital goods and 949 intermediate inputs. OGL imports accounted for 30% of total imports by 1990. While the tariff rates were raised substantially during this period, items on OGL list were given large concessions on those rates through 'exemptions' so that the tariffs did not significantly add to the restrictive effect of licensing. The Government also introduced several export incentives, especially after 1985. By 1990, 31 sectors had been freed from industrial licensing which had a trade liberalizing effect as it freed machinery from industrial licensing clearance. Improved agricultural performance and the discovery of oil also helped increased imports of machinery and intermediate products.

Between 1980-81 and 1990-91, while imports increased by 344%, exports recorded an increase of 485% in value terms at current prices, though the trade balance was always negative during this period since the imports were at a much higher level to begin with. (Table 2). Even when the figures are converted into values at constant prices, the annual rate of growth in both imports and exports would appear to be quite substantial.

Table -2
Foreign Trade of India – 1980-81 to 1990-91.
(Rs. Billion)

Year	Imports	Exports	Balance of Trade
1980-81	125.49	67.11	-58.38
1981-82	136.08	78.06	-58.02
1982-93	142.93	88.03	-54.89
1983-84	158.31	97.71	-60.61
1984-85	171.34	117.44	-53.91

1985-86	196.58	108.95	-87.03
1986-87	200.96	124.52	-76.44
1987-88	222.44	156.74	-65.70
1988-89	282.35	202.31	-80.04
1989-90	354.16	276.81	-77.34
1990-91	431.93	325 .58	-106.35

[Source: INDIA – A Reference Annual – Ministry of Information & Broadcasting, Govt. of India.]

The setting for comprehensive trade liberalization

The substantial growth in imports and exports (though with negative trade balance) in the 1980s is at least partly attributable to liberalization measures which were complemented by an expansionary fiscal policy. Though the rate of growth of the economy increased to 7.6% during 1988-91, this was at the cost of growing fiscal deficit. The fiscal deficit of Central and State Governments together, as a percentage of GDP, rose from an already high of 9% in 1980-81 to 12.7% in 1990-91 and that of Central Government alone increased from 6.1% to 8.4%. Correspondingly, Government's debt (internal and external borrowings} increased year after year and accumulated rapidly over the years. Interest payments amounted to 2% of GDP in 1980-81 and 10% of Central Government's expenditure in 1980-81 which increased to 4% and 20% respectively in 1990-91. The situation became critical in 1991 when Government had to face the prospect of defaulting on external commitments for the first time. The Government took emergency measures to tide over the crisis like using stocks of gold to obtain foreign exchange, using special facilities of IMF/World Bank and bilateral assistance from some developed countries, among others. The balance of payment crisis of 1991, unlike on previous occasions, left a deep impression on policy makers and forced them to think seriously about lasting reforms in the domestic and external sectors of the economy.

The collapse of the Soviet Union and the rise of China as an economic power following its opening up its economy to foreign investment and trade in a big way were the international events which supported the new thinking in the Government towards a pro-market and pro-free trade policy. A new Government of the Congress Party, led by one of their veteran leaders as Prime Minister and with a well-known career Economist as Finance Minister came to power just after the payments crisis occurred in 1991. The new team lost no time in grappling with the situation and announced a series of measures, the main focus of which was on trade reforms, fiscal discipline, structural reforms and industrial policy reforms.

The economic reforms initiated by the Government generated debate among academics, different interest groups and generally among educated public. In the beginning, there was skepticism all around. Even industrialists were somewhat wary about the effectiveness of the reform measures and Government's commitment to carry forward them further. Admittedly, the pace of reforms in the 1990s was not fast enough, as there are many constraints in a democracy. However, as the process of reforms continued and results were visible towards the late 1990s and later, apprehensions about opening up the economy to international competition more or less disappeared, notwithstanding the continued harangue of leftist ideologists against the ‘evils’ of globalization. In the initial years, major changes were possible, but the reforms process lost steam after 1993. This was partly due to political pressures on the government, exacerbated by a scam in the stock market that was (wrongly) attributed to market liberalization. The WTO negotiations were carried out by groups of officials in the commerce ministry, with inadequate transparency. As there was no seeking of consensus on MFN issues, the officials often did not have a clear political brief at the negotiations, and hence India was often an unwilling signatory to several agreements, including TRIPS.

These events had their political fallout in that the congress government lost power in 1996.The Congress party failed to get a majority and in the next three years several minority /coalition Governments were in office. This was also a reason for reforms not picking up faster. In 1999 the BJP and its allies formed a stable Government which ruled till mid-2004. This period saw the reforms process taken forward on all fronts. The government understood the advantages of opening up economy and trade, and initiated a succession of measures that liberalized controls. Most important, the integration in foreign policy between diplomacy and trade occurred at this time.

It is interesting to note in retrospect, that since 1991, no ruling party opposed the reforms. Four different Governments were in office during the 1990s, the Congress Government which initiated the reforms in 1991, the United Front coalition (1996-98) which continued the process, the Bharatiya Janatha Party-led coalition which took office in 1998 and then again in October 1999 which implemented further measures of reform. Although there is broad consensus among political parties on the need for and direction of reforms, certain specific measures are often subjected to heated debate in Parliament and outside and sometimes bitterly opposed by the opposition parties. Presently, a Congress-led coalition of political parties is in power with outside support from leftist parties. Despite the constraints imposed by coalition politics, the wide-ranging economic reforms have come to stay and will only further improve in the coming years.

At each stage of the process, there was the triangle of public perception, electoral politics and sound economic policy to be managed in tandem. Looking back, there were successes as well as mistakes. The Uruguay round trade negotiations were by and large carried out by the executive, with little political backing, and the fact that even after a decade, the elements of multinational free trade have not been fully absorbed by all sections of the economy, is perhaps a consequence of this elitist approach. That India is not able to present liberal alternatives in the Doha round, is at least, in part, due to the fact that the different parties in power in the last decade have not been able to generate a national consensus on these issues.

The political leadership in charge of reforms, Mr. Manmohan Singh, and later Mr. Chidambaram, lacked the political credibility base to push through a comprehensive agenda. It was only during the NDA regime that political leadership was able to push through measures that were both politically feasible and economically correct; but they failed to take note o those marginalized by the policies, and hence had to lose out at the next polls.

The important feature is that notwithstanding these, the agenda is on track, sometimes fast, sometimes halting, but without taking a step back.

Progress of Trade Reforms

First, it is clear that need for liberalizing trade was as much due to compulsions and strains of the internal economy, as the ongoing multilateral negotiations. There is sufficient evidence to conclude that the approach to the multilateral negotiations did not follow a comprehensive strategy, that the negotiators were often left with incremental choices, without backing of a trade strategy, and that New Delhi was more concerned with trade reforms as a addendum to its overall reform agenda, rather than as a separate strategic agenda to be pursued. The reluctance of the negotiators to yield to multilateral concerns in several areas including intellectual property, the need to specify high bound rates, while at the same time adopting much more applied tariff rates, are some of the examples of these. Within the country, there was little debate on trade liberalization issues until the WTO agreements were signed, more through executive decision making than with public approval or parliamentary debate. In subsequent years, this lack of consensus and participation has resulted in the future rounds of trade liberalization being viewed with some apprehension and concern by the public and the polity, constraining the negotiators, both executive and politic, from moving further ahead.

Second, there were foreign policy concerns as well. The collapse of the Soviet Union had removed an important trade ally. Relations with the United States continued to be cautious, and in fact, deteriorated after the nuclear blast of 1998. The early nineties found foreign policy looking eastwards to Asia. There was an attempt to strengthen political and economic ties with South East Asia that was reciprocated. However, the Asian financial crisis of 1997, affected growth of Asian trade, and India had to adopt a cautious approach to interactions with Asia. There was a feeling that India was becoming somewhat friendless, and a need to reorient foreign policy in eh context of economic developments. The NDA government did just that between 1998 and 2004, a policy that has been followed by the government since then. On one hand, there was a need to build strategic relationship with USA, the dominant world power, and the foreign policy as well as economic reform initiatives has had this primary consideration. There has been re-engagement with Asia, with China and Japan in particular, and with ASEAN. Singapore has emerged as a friend and important trading partner, with the first comprehensive economic and trade agreement being signed between the two countries in 2005. Trade with Asia has boomed, and several regional and preferential trade agreements are under negotiation.

Third, with the growth of the economy, there has been need to ensure raw materials in the form of commodities, metals, ore and most importantly, oil and coal, for the growing needs of the economy. There has been a greater focus on integrating trade and foreign policy objectives, and some results are already visible. The private sector has also been driving this in its search for business opportunities overseas.

Fourth, the reality of coalition politics as well as domestic industry concerns has narrowed the flexibility available with government for further trade liberalization. In multilateral negotiations, India is considered a free loader, taking advantage of concessions available, but reluctant to give much in return. The stalled round of negotiations has as much to do with the lean brief threat Indian negotiators bring to the table, as with the reluctance of the US and EU to reduce agricultural subsidies.

Finally, the trend towards bilateral free trade agreements, and regional agreements, is in part due to the inability to offer MFN concessions to all, and in part to participate in the global trends of such agreements. It is clear that though these RTAs and FTAs are often WTO plus in terms of concessions, yet there is cherry picking possible between negotiators so that the lists in these agreements are quite restrictive, a win- win situation for both the countries.

Within these policy constraints, the tariff reforms have been fairly impressive.

The initial package of reforms had done away with import licensing on all but a few intermediate products and capital goods. Consumer goods, accounting for about 30 percent tariff lines remained under licensing. At present, all goods, except for a few which are disallowed on environmental or health and safety considerations and a few which are to be imported only by State agencies, can be imported without a license or restrictions. Under the Uruguay Round Agreement on Agriculture, all border measures on agricultural goods have been replaced by tariffs.

Tariff rates

In 1990-91, the highest tariff rate for non-agricultural, industrial goods stood at 355%, the simple average rate at 113% and the import-weighted average at 87%. A major task of reforms was therefore to lower tariffs. This was accomplished by a gradual compression of peak rates and a reduction in the number of tariff bands. The top rate fell to 85% in 1993-94, to 55% in 1995-96, to 25% by 2004 and to 12.5% in the next two years. In the next year's budget, the peak rate is expected to be brought down to 10% and at this level; it would be comparable to that of East Asian nations.

In agricultural products, India's approach has been similar to that of the member countries of OECD, choosing very high tariff bindings (ranging from 100 to 300 per cent) to replace border measures agreed to be replaced under the Uruguay Round

Agreement on Agriculture. India had traditionally zero or very low bound rates on some agricultural products such as skimmed milk powder, rice, corn, wheat and millet. These were renegotiated under the provisions of GATT in December 1999 in return for concessions in other products. India's average bound rate, according to WTO, in agriculture was 115.3% as compared to MFN tariff rate of 41.7%, in 2001-02.

Export controls

There were restrictions on export of a number of commodities before the reform process began in the Nineties. Along with liberalization of imports in the reform process, the Government reduced the number of items subject to export control from 439 in 1991 to 296 in 1992 with prohibited items reduced to 16. This process of removing export control continued thereafter and export prohibitions currently apply only to a smaller number of items on health, environmental or moral grounds. Export restrictions now apply only to cattle, camels, fertilizers, cereals, groundnut oil and pulses.

Exchange Controls

Exchange controls and overvaluation of rupee were also acting as additional barriers in the traded goods sector and the Government took steps to remove these barriers as part of the liberalization programme. The rupee was devalued in 1991 from 21.2 rupees to 25.8 rupees to the dollar. A dual exchange system was introduced in February 1992. Under this system importers were allowed to sell 60% of their foreign exchange earnings in the open market at higher prices. The balance was to be sold to Government at a lower official price. At the same time, importers were authorized to purchase foreign exchange in the open market at higher prices, effectively ending the exchange control regime. Within a year the official exchange rate was unified with market exchange rate. In February 1994, many current account transactions including all current business transactions, education, medical expenses and foreign travel were also permitted at market exchange rate. These steps propelled India to accept the IMF's Article VIII obligations which made the rupee officially convertible on the current account. In the context of surging foreign exchange reserves, many capital transactions were also freed from restrictions. For example, business firms can borrow freely abroad as long as the maturity period of the loan is five years or more. Residents can also remit up to $ 100,000 abroad every year.

Trade in Services

There has been considerable progress in liberalizing trade in services sector. The Government had monopoly or near monopoly in insurance, banking and telecommunications. With the establishment of an Insurance Regulatory Authority (IRDA) in December 1999, the insurance sector opened up for private entry including entry of foreign investors. Foreign ownership up to 49% is now permitted provided a license is obtained from the IRDA.

In the banking sector, private sector banks (including foreign banks) were already operating in the country. Foreign direct investment (FDI) in private sector banks is permitted up to 74% of ownership under the automatic route. Foreign banks are also allowed to open a specified number of new branches every year. More than 25 foreign bank with full banking licenses and about 150 foreign bank branches are operating in India now. Under the 1997 WTO Financial Services Agreement, India has committed itself to permitting twelve foreign bank branches to be established every year. Under the CECA with Singapore, selected Singapore banks have been given national treatment, that is, they would be allowed to operate in India under RBI regulations.

Like the insurance sector, the telecommunications sector was also a State monopoly until the early 1990s. The 1994 National Telecommunications Policy allowed the private sector including foreign investors in providing basic, cellular and value added telephone services. With rapid changes in technology, a new Telecom Policy was adopted in 1999. FDI was increased up to 49% and ownership was permitted in basic, cellular mobile, paging and value added services and in global mobile communications by satellites, subject to licensing by Department of Telecommunications. The FDI limit was later raised to 74%. FDI up to 100% of ownership is allowed, with some conditions, for internet service providers not providing gateways (for both satellite and submarine calls), infrastructure providers providing dark fiber, electronic mail and voice mail. For internet service providers with gateways, radio-paging and end-to-end width, up to 74% foreign investment is permitted subject to licensing and security requirements.

In e-commerce, FDI is permitted up to 100%. Automatic approval is given for foreign equity in software and almost all areas of electronics. In order to encourage exports and to provide employment of skilled workers, full foreign ownership is permitted in information technology units set up exclusively for exports. Such units can be set up under several schemes including export-oriented units, export processing zones, special economic zones, software technology parks, and electronic hardware technology parks.

The IT industry has been the most significant beneficiary of the opening up of the economy. Between 1995 and 2000 the Indian IT industry recorded a CAGR (compound annual growth rate) of more than 42%. India’s exports of computer software beat global recession of 2001-02 and grew by a healthy 31.4%. In absolute terms software and services exports went up to $ 7.875 billion in 2001-02 as against $ 5.978 billion in 2000-01. Latest reports from NASSCOM, India indicate that exports of IT/ITES services and products during 2006-07 were $31.3 billion, up from $23.3 billion in 2005-06.

The transport infrastructure sector is another area which has been opened to foreign investment. Full ownership under the automatic route is permitted for projects for construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular tunnels, ports and harbours. For construction of ports and harbours, automatic approval for foreign equity up to 100% is available. No approval is required for foreign equity up to 51% in projects providing support services for water transport. FDI up to 100% is permitted in airports, though FDI above 74% requires prior approval. Foreign equity up to 40% and investment by non-resident Indians up to 100% is permitted in domestic air transport services.

Attempts to bring private investment including FDI into the power sector have not met with much success. The Electricity Act of 2003 offers a comprehensive framework for restructuring the power sector. It attempts to introduce competition through private sector participation along with the public sector entities in generation, transmission and distribution. The Act completely eliminates licensing requirements in generation and freely permits captive generation. Only hydro-electric projects would now require clearance from Central Electricity Authority. Distribution licensees would be free to undertake generation, and generating companies would be free to do distribution business. Trading has been recognized as a distinct activity, with regulatory Commissions authorized to fix ceilings on trading margins, if necessary. FDI is permitted in all three activities.

Foreign Investment Policy

India has continued to liberalize its foreign investment regime ever since 1991. India also continues to streamline foreign investment regulations and reduce or remove equity restrictions. In the recent move to rationalize policy further, in February 2006 equity restrictions were lifted in several activities in products subject to industrial licensing within 25 k.m. of large cities, and in sensitive sectors such as manufacture of explosives and hazardous chemicals, and 'Greenfield' airports, where investment has been permitted under automatic route subject to sectoral regulations. Total FDI during 2006-07 was provisionally estimated by Reserve Bank of India at $8.44 billion. Portfolio investment by Foreign Institutional Investors (FIIs) has sharply increased in the last few years, and is of the order of $ 14 billion.

Domestic Economy

There have been trade and investment facilitating reforms in the domestic economy as well.
Industrial licensing requirements have been removed except for five industries. Only three industries are now reserved for the Public sector. The number of products reserved for the small scale sector has been reduced.

Fiscal Policy

India had experienced the negative consequences of an expansionary fiscal policy based on ever increasing borrowings (internal and external) during the years preceding 1991. In order to ensure that such a scenario is not repeated, the Government has enacted the Fiscal Responsibility and Budget Management Act (FRBMA) in 2003 which calls upon the Central Government to take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by 31 March 2009.

The Central Government's fiscal and revenue deficits have declined as a result of measures taken to achieve this objective. The fiscal deficit as a per cent of GDP fell to 4% in 2004-05 from the high level of 6.2% in 2001-02. It is now estimated to have come down to 3.7% in 2006-07.

Monetary Policy

Monetary policy is the responsibility of the Reserve Bank of India (RBI). Of late, considerations of financial stability have assumed greater importance in view of the increasing openness of the Indian economy and financial sector reforms. The RBI has from time to time, taken steps to contain inflation and at the same time provided sufficient liquidity to support investment demand in the economy. It continues to monitor liquidity and inflation closely and also intervenes to sterilize inward flows.

Financial Sector and Capital markets

The focus of financial sector reforms is on the banking sector and is aimed at providing public sector banks with greater autonomy so as to increase their efficiency. Foreign banks have been allowed to set up wholly owned subsidiaries in India as well as off shore banking units in Special Economic Zones. Amendments to the Banking Act, which are under consideration, would raise the current limit on FDI in domestic banks from the present limit of 49% to 74% before the scheduled date of 2009 and lift the 10% limit on voting rights. As a result of reforms undertaken, non-performing loans continued to decline and aggregate capital adequacy ratio has risen.

Efforts to create a well functioning capital market are being pursued by the Securities and Exchange Board of India (SEBI), the security market regulator. The security exchanges have been corporatized and were in the process of being demutualized. All listed companies were also required to adopt corporate governance requirements specified in the listing agreement.

Impact of reforms

The reforms discussed above have brought about important changes in trade flows. There have been perceptible changes in growth of trade, composition of trade and direction of trade in the last fifteen years.

Growth in trade

India's share in world exports of goods and services had declined from 2 per cent at independence to 0.5 per cent by mid-eighties. By 2002 it had revived to 0.8 per cent and was expected to achieve the level of 1% of world exports in 2006-07 and to 1.5% by 2009. Since the mid-eighties, India's exports of goods and services have grown faster than world exports. Although trade has performed less spectacularly than that of China, there is no doubt that there has been a remarkable improvement in exports and imports in the Nineties and later, as shown the following table:

Table – 3
Growth of imports and Exports
(Rs. Billion – At current prices)

Year	Imports	% change	Exports	% change	Trade Balance
1986-87	200.96	+ 1.8	124.51	+ 14.2	- 76.4
1994-95	899.71	+23.1	8267.41	+ 22.2	- 73.0
1995-96	1226.78	+36.4	1063.53	+ 28.6	-163.2
1996-97	1389.19	+13.2	1188.18	+ 11.7	-201.0
1997-98	1541.76	+11.0	1292.78	+ 8.8	-249.0
1998-99	1783.32	+15.7	1397.53	+ 8.1	-385.8
1999-00	2152.80	+20.9	1595.62	+ 14.2	-559.7
2000-01	2308.73	+10.7	2035.71	+ 27.6	-273.0
2001-02	2452.00	+ 6.2	2090.18	+ 2.7	-361.7
2002-03	2972.10	+21.2	2551.37	+ 22.1	-420.7
2003-04	3591.10	+20.8	2933.67	+ 15.0	-657.4
2004-05	5010.60	+39.5	3753.39	+ 27.9	-1257.2
2005-06	6604.10	+31.8	4564.18	+ 21.6	-2039.9
2006-07*	6135.23		4166.86		-1968.5

[Source: DGCI&S, Kolkota, Department of Commerce, Government of India]
* April-December 2006.

Merchandise trade as a percentage of GDP increased from roughly 21% in 2001-02 to about 33% in 2005-06 reflecting greater openness of India's goods markets. Imports have grown faster than exports, leading to a widening trade deficit. The services trade surplus as a percentage of GDP increased from 0.7% to 2.8% in 2005-06 as software and IT exports surged.

The composition of merchandise trade in 2005-06 as compared to 2000-01 is shown in the following table:

Table – 4
(Per cent share in total)

Commodity group	Exports (f.o.b)		Imports (c.i.f.)	
	2000-01	2005-06	2000-01	'05-06
Clothing & textiles	27	17.1		
Fuels	4.3	11.5	34.7	33.7
Electrical & non-Electrical machinery	5.1	6.3	12.8	16.4
Transport equipment	2.8	4.6	2.4	6.4
Chemicals	10.5	11.6	9.0	9.3
Other semi-manufactures	21.1	17.5	12.1	8.4
Iron & steel	2.9	4.8	1.5	3.0
Other mining	2.9	7.2	4.7	4.7

Agricultural commodities	14.1	10.4	7.6	4.9
Other consumer goods	7.2	7.9	5.1	4.9
Others	2.2	1.0	1.8	0.9
Gold			8.3	7.3
Total value: US$ (billion)	45.2	103.4	51.4	149.8

(Source: World Trade Organisation, 2006.)

The share of manufactured goods like electrical and non-electrical machinery, transport equipment and chemicals in exports has increased while that of clothing and textiles and agricultural commodities has declined substantially. Share of capital goods (machinery and transport equipment) increased from 7.9% in 2000-01 to 10.9% in 2005-06. Growth in labour-intensive special skill manufactures like jewellery whose share rose from 2.1% to 3.4% in the same period. The share of manufactures (excluding petroleum products) as a group in exports show some decline from 76.4 in 2000-01 to 69.8 in 2005-06. The share of agricultural products in India's exports which was 26% in 1987-88 has been gradually declining during the nineties, reaching 14.1 % in 200-01 and 10.4% in 2005-06.

Fuels accounted for 34-35% of imports in 200-01 as well as in 2005-06. The share of manufactures in India's imports has also increased appreciably. The significant point is that the role of agriculture is declining in both exports and imports while that of manufactured goods, as a whole, has been increasing in recent years.

The share of services in total exports of goods and services rose from 19.6% in 1990 to 33% in 2001. The main items in the invisibles receipts of India have been (1) non-factor services which include travel, transportation, and miscellaneous (in which software services are included) and transfers, official and private (remittances by individuals from abroad). The percentage share of transfers (mostly remittances) and software services in invisible receipts was 35.4 and 22.3 respectively in 2002-03. The current account which was in deficit till 2000-01 turned surplus in the next two years mainly due to sharp rise in receipts on account of remittances from abroad and software services exports. As discussed earlier, India's software and service exports registered annual growth rate of well over 30% in the last few years.

Direction of trade

Significant changes have also occurred in the direction of trade during the period of trade reforms, as shown in the table below:

Table – 5
Percentage share in India's exports and exports

Region/countries	1992 - 93		2000-01		2005-06	
	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.

Europe – total	33.8	34.4	25.9	27.6	24.2	22.2
EC countries	28.3	30.2	24.0	21.1	22.5	17.2
Switzerland	1.1	1.7	..	6.3	..	4.4
Other Europe	4.4	2.5	2.0	0.3	1.7	0.5
America	21.0	13.2	24.7	8.2	20.8	8.8
U.S.	19.0	9.8	20.9	6.0	16.9	6.3
Other America	2.0	3.4	3.8	2.2	3.9	2.4
Asia	26.5	21.1	26.2	22.2	32.2	27.4
Japan	7.7	6.5	4.0	3.6	2.4	2.7
Singapore	3.2	2.9	2.0	2.9	5.3	2.2
China	..	..	1.9	3.0	6.6	7.3
Hong Kong	4.1	0.8	5.9	..	4.3	..
Other Asia	11.4	10.9	12.4	13.1	13.6	15.2
Africa	3.1	3.5	5.3	4.1	6.8	3.3
U.A.E	4.4	5.1	5.8		8.3	
				*5.2		*6.7
Other Middle East	n.a.	n.a.	5.5		6.4	
Others	11.3	22.7	6.5	32.4	1.4	31.7
Total trade ($ billion)	18.5	21.9	41.2	51.4	103.4	149.8

*These import shares are for the entire Middle East region.
[Source: 1. Trade policy review, WTO
2. 'India's Trade Reform' – by Arvind Panagaria, Columbia University, 2006.]
Note: Import share of 'Other Asia' during 2000-01 and 2005-06 includes that of Australia also.

There is shift in the direction of trade lace in favour of Asian countries (including China but excluding Japan). Their share in India's exports and imports has risen sharply, by 11 percentage points in respect of exports and by 10.1 percentage points in respect of imports between 1992-93 and 2005-06. Japan's share has, over the years, declined. On the other hand, China has emerged as an important trading partner, accounting for 6.6% of India's exports and 7.3% of India's imports in 2005-06. The share of Middle East countries in India's exports has also increased; in particular, share of U.A.E. has almost doubled between 1992-93 and 2005-06. Similarly, Africa accounted for nearly 7% of India's exports in 2005-06 as against 3.1% in 1992-93. In the meanwhile, share of EC countries as well as other European countries showed significant decline during this period. Nevertheless, EC remains an important partner in India's trade, accounting for over 20% of India's exports and over 17% of India's imports. Special mention may be made of Switzerland which had a share of 6.3% in

2000-01 and 4.4% in 2005-06 in India's imports. The share of U.S.A. was 21% in 2000-01, up from 19% in 1992-93, but by 2005-06 showed some decline to about 17%. The U.S., however, retains the position as India's largest trading partner as an individual country, as far as India's exports are concerned.

The diversification of India's markets for exports and imports reflects, to some extent, the changing composition of India's trade. For example, India's exports to China consisted of medium to high technology products. In 2002-03, three product groups, viz: iron ore, engineering goods and chemicals accounted for more than 70 per cent of India's exports to China. Electronic goods, chemicals, and textiles, yarn, fabric and made-up articles together accounted for about half of the total value of India's imports from China.

Asian countries (including Middle East countries) accounted for nearly half (47 per cent) of India's total exports in 2005 while the share of Asia in total world export was only about one-quarter (26 per cent). In contrast, Europe accounted for only 24 per cent of India's total exports in 2005 though its share in total world export was as high as 40 per cent.

Growth and productivity

Trade liberalization measures have enabled the Indian economy achieve growth, increased productivity and efficiency. The following table shows the growth in GDP, per capita GDP and sectoral shares since 2000-01.

Table – 6
India's GDP and sectoral share

	2000-01	200 1- 02	2002-03	2003-04	2004-05	2005-06	2006-07
Real GDP at factor cost (Rs. Billion – 1999-2000 prices)	18648	19729 (+5.5)	20477 (+3.8)	22226 (+8.5)	23897 (+7.5)	26045 (+9.0)	28440* (+9.2)
Current GDP at factor Cost (Rs. Billion)	19254	21002 (+9.1)	22653 (+7.9)	25494 (+12.5)	28559 (+12)	32509 (+13.8)	37175* (+14.4)
Current GDP at factor Cost (US$ billion)	421.5	440.4 (+4. 5)	468.1 (6.3)	554.8 (+18.5)	635.6 (+17.6)	734.3 (+15. 5)	
Current GDP at market Prices: Rs. Billion	21024	22811 (+8. 5)	24581 (+11.0)	27655 (+12. 5)	31266 (+13.0)	35672 (+14.1)	41006* (+15)
US$ billion	460.2	478.3 (+3.9)	507. 9 (+6.2)	601.8 (+18. 5)	695. 9 (+15. 6)	805.7 (+15.8)	
GDP per capita at current							

market prices:						
Rs.	20632	21975 (+6. 5)	23299 (+6.0)	25773 (+10.4)	28684 (+11.3)	32224 (+12.3)
US$	451.6	460.8 (+2.0)	481.4 (+4.5)	560.9 (+16. 5)	638.4 (+13.8)	727.8 (+14.0)

Share of main sectors in the economy: (per cent)

Agriculture, forestry & Fishing.	23.4	23.2	20.9	20. 9	18.8	18. 3
Mining & quarrying	2.4	2.3	2.8	2. 5	3. 0	2. 8
Manufacturing	15.6	15.0	15.3	15. 2	15. 9	16. 0
Electricity, gas & water	2.4	2. 3	2.4	2. 2	2. 1	2. 0
Construction	5. 8	5. 8	6. 0	6. 2	6. 5	6. 8
Services	50. 5	51. 5	52. 7	52. 9	53. 7	54. 1

*Advance Estimate. Note: GDP figures for 2005-06 are provisional.
Figures in brackets are year-to-year growth rates.
[Source: 1. Trade policy review, WTO 2. Economic Survey 2006-07, Govt. of India.]

The Indian economy has achieved impressive growth rates in the last few years, second only to that of China. This would not have been possible without the comprehensive reforms undertaken in the last sixteen years. Per capita GDP has also recorded substantial increase. It will also be seen from Table-5 that more than half of GDP is accounted for by the Services sector.

In assessing the contribution of liberalization to growth, it is useful to see whether liberalization was accompanied by growth in total factor productivity (TFP). Total factor productivity reflects the efficiency with which factors of production are used and therefore a key determinant of an economy's performance, especially its international competitiveness. One of the most important sources of TFP growth in the long run is technological progress. Growths of TFP in the three main sectors of the economy are given below.

Table - 7

Total factor productivity in India, 1978-94
(Annual % change)

	1978-93				1993-04			
	Overall	Agriculture	Industry	Services	Overall	Agriculture	Industry	Services
Output	4.5	2.7	5.4	5.9	6..5	2.2	6.7	9.1
Employment	2.1	1.4	3.3	3.8	1..9	0.7	3.6	3.7
Capital	1.0	0.2	1.4	0.3	1.8	0.7	1.7	1.1
Land	-0.1	-0.1	n.a.	n.a.	0.0	-0.1	n.a.	n.a.
Education	0.3	0.2	0.4	0.4	0.4	0..3	0.3	0.4
TPP	1.1	1.0	0.3	1.4	2..3	0..5	1.1	3..9
Labour producti-	2.4	1..3	2.1	2.1	4.6	1.5	3.1	5.4

vity.								
Capital producti-vity.	1.8	1.7	1.4	3.5	2.4	0.5	2.2	5..5

n.a. Not applicable.
[Source: Trade policy review, WTO quoting Bosworth B. and Collin S. (2007). "Accounting for Growth: Comparing China and India", *Economics of Developing Countries Papers, January.]*

As shown above, average annual output growth in India increased from 4.5% during the period preceding the reforms of 1991 to 6.5% during 1993-04. Of this 2 percentage point increase , 1.2 points were attributable to improved TFP, which more than doubled from an average annual of 1.1% during 1978-93 to 2.3% during the period 1993-04. The rest of the rise was largely due to increased investment. Similar is the case in respect of labour productivity and capital productivity. Thus, there has been an overall and substantial increase in productivity during the reform period. Growth in both output and TFP has been much faster in the services sector than in industry where performance seems to have been hampered by, *inter alia*, rigid labour laws and inadequate infrastructure. By contrast, growth in output and TFP in agriculture has slowed down, possibly owing to weather and other natural factors.

Trade negotiations and arrangements

India's foreign trade policy aims to double India's share of global merchandise trade by 2009 over the 2004 level and to use trade to generate employment. While exports are a key goal, the policy acknowledges the importance of facilitating imports required to stimulate the economy and calls for a simplification of import procedures and reduction of import barriers, and coherence and consistency between trade and other economic policies. While unilateral measures have been implemented and as the process of reforms is continuing, it is natural that the country should take a more active role in international (multilateral and bilateral) trade negotiations to achieve a fair and equitable share of trade benefits.

India is an active Member of the WTO. In the current negotiations, it has submitted proposals relating to, *inter alia*, agriculture, non-agricultural market access (NAMA), services, disputes, competition policy, trade facilities, rules, TRIPS, and special and differential treatment. A number of these proposals were made jointly with other Members and in many cases with developing countries, including the G-20, G-33, and NAMA-11 groups. India's position prior to the Doha Round of negotiations placed emphasis on securing the objectives outlined in the mandated negotiations and the implementation issues raised by a number of developing countries. After the failure of negotiations at Doha, at the Ministerial Conference in Cancun in September 2003, and in Hong Kong in December 2005, India stressed the need to address the question of agricultural subsidies in rich countries and tariff and non-tariff barriers maintained by these countries on products of export interest to developing countries. India believes that the interests of its 650 million rural poor, who are dependent on agriculture for livelihood, cannot be ignored. India is therefore stressing the need for special and differential treatment through proportionately lower overall bound tariff reduction commitments by developing countries, coupled with a special safeguard mechanism and a list of special products vital to ensuring livelihood and food security of farmers in developing countries. These negotiations are still continuing.

In respect of non-agriculture market access (NAMA), India and its coalition partners believe that progress must be made for achieving a fair, balanced, and development oriented set of modalities based on the mandated principles of placing development concerns at the heart of the negotiations. India and other developing countries also believe that the developed countries should concede less than full reciprocity in reduction commitments on the part of developing countries, comparable level of agricultural market access and appropriate flexibilities to manage adjustment costs and address development needs. On services India seeks increased market access especially through liberalization of professional services trade in modes 1 (cross border supplies) and 4 (movement of natural persons), while securing a balance in the outcome of commitments across all modes.

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On agriculture, India has to make up its mind on two counts. First, whether small and marginal farmers suffer today because of cheap imports or because of extensive state intervention that has prevented the emergence of an integrated domestic market, distorted resource allocation and cropping patterns because of extensive subsidies, seen a near breakdown of technology generation and dissemination systems in agriculture, and prevented the entry of modern trading and logistics. It is difficult to argue that the external world alone is responsible for the woes of India farmers.

Second, there is the question if India would be a net importer of cereals and food grains in coming years. Indian farmers are already shifting to more value-added crops. Given the adverse land-man ratio and the difficulties in establishing a land market, India cannot expect to emerge as an exporter of wheat, rice, corn and edible oils, which are land-intensive crops.

In the services sectors, India is moving away from its dependence on Mode 4 and competitively offering services under Modes 1 and 2. Technological advances have made the movement of personnel less important. Also, emerging economies must recognize that any further surge of migrant workers will be socially resisted in OECD countries

In respect of non-agriculture market access (NAMA), India and other developing countries also believe that the developed countries should concede less than full reciprocity in reduction commitments on the part of developing countries, comparable level of agricultural market access and appropriate flexibilities to manage adjustment costs and address development needs. As the current round is considered to be a development round, India emphases that meaningful and effective special and differential treatment must be integral to the negotiations in accordance with the mandate, and that issues of particular concern to developing countries should be addressed.

Regional trade arrangements

India's policy in regard to international trade negotiations is aimed at securing a more equitable share in the benefits of global trade for itself and for developing countries in general. However, multilateral negotiations, especially in sensitive areas like agriculture, involving developed countries, on the one hand, and countries at various stages of development with different resource endowments and political structures, on the other, is a protracted and time-consuming process. While the main focus, therefore, has been on multilateral trade negotiations, India found it expedient to enter into agreements with other developing countries including India's neighbors with whom India could have mutually beneficial trade arrangements. This was considered necessary to sustain India's exports growth and the unilateral liberalization measures being implemented since 1991. Current negotiations have resulted in regional agreements like SAFTA and BIMST-EC. India is also seeking to develop ties with other regional groupings such as ASEAN and MERCOSUR. Bilateral agreements were entered into in recent years with Singapore, Sri Lanka and Thailand. The agreement with Singapore goes beyond trade on goods, to include services and investment.

A Comprehensive Economic Cooperation Agreement was signed between India and Singapore in 2005. The agreement includes trade in goods, services, and investment. India is also exploring the possibility of establishing a comprehensive economic cooperation agreement with Southern African Customs Union. Agreements to promote economic cooperation were also signed with MERCOSUR and Chile. Closer trade and investment ties are also sought with the European Union and the United States through India-EU Strategic Partnership signed in September 2005 and US-India Trade Policy Forum. The process of discussions and consultations is continuing.

India is also negotiating trade agreements with a number of other countries like Republic of Korea, Mauritius and the Gulf Cooperation Council. Joint Study groups have also been set up to explore the feasibility of comprehensive economic cooperation agreements with China, Japan, Indonesia, Malaysia, Australia and the Russian Federation.

Looking ahead – Prospects and Problems

"Twenty years ago the rest of the world saw India as a pauper. Now it is just as famous for its software engineers, Bollywood movie actors, literary giants and steel magnates" says an article written by Simon Robinson under the title ‘A Young Giant Awakens’ in a recent issue of Time magazine.

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The observation quoted above is not far from truth.

India has certainly succeeded in achieving greater integration of its economy with the world system through the reform measures implemented in the last fifteen years. As discussed above, economic growth rate has risen to over 9%, exports have increased substantially, foreign exchange reserves have swelled to a comfortable level, industrial production recorded healthy growth, inflation has been contained and fiscal discipline has been maintained. However, agriculture sector with low growth and shrinking share in GDP, is a cause of concern. In 2006-07 the share of agriculture in GDP declined to 18.5% while the share of services sector improved to 55.1%. As agriculture provided livelihood to around 650 million people, it is imperative that all-out efforts be made to increase output agriculture and allied activities. Further efforts are needed to address the sector’s low productivity and the problems of marginal farmers. The current trade policy places emphasis on agro-exports and in order to encourage value addition in traded agro-products, several import concessions are given to exporters. It is also important to have increased access to international markets to provide a stimulus for higher production of agricultural products generally, and products like mangoes and value added mango preparations which have good demand abroad, in particular.

Although industrial production has improved with a growth rate of 8 to 10% in recent years the share of industry in GDP is only 26.4%, a small improvement in the last two decades. This is in sharp contrast to the situation in China and other countries. There is need to expand the manufacturing base, in order to provide for greater employment.

Infrastructure bottlenecks continue to constrain growth. Transport and Power are the two sectors which require urgent attention to improve supply. Already steps have been taken to increase public investment, and more importantly, to involve private sector (including foreign investors) to invest, own and manage transport and power projects. Indian businessmen have recently come forward to take up large infrastructure projects in transport and power sectors. But the process has to be speeded up.

On the trade front, the persisting trade deficit has been a matter of concern. Over the years, trade deficit has been increasing. Thus between 2003-04 and 2005-06, the deficit has more than tripled. Liberalization of trade has led to a sharp rise in imports which could not be matched by exports. India’s current account balance, however, showed a surplus in 2002-03 and 2003-04 because of increased remittances by Indian workers abroad, earnings from trade in services (including software services) and, to some extent, portfolio investment by Foreign Institutional Investors (FIIs). But services exports and remittances may not be able to compensate for the burgeoning trade deficit for long, and depending on portfolio investments by foreign institutions is, at best, risky. It is therefore necessary to expand India’s exports in all possible ways. This requires new markets and better access in the existing markets for India’s products. Towards this end, India has been pursuing multilateral, regional and bilateral trade negotiations for the last several years.

As regards multilateral negotiations, the Doha round of talks suffered another setback when the G-4 talks at Potsdam, Germany, in June this year failed to arrive at an agreement on how much tariffs and subsidy cuts developed and developing countries should undertake. Negotiations are expected to start again in September. India's Commerce and Industry Minister has stated that the new draft text on NAMA prepared for the next round of talks can be a good basis for intensive negotiations to revive the failed talks and hoped that the mandate of Doha round to speed up development of poorer countries will be addressed. However, in view of the protracted and uncertain nature of multilateral negotiations, and in line with the universal trend to forge regional and bilateral trade arrangements, India has embarked upon regional and bilateral trade agreements, as already discussed in this Chapter. India needs to concentrate on such agreements/arrangements with other Asian countries and countries of Africa and Latin America., in order to boost exports on mutually beneficial terms. In fact, it would be desirable to explore the possibility to form an Asian Free Trade Area including China and Japan.

Most important, there is the problem of building up political consensus for further reforms. Though there was broad consensus on the basic direction of reforms as mentioned earlier, the implementation of reforms during the 1990s was not altogether smooth. There have been several instances of political parties supporting reforms when in power and trying to block them when in opposition. Thus, the Bharatiya Janata Party (BJP) opposed the opening up of the insurance sector when the ruling Congress Party wanted to do so and later the Congress opposed the same reform when the ruling BJP wanted to open the insurance sector. The Congress Party agreed eventually and the insurance reforms went through. Similarly, the NDA had difficulty privatizing a State-owned aluminium company, as the Congress opposed the move. At present, certain important measures are pending implementation due to strong opposition by some political parties, mainly leftist parties. The interaction of party politics with economic reforms is a fact of life in India as in other democratic countries. An important aspect of the unfinished agenda should therefore be wide dissemination of information and debate about the necessity of reforms which should include a frank discussion on some of its temporary negative consequences, if any, and ways of minimizing their impact.

In line with the universal trend, India has embarked upon regional and bilateral trade agreements, as already discussed in this Chapter. India needs to concentrate on such agreements/arrangements with other Asian countries and countries of Africa and Latin America., in order to boost exports on mutually beneficial terms. In fact, it would be desirable to explore the possibility to form an Asian Free Trade Area including China and Japan.

There are prospects of closer ties between India and Canada for trade and investment. According to latest press reports, Indian business groups (Tata-controlled VSNL, Aditya Birla group's Hindalco and Essar group) have recently acquired certain business firms in Canada. In order to safeguard investor's rights, India and Canada recently expedited efforts to clinch a foreign investment promotion and protection agreement (FIPPA). The agreement lists several opportunities for Canadian business in service sector (financial services, information technology and infrastructure). But before that happens, Canada wants India to further open up its financial sector. Officials believe, it is reported, that the pact, when finalized, can lead to bilateral trade flows in goods and services jumping to $20 billion in the next five years.

On the domestic scene, certain steps need to be taken by the Government to improve efficiency in policy making and implementation. Better inter-Ministerial coordination and regular review of policy and procedures is the need of the time. The Commerce Ministry has to work in close coordination with the Ministries of External Affairs and Finance at every stage of policy formulation as well as implementation. Existing institutional arrangements have to be strengthened for this purpose.

Conclusion

In the first two and half decades of Planning, India's trade policy was heavily influenced by the socialist policy of its leaders, allowing for import of only essential machinery and raw materials for industries conforming to the prevailing industrial licensing policy of the Government. Import substitution was the key word of development strategy. This period was marked by tight import controls and restrictions, though attempts were made to relax them in between. Growth in exports was slow and insufficient resulting in adverse balance of trade and payments. Poor economic conditions and political developments (especially since mid-Sixties) have also contributed to a restrictive trade policy.

The situation changed somewhat after 1976 when it was realized that industrial growth would be adversely affected if more liberal of machinery and raw materials was not allowed. Lobbying by industrialists, increasing remittances from abroad resulting in improved foreign exchange position, political stability and a regime which was comparatively more receptive to the idea of trade reforms during the 1980s, have helped in progressively relaxing trade controls and restrictions. This period however witnessed an unprecedented expansion in fiscal deficits of the Government (financed by borrowings, internal and external) leading to a balance of payments crisis by early 1991.

It was the balance of payments crisis in early 1991 which triggered a series of reform measures by the new Congress Government which came to power at that time. Emergency measures were called for which included, among other things, assistance from IMF and World Bank, to tide over the situation. Despite criticisms and apprehensions from various quarters, a package of comprehensive reforms aimed at ending licensing and controls in industry and trade was introduced and implemented over the years, details of which have already been discussed above. The impact of these reforms is reflected in the substantial increase in growth and productivity, especially in the last five years. Industrial licensing system has almost been abolished, more and more areas have been thrown open for foreign investment, tariffs on non-agricultural goods have been drastically reduced, non-tariff barriers were progressively brought down and all-out efforts are made to promote exports. The Indian Rupee is now officially convertible on current account. It is gratifying to note that the post-1991 reforms could survive political developments and regime changes indicating that there has come into existence a broad consensus in the development perspective among major political parties in the country. This does not, however mean total unanimity of views; on specific issues there are bitter arguments for and against, but the overall direction of reforms is not in dispute.

India has succeeded, to a large extent, in integrating with the global economy. While playing an active role in the ongoing multilateral trade negotiations under the auspices of WTO, India has been reaching out to many countries, especially in Asia, Africa and Latin America for expanding bilateral trade and promoting joint ventures.
Admittedly, the reform process has to be carried on further and the problem areas of the domestic economy like infrastructure (mainly transport and power) have to be strengthened. The present economic and political conditions indicate that these will be taken care of.

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Appendix
India's commitments under regional trade agreements

Agreement	Trade in goods	Trade in services	Other areas
SAFTA	Non-LDC members, includi India are to reduce tariffs 20% within two yea followed by a reduction to 5% in five years (six years f Sri Lanka) and three years f imports from LDC membe India has a negative list 744 imports from LDCs a 865 items from non-LD members that are exclud from tariff reducti commitments.[a] The first tar reductions came into effect 1 July 2006.	n.a.	n.a.
Asia Pacif Trade Agreement (Bangkok Agreement)	Tariff preferences for 570 H six-digit tariff lines and additional 48 tariff lines f LDC members with margin preference ranging from 5% 100%. Special concession some items have also bee extended to the LDCs.	n.a.	n.a.

Table II.1 (cont'd)

BIMST-EC	Framework Agreement sign in February 2004 to form free-trade area by 2012 with additional five years given the LDC membe Negotiations on trade in goo were to be completed by t end of 2005, but are yet conclude. Negotiations services and investment ha commenced and must concluded by 2007.	n.a.	n.a.
GSTP	Tariff concessions of 10%-50 on 53 tariff lines at the HS si digit level. Tariff concessio of 50% apply to three tar lines and are available only Bangladesh, Benin, Guine Haiti, Mozambique, Sudan, a	n.a.	n.a.

Agreement	Trade in goods	Trade in services	Other areas
	Tanzania.		
Special preferential areas	Tariff preferences for certa imports from Mauritiu Seychelles, and Tonga.	n.a.	n.a.
Afghanistan	Tariff reductions on 38 HS si digit tariff lines, with margi of preferences of 50% or 100 of the MFN tariff in force fro 13 May 2003.	n.a.	n.a.
Nepal	Tariff exemptions for all goo subject to rules of origi Imports of certain goo (vanaspati, copper product acrylic yarn and zinc oxide) a subject to annual quotas.	n.a.	n.a.
Singapore (CECA)	Zero duty as of 1 August 20(for 506 HS eight-digit produc covered by the early harve programme. Phased reductic and elimination of duty by April 2009 for 2,202 HS eigh digit products and phas reduction of duty by 50% by April 2009 for 2,407 HS eigh digit products. Some 6,500 H eight-digit products a excluded from duty reduction	Services included ar business service communication (telecommunications ar audiovisual), constructio distribution, financi (banking), health, tourisr recreational and transpc (maritime) service Temporary movement natural persons and med are addressed in separa chapters.	Investment, standards, SP intellectual property righ science ar technology, education ar dispute settlement.
Sri Lanka	Zero duty as of 1 March 20(for over 1,000 tariff lines and 50% margin of preference f all other items exce 429 items on a negative lis Tariff concessions on textil are 25% below the MFN rat Tariff quotas apply to tea ar garments and vanaspati. Tot quantum of import restricted 250,000 tonnes per annum.	n.a.	n.a.
Thailand	Early harvest scheme f 82 products at the HS six-dig level; tariffs to be reduced phases from 1 September 20(	n.a.	n.a.

Agreement	Trade in goods	Trade in services	Other areas
	and to be eliminated l 1 September 2006.		

n.a. Not applicable.

a India has offered Bangladesh market access for 8 million pieces of garments, of which 3 million using fabrics of Indian origin, three million using fabrics either of Indian or Bangladesh origin and two million unconditionally. These are part of India's sensitive list.

Source: Trade Policy Review of WTO quoting Minis try of Commerce and Industry online information. Viewed at: http://commerce.nic.in/India_rta.htm, [16 May 2006].

Balance of payments, 2000-05

(US$ million)

	2000/01	2001/02	2002/03	2003/04	2004/05
Current account	-2,666	3,400	6,345	14,083	-2,470
(Per cent of GDP)	(-0.6)	(0.7)	(1.2)	(2.3)	(-0.4)
Goods and services balance	-10,768	-8,250	-7,047	-3,574	-18,276
Goods balance	-12,460	-11,574	-10,690	-13,718	-33,702
Exports (f.o.b.)	45,452	44,703	53,774	66,285	85,206
Imports (c.i.f.)	57,912	56,277	64,464	80,003	118,908
Services balance	1,692	3,324	3,643	10,144	15,426
Receipts	16,268	17,140	20,763	26,868	43,249
Travel	3,497	3,137	3,312	5,037	6,666
Transportation	2,046	2,161	2,536	3,207	4,683
Insurance	270	288	369	419	870
Software services	6,341	7,556	9,600	12,800	17,700
Other	4,114	3,998	4,946	5,405	13,330
Payments	14,576	13,816	17,120	16,724	27,823
Travel	2,804	3,014	3,341	3,602	5,249
Transportation	3,558	3,467	3,272	2,328	4,539
Insurance	223	280	350	363	722
Software services	591	672	737	476	800
Other	7,400	6,383	9,420	9,955	16,513
Income	-5,004	-4,206	-3,446	-4,505	-4,979
Credit	2,682	3,379	3,522	3,904	4,593
Investment income	2,554	3,254	3,405	3,774	4,124
Compensation of employees	128	125	117	130	469
Debit	7,686	7,585	6,968	8,409	9,572
Investment income	7,218	7,098	6,949	7,531	8,219
Compensation of employees	468	487	19	878	1,353
Current transfers (net)	13,106	15,856	16,838	22,162	20,785
Credit	13,317	16,218	17,640	22,736	21,691
Official	252	458	451	554	616
Private	13,065	15,760	17,189	22,182	21,075
Debit	211	362	802	574	906
Official	0	0	0	0	356
Private	211	362	802	574	550
Capital account	8,840	8,551	10,840	16,736	28,022

	2000/01	2001/02	2002/03	2003/04	2004/05
(Per cent of GDP)	(1.9)	(1.8)	(2.1)	(2.8)	(4.0)
Direct investment	3,272	4,734	3,217	2,388	3,713
In India	4,031	6,125	5,036	4,322	5,987
Abroad	-759	-1,391	-1,819	-1,934	-2,274
Portfolio investment	2,590	1,952	944	11,356	9,287
Assets	2,760	2,021	979	11,356	9,311
Liabilities	-170	-69	-35	0	-24
Loans	5,264	-1,261	-3,850	-4,364	10,909
External assistance	410	1,117	-3,128	-2,858	1,923
Commercial borrowing, net	4,303	-1,585	-1,692	-2,925	5,194
Short-term credit, net	551	-793	970	1,419	3,792
Banking capital	-1,961	2,864	10,425	6,033	3,874
Commercial banks	-1,882	2,660	10,135	6,501	3,979
Assets	-4,174	-444	5,113	789	-47
)					
Liabilities	2,292	3,104	5,022	5,712	4,026
NRI deposits, net[b]	2,316	2,754	2,978	3,642	-964
Other	-79	204	290	-468	-105
Rupee debt service, net	-617	-519	-474	-376	-417
Other capital net	292	781	578	1,699	656
Net errors and omissioi	-305	-194	-200	602	607
Overall balance payments	5,868	11,757	16,985	31,421	26,159
Foreign exchan; reserves (US$ billion, en period)	42.3	54.1	76.1	113.0	141.5
in months of imports	8.8	11.5	14.2	16.9	14.3

a Provisional.
b NRI = Non-resident Indians.

Source: WTO quoting Reserve Bank of India, *RBI Bulletin (various issues).*