RECONCILING SUSTAINABLE DEVELOPMENT AND TRADE POLICY ISSUES IN INDIA: AN EMPIRICAL EVIDENCE

By,

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SECTION I

TRADE AND DEVELOPMENT

1.1. INTRODUCTION

The relationship between trade policy and economic performance is one of the oldest controversies in economic development. In recent years, there has been a revival of interest in the debate on trade and growth due in part to current widespread trade. The endogenous growth theories identified several mechanisms by which trade reforms may have a sustained impact on economic growth. They argued, first, trade liberalization increases the variety of goods and services, and raises productivity by providing higher quality intermediate and capital goods. Second, trade liberalization leads to the exploitation of scale economies as reforms in the reforming economy expand into world markets. Finally, trade reforms may lead to greater technological progress in the reforming economy as reforms are able increasingly to capture new ideas being generated in the rest of the world.

While the endogenous growth theories provide new and important insights on the dynamic effects of trade on growth, the theoretical literature does not yield an unambiguous conclusion on whether trade reforms have a positive impact on economic growth. Both the ambiguity in the theoretical literature and the weak empirical evidence have led trade liberalization sceptics to argue that the effect of trade liberalization on growth is, at best, very tenuous, and at worst, doubtful.

As for as India is concerned, it maintained one of the restrictive trade regimes in the world. It imposed a system of high tariffs and stiff non-tariff barriers such as licensing and quotas, which virtually closed the economy from the international trade arena. India implemented economic reform since the middle of 1991, and has made drastic changes in trade policy to reorient itself to integrate with the global economy. While reviewing the trade policy measures, an important question that is analyzed in this paper is: How India’s trade has an impact on sustainable economic development?
1.2. SUSTAINABLE DEVELOPMENT AND TRADE POLICY: DIFFERENCE PERSPECTIVES?

The potential for relationship between the international trade policy and sustainable development is quite clear. To truly understand the relationship between them (or more accurately, to surmise how this relationship might be improved) it is important to move beyond the usual rhetoric that is often part of such discussions. The first point of rhetoric that must be jettisoned is that international trade and sustainable development are separate debates. It might be assumed that whereas external trade is a corporate drive towards a more open and inter-connected world economy (the ultimate beneficiaries of which are ‘consumers’), whereas, sustainable development centres upon public goals of improving environmental standards and the position of the world’s poor. The former clearly focused on the reach of the global market, whilst the latter focused on issues of environmental degradation and global poverty. But to suggest that international trade and sustainable development are separate debates is to miss the point. Even if we ignores the arguments based on a causal relationship between the integration of the economy and the existence of negative externalities, it is important to recognize that *international trade and sustainable development are the same debate*, because they both focus on the same issues. In short, both are attempts to understand a changing world, where increasing opportunities for commerce, communication and the linking of cultures exist alongside ever-worsening environmental problems and increasing social inequities. Or to put it slightly differently, *whilst international trade presents the international order with a new future, sustainable development tempers this with a realism of past experience.*

Moreover, while it is true that the debate on international trade policy has up to this point largely focused on the ‘private’ and the ‘corporate’ and the debate on sustainable development has remained largely within the realm of public policy, this is an artificial – and ultimately, damaging – divide. And though an inevitable suspicion of regulation seems to be a key feature of globalization, in contrast with the perceived importance of regulation in contributing to the attainment of sustainable development, this is a current trend rather than a permanent dichotomy. Economic reality demands a much more integrated approach from both the private and public sectors if either international trade or sustainable development is to become a viable global proposition.

1.3. DATA COLLECTION

The objective of this paper is to provide a review of the impact of trade policy reforms on the development of Indian economy i.e. from 1991 to 2005. For the purpose of this study the data has been collected from 1991 to 2005. The sources of data was the Indian Banking Association's Bulletin, Economic Survey of India, CMIE, World Development Report, WTO Reviews etc., We calculated the Index for various variables for the liberalization period.
1.4. PAPER DESIGN

For convenient, this paper is divided into four sections. The first section represents introduction, the relationship between sustainable development and trade policy and gives the conceptual framework of the paper. The next section deals with the experience of India during the 1990s with regard to its unilateral liberalization moves and the changes induced through multilateral trade negotiations. The third section performance of external trade of India, Balance of payments, foreign investment, external debt. The fourth section presents a computational analysis of the impact of trade policy and sustainable development of India (both positive negative side), conclusions and policy implications are discussed.

SECTION II

INDIA AND THE WORLD ECONOMY

India was largely insulated from the world trading system for more than four decades after independence in 1947. Pursuit of an inward-oriented development strategy, rationalized both by a wary, almost hostile attitude toward foreign trade, technology, and investment and by pessimism about export markets, inevitably led to India becoming marginalized in world trade. During the period of rapid growth in world exports, at nearly 7.9 percent per year on average during 1950-73 before the first oil shock, India's exports grew at a much slower rate of 2.7 percent per year, and the ratio of exports to GDP declined from a high of 7.3 percent in 1951 to its lowest level of 3 percent in 1965 and remained below 4 percent until 1973. Again when private capital flows to developing countries grew phenomenally since the mid-1980s, India was not one of the favored destinations for private foreign investors. After the collapse of the Bretton Woods system of fixed exchange rates in 1971, Indian exchange rate policies achieved significant depreciation of the rupee for some time against major currencies as the latter floated against each other. The depreciation, coupled with deliberate export promotion (or at least reduction of bias against exports), led Indian exports to grow faster, on average, than world exports (in volume) since 1973. Still, in value terms, India's share in world merchandise exports, which stood at 2.2 percentage 1948, declined to 0.5 percent in 1983 and have recovered since only to 0.6 percent in 2000.

2.1. ECONOMIC REFORMS OF INDIA

The external sector of the Indian economy was the focal point of the economic crisis of 1991. Some of the most far-reaching reforms were focused on restoring the health of the external sector. They included the transition to a market determined exchange rate, major reductions in customs tariffs, phased elimination of quantitative restrictions on imports, decisive opening up to foreign direct and portfolio investment, strict controls on short-term external debt, and the deliberate buildup of foreign exchange reserves.
2.1.1. **New Trade Policy**

In 1991, as a part of the comprehensive economic reform programme, there was a significant liberalization of the trade regime with respect to capital goods. These reforms were not introduced as a package in one fell swoop. The external sector reforms since 1991 have consisted of:

1. Devaluation of the rupee
2. Abolition of import licensing
3. Significant reductions in tariff rates and their dispersion
4. Reforms of Non-Resident Indians
6. Convertibility of Rupee
7. Reforms of Quantitative Restrictions
8. Imposition of Anti-Dumping Duties
9. Reforms of Foreign Direct Investment
10. India joined the Information Technology Agreement.
12. Gold Deposit Scheme was announced in 1999-2000 budget, facilities were provided to handicapped persons to allow them to import certain items.
13. To strengthen foreign trade monitoring system, measures taken includes (a) Counter Assistance System in Directorate General of Foreign Trade (DGFT) headquarters and all its regional offices, (b) computerization of all DGFT offices, (c) Electronic Data Interchange (ED) and Electronic Commerce (EC).
15. On March 31 1999, the following new schemes to boost service exports were introduced. The setting up of Special Economic Zones (SEZs). As a first step, four existing Export Processing Zones (EPZs)—at Kandla, Santa Cruz, Cochin and Surat—were converted into SEZs with effect from 1 November, 2000. Setting up of new SEZs in the following areas has been progressing steadily: Positra (Gujarat), Nangunery (Tamil Nadu), Kakinada-Vizag (Andhra Pradesh), Paradip (Orissa), Kulpi (West Bengal) and Bhadohi (Uttar Pradesh).
16. With the view that agriculture is the responsibility of state governments, the central government has insisted through the revised EXIM policy of 1997-2002 that the state governments should identify and develop product-specific agricultural export zones (AEZ). Two AEZs exist, one in Tamil Nadu and another in Gujarat.

It is clear that compared to the highly restrictive trade, payments, and capital flow regime that characterized India for more than four decades until 1991, the post-1991 regime represents a radical change and is far more liberal.
SECTION III

TRADE AND DEVELOPMENT IN INDIA

A liberal international trade policy is now widely accepted as an important part of growth and development policy. It is argued that trade liberalization will stimulate production in labor-intensive sectors in India. Trade liberalization is also provides a pro-competitive effect on domestic firms, which results in additional gains from the economies of large-scale production. It is in terms of these components that we have to study the trends in India's foreign trade during the reform period.

3.1. DIRECTION OF FOREIGN TRADE

3.1.1. Exports

Direction of foreign trade is indicative of the structure and level of economic development. As a country develops and its trade gets diversified, it has to seek new outlets for its exports. Its horizon of choice in terms of imports also gets widened and the country begins to trade with an increasingly large number of countries. The figure 1 shows the trends of export direction of India.

Figure 1

Direction of India’s Exports (% of total)

Note: PCs - Pacific Countries (Cook Islands, Fiji Islands, Soloman Islands etc.)
PRC - People’s Republic of China
US - United States
EU - European Union
According to the figure 1 during 2004, the share of exports has increased with respect of People’s Republic of China and Pacific Countries. The exports of India to Japan have considerably decreased during the same period. As a single country, the US stands first in case of exports relationship with India. The following figure 2 depicts India’s import sources from different countries.

3.1.2. Imports

As it is shown in the figure 2 (and the table 1) USA stands first in exporting countries to India. India imported worth of $4,444 million from USA during 2002-03 and was decreased to $1721 million during 2004-05. During 2004-05, China stands first in exporting its goods and services to India. These imports, presently, are limited to low-price consumer goods.

Figure 2
Sources of India’s Exports

(US $ million)
Table 1
Sources of India’s Imports

<table>
<thead>
<tr>
<th>Country</th>
<th>2002-03</th>
<th>2003-04</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>4444</td>
<td>1428</td>
<td>1721</td>
</tr>
<tr>
<td>Belgium</td>
<td>3712</td>
<td>1294</td>
<td>1552</td>
</tr>
<tr>
<td>China</td>
<td>2792</td>
<td>1120</td>
<td>1877</td>
</tr>
<tr>
<td>UK</td>
<td>2777</td>
<td>1040</td>
<td>926</td>
</tr>
<tr>
<td>Germany</td>
<td>2405</td>
<td>785</td>
<td>1011</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2330</td>
<td>1318</td>
<td>1636</td>
</tr>
<tr>
<td>South Africa</td>
<td>2094</td>
<td>845</td>
<td>512</td>
</tr>
<tr>
<td>Japan</td>
<td>1836</td>
<td>739</td>
<td>859</td>
</tr>
<tr>
<td>South Korea</td>
<td>1522</td>
<td>642</td>
<td>930</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1465</td>
<td>580</td>
<td>631</td>
</tr>
<tr>
<td>Australia</td>
<td>1337</td>
<td>560</td>
<td>1076</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1381</td>
<td>645</td>
<td>825</td>
</tr>
<tr>
<td>UAE</td>
<td>957</td>
<td>317</td>
<td>1037</td>
</tr>
</tbody>
</table>

Source: RBI Annual Reviews.

3.2. COMPOSITION OF FOREIGN TRADE

3.2.1. Exports

Significant variations in growth rates of exports of various groups resulted in pronounced changes in composition of India's exports. Table 2 shows that in 1991-92, two groups, namely, manufactured goods (with 74.89 percent share in totals exports) and agricultural and allied products (with 17.88 percent share) constituted 92.77 percent of India's exports. The shares of other groups like ores and minerals, petroleum and crude products and of other commodities were very low. From 1991-92 to 2003-04, the share of agriculture and allied products and of manufactured goods has been fluctuating.
Table 2

Commodity Group-wise Composition and Growth of Exports of India

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Agriculture and Allied Products</td>
<td>17.88</td>
<td>16.91</td>
<td>18.11</td>
<td>20.50</td>
<td>18.92</td>
<td>17.81</td>
<td>19.58 (6.59)</td>
</tr>
<tr>
<td>2.</td>
<td>Ores and Minerals</td>
<td>5.20</td>
<td>3.97</td>
<td>3.99</td>
<td>3.50</td>
<td>3.03</td>
<td>2.64</td>
<td>10.02 (3.61)</td>
</tr>
<tr>
<td>3.</td>
<td>Manufactured Goods</td>
<td>73.59</td>
<td>75.51</td>
<td>74.89</td>
<td>73.53</td>
<td>75.83</td>
<td>76.64</td>
<td>17.58 (11.81)</td>
</tr>
<tr>
<td>4.</td>
<td>Petroleum &amp; Crude Products</td>
<td>2.23</td>
<td>2.26</td>
<td>1.78</td>
<td>1.43</td>
<td>1.01</td>
<td>0.26</td>
<td>-11.85 (1.42)</td>
</tr>
<tr>
<td>5.</td>
<td>Other Commodities</td>
<td>0.99</td>
<td>1.02</td>
<td>1.20</td>
<td>1.01</td>
<td>1.19</td>
<td>2.61</td>
<td>29.40 (5.57)</td>
</tr>
</tbody>
</table>

Total Exports 100 100 100 100 100 100 17.51 (10.68)

Notes: 1. * CAG : Compound Annual Growth Rate from 1990-91 to 2003-04.
        2. Year 1991-92 has been excluded while computing growth rates due to Balance of payments constraints.
        3. Figures in parentheses represent t-values

Source: Compilation of CMIE and RBI Annual Reports.

An analysis of export performance, measured in terms of growth rates of total exports, of commodity groups given in table 2 shows that total exports increased at compound annual rate of 17.51 percent during the period 1992-93 to 1998-99. Of 5 groups considered exports of 3 groups, namely, agricultural and allied products, manufactured goods and of other commodities increased at faster rate than total exports. Other commodities group experienced highest export growth rate of 29.40 percent, followed by agricultural and allied products (19.58 percent) and manufactured goods (17.58 percent).

Agricultural and allied products group experienced high export growth due to thrust given to agricultural exports in the form of income tax exemptions for export earnings, comfortable domestic supply situation and improvement in international prices of some of India's major agricultural exports. Of remaining 2 groups, ores and minerals group recorded lower growth rate of 10.02 percent, while export growth decelerated in case of petroleum and crude products group.
3.2.2. Imports

India’s imports can be classified into three parts, viz., (1) consumer goods, (2) raw materials and intermediates, and (3) capital goods. While the imports of consumer goods have been totally restricted and been permitted only when required to meet domestic shortages, imports of raw materials, intermediate goods and capital goods have generally increased. We can observe different trends from Table 3.

Table 3
India’s Principal Imports

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Items</th>
<th>1990-91</th>
<th>1994-95</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Consumer Goods</td>
<td>4.5</td>
<td>5.8</td>
<td>3.9</td>
</tr>
<tr>
<td>2.</td>
<td>Raw Materials &amp; Intermediate Goods</td>
<td>79.5</td>
<td>68.6</td>
<td>79.4</td>
</tr>
<tr>
<td>3.</td>
<td>Capital Goods</td>
<td>16.0</td>
<td>25.6</td>
<td>16.7</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Imports of capital goods increased fast during the decade of 1990s. This increase could be attributed to the following three reasons:

- Indian manufacturers introduced advanced technology to meet international competition.
- Inflow of FDI rose.
- Import duties were reduced and regulations on imports of capital goods were relaxed.

Imports of Intermediate Goods

The group of commodities which has been growing importance over the years consists of raw materials and intermediate goods most of which are in the nature of 'maintenance imports'. As the growth process moved, shortages and scarcities of different types of raw materials and intermediate goods began to be felt. These shortages would adversely affect the utilization of capital goods, but for their imports. Hence, the large imports of these commodities have been allowed. Among these imports, the most significant have been crude oil and petroleum products, fibres, fertilizers and chemical products, iron and steel, and non-ferrous metals.

The analysis clearly indicates that the composition of India's foreign trade reflects, to a great extent, the structural changes that the Indian economy has undergone since 1991. It is no longer an exporter of primary commodities and an importer of manufactured goods. It exports manufactured goods and imports raw materials, intermediate goods and capital goods.
3.3. VOLUME OF INDIA’S FOREIGN TRADE

3.3.1. Imports

Volume relates to the size of international transactions. As envisaged in our development strategy the volume of merchandise trade has been on the rise; the trade to GDP ratio has gone up from 13 per cent in the 1980 to about 20 per cent during 2004-05. The increase has been shared both by exports and imports. The table 4 shows the principal imports of India from 1990-91 to 2004-05.

Table 4

<table>
<thead>
<tr>
<th>Items</th>
<th>1990-91</th>
<th>2001-02</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petroleum Products</td>
<td>10,816</td>
<td>66,770</td>
<td>94,520</td>
</tr>
<tr>
<td>Chemical Elements and Compounds</td>
<td>2,289</td>
<td>11,140</td>
<td>18,483</td>
</tr>
<tr>
<td>Fertilizers</td>
<td>1,766</td>
<td>3,210</td>
<td>3,303</td>
</tr>
<tr>
<td>Iron &amp; Steel</td>
<td>2,334</td>
<td>3,968</td>
<td>6,893</td>
</tr>
<tr>
<td>Non-ferrous Metals</td>
<td>1,108</td>
<td>3,082</td>
<td>3,303</td>
</tr>
<tr>
<td>Capital Goods</td>
<td>10,471</td>
<td>44,425</td>
<td>78,722</td>
</tr>
<tr>
<td>Total (incl. others)</td>
<td>43,193</td>
<td>2,43,645</td>
<td>3,53,976</td>
</tr>
</tbody>
</table>

Source : CMIE Reports.

As shown in the table, imports of petroleum products were very high compared to any other items since the implementation of economic reforms. The imports of petroleum products contributed to increase in the production of industrial goods and thereby increase in exports.
Figure 3 shows that the growth rate of merchandise imports has increased from 14.4 percent in 1990 to 30.4 percent during 1994 and was gradually decreased to -7.1 percent in 1998, but was increased to 16.5 percent in 1999. Due to increase in domestic production and import substitution measures, the merchandise imports decreased to 13.8 percent during 2005.

3.3.2. Exports

India's total exports have increased by more than 300 times during the last five decades, from Rs. 606 crores in 1950-51 to over Rs. 2,91,582 crores in 2003-04. However, the increase has not been uniform over the years. Whereas the exports hardly showed any variation during the first decade and a half, i.e., between 1950-51 and 1965-66, these multiplied by more than 280 times during the next three and a half decades, i.e., between 1966-67 and 2004-05. The figure 4 shows the variations in growth rate of merchandise exports of India from 1990 to 2005.
The rising trend in exports came to a halt in 1996 when exports increased by only 5.6 per cent in dollar terms as against 20.3 per cent in 1993, 17.9 per cent in 1994 and 20.3 per cent in 1995. The trend continued in 1997 also; exports in dollar terms increased by a mere 4.6 per cent. Exports remained subdued during much of 1998 also for the first time in many years; exports recorded a negative growth of 3.9 per cent in dollar terms.

Exports witnessed a sharp upward trend in the last quarter of 1998-99. For the first time in four years there was shift in terms of trade in favor of non-oil exporting developing countries. Higher international prices of manufactured goods too pushed up import prices and allowed domestic industry to improve their profit margins in their national markets, especially in those sectors where cheaper imports had acted as a damper in recent years. All this translated in a 19.6 per cent growth in exports during the year 2000.
a. **Slowdown in 2001-02**

The euphoria did not last long. During 2001, the growth rate of exports perished to negative 0.8 per cent. The slowdown in exports could be attributed to the following factors:

- A marked deceleration in world output and trade.
- Slackening of global demand.

b. **Revival in 2002-05**

Exports recorded a robust growth of 11.04% during 2002, 15.1% in 2003, 16.6% in 2004 and 20.34% in 2005, aided by the following factors:

- Rise in international commodity prices.
- Recovery of the domestic manufacturing sector.
- Depreciation of the rupee, in nominal and real effective terms.
- Introduction of various export promotion measures.

The upward trend maintained itself in 2005 notwithstanding an appreciation in exchange rate of rupee. This only goes to show that Indian exporters are successfully exploiting the scope of productivity gains that exist today. This should improve further as infrastructure in the country improves to world class levels. This trend should only strengthen further as India progressively gets greater market access, especially in services, within the framework of WTO.

3.4. **EXPORTS OF SERVICES (or Invisibles)**

Exports of services supplement the merchandise-exports as a source of foreign exchange earnings. Services encompass telecommunications, transportation, tourism, banking, insurance, construction, computer-related services, and professional ones. But as with trade in goods, the nature of services, too, is daily changing, acquiring fresh dimensions. Trade in services, and high technology industries are also virtually symbiotic.

3.4.1. **India's Exports of Services**

India's exports of services are valued at about $25 billion annually. These form about 1.2 per cent of world's total exports of services. *Apparently, India's share in world's exports of services is more than the share of India's merchandise exports in world's total merchandise exports.*

Composition-wise, India's service exports generally consist of business services, tourist services, computer software services, (these alone amounted to $8.90 billion in 2002-03, and are estimated to be of the value of $11.77 billion in 2003-04, further growing by 30 per cent per annum in future) and transportation services. Direction-wise, India's service exports are widely transacted across the globe.
3.5. QUANTITATIVE RESTRICTIONS (QRs)

Ever since independence, India adopted the policy of extending protection to indigenous producers against foreign competition. In pursuance of this policy import tariffs were imposed and periodically raised. The policy was reversed for the first time in July 1991, when the tariff ceilings were lowered. The process continued thereafter also. However, for a certain class of over 2,700 goods the question of tariff lowering did not arise. These were subject to QRs. That is, they were not allowed to be imported at all, with the exception of small amounts as baggage allowance for travelers. The bulk of these goods come under the heads: consumer goods, automobiles, textiles, cigarettes, petroleum and agricultural products.

Beginning April 1, 2001, all QRs have been abolished, except those on a few defence and health related products. The phase out of QRs implies unrestricted import, or export of items. Curbs would still apply on goods imported by state agencies like cereals, fertilizers and petroleum etc.

3.5.1. Implications of QRs on Development.

- Indian consumers will face expanded choices and access to higher quality goods.
- Indian producers using inputs will also face expanded choice and access to better inputs.
- Smuggling will suffer. instead now goods could enter the authorized route.
- QRs may be substituted by tariffs. The net fallout will be less protection for the Indian industry, resulting in it being forced to improve efficiency.
- The opening of the economy to imports could lead to a complete domination of the Indian market by imported products. If local producers are forced to curb production, it would necessarily hurt the growth of the economy.
- A slump in growth would hurt all interests, including consumers. Having access to imported products would mean very little to the consumer if she does not have the income to buy them.
- Free imports also send out a message to foreign investors that they are better off exporting their finished products to this country rather than setting up manufacturing facilities here.
3.6. FOREIGN CAPITAL

The international character of Indian economy can also be evaluated through foreign investment size and trends therein in recent years. Following relaxations in regulatory provisions and incentives for foreign investment, the international corporate sector has in recent years, embarked upon various investment programmes in manufacturing, and trading sectors of India. Foreign investment approval amounted to Rs. 1283.2 million (1990), Rs. 5341.1 (1991) and Rs. 38875.4 (1992) million. The investment has mainly come from USA, Switzerland, Japan and NRIs. The FDI is being viewed as a vehicle of export-led economic growth and the emphasis on technology transfer is being diluted. Figure 5 A shows the total capital inflow towards India and figure 5 B shows composition of total capital inflow i.e., Non-debt Creating Inflows, Debt-creating Inflows and other capital i.e. delayed export receipts, advance payments against imports, loans to non-residents by residents and banking capital during 1991 to 2005.
The rate of capital inflows has accelerated; as a result capital account surplus have exceeded current account deficits in more recent years.
3.6.1. FDI Regime

FDI is the area where the multi-national corporations have been most active. In fact, these MNCs will be the major instruments of FDI flows. It is appropriate to note that in the recent past, FDI flows have increased at the rate which is most double the growth of world trade. The figure 6 shows the performance of FDI inflows to India from 1990-91 to 2004-05.

**Figure 6**

*Foreign Direct Investment (US $ million)*

The reforms of 1991 removed many of the restrictions on inflows of FDI and made India more welcoming and less hostile as a host for FDI, although FDI is still prohibited in certain sectors of the economy such as retail trade. The government has recognized FDI data for 2000-01, 2001-02 and 2002-03 along the lines recommended by the IMF, to include some hitherto uncaptured elements of capital. The fresh items have been classified under equity capital, reinvested earnings and other capital. As per the revised data, FDI inflows during 2000-01 were $2,339, $3,904 in 2001-02, $2,574 in 2002-03, $3,200 in 2003-04 and $4,673 in 2004-05.

India's share in FDI flows to developing countries, even in the peak year of 1997-98, was only 2 percent. Several smaller Asian countries, let alone China (which received a massive $60 billion of FDI in 2004), receive much higher FDI flows than India. Thailand, in spite of its financial crisis of 1997, received $7 billion and $11 billion of FDI, respectively, in 1998 and 2004.
3.6.2. Non Resident Indians

NRI deposits, which were negligible in 1980-81, amounted to $14 billion in 1990-91. Short-term debt at $8.5 billion in 1990-91 was more than 2.5 times the level of net foreign exchange reserves at $2.1 billion. With greater political uncertainty, as three prime ministers followed in quick succession in 1990, when oil prices rose as the Gulf War broke out, the confidence of external lenders, particularly NRIs, in the government's ability to manage the economy eroded. NRI deposits dried up, with net inflows falling from $2.3 billion in 1989-90 to $1.6 billion in 1990-91 and to a mere $290 million in 1991-92. Thus India came close to having to default on its external debt.

It is clear that, as in foreign trade, liberalizing policies that relate to FDI in and of themselves would have limited effects unless other domestic policies that adversely affect the returns of investors are reformed. Clearly if crucial sectors such as power, transport, ports, and communication continue to be dominated by poorly performing public enterprises, and bureaucratic controls at central and state levels are still inhibiting, external sector reforms by themselves would be inadequate to put India on a path of sustained and rapid growth.

SECTION IV

TRADE POLICY AND SUSTAINABLE DEVELOPMENT: A REVIEW

4.1. TRADE AND DEVELOPMENT: IS THERE A LINK?

The study reveals that trade policy reforms proved as successful in consolidating development of India. Trade performance is better in terms of openness ratios, self-reliance ratios, improvement in income terms of trade, rapid increase in quantity index of exports as compared to unit value index of exports, rapid growth of exports of agricultural and allied products and of manufactured products. Foreign trade performance is worse in terms of small share of India's exports (about 0.6 percent) of world exports, increased balance of trade deficit, unsustainable export growth and higher imports/GDP ratio as compared to export/GDP ratio. Dismal performance in foreign trade sector is result of various external factors: imposition of various existing as well as new non-tariff barriers like environment and labour standards, imposition of various forms of antidumping and countervailing duties, imposition of sanitary and internal factors: infrastructural bottlenecks, labour inflexibility, inefficient banking system, 551 reservations, low capacity utilization, lack of timely and regular supplies of raw materials and delays, lack of marketing facilities, lack of information about health and sanitary regulations of trading partners, *adhocism* in trade policy and absence of bold initiatives in trade reforms.
Over the past decade real GDP growth averaged around six per cent per annum; in the mid-1990s it reached an all-time high of seven per cent, decelerating thereafter to around 5.5 per cent per annum over the five years ending in 2001-02. This is commendable both by India's historical standards and in comparison with the growth rates of other developing countries. Development indicators such as adult literacy rates and poverty levels also show considerable progress. Even so, these achievements leave a lot to be desired. Although poverty levels declined from 36 per cent during the mid-1990s to 26 per cent by the end of the decade of the 1990s, more than 250 million people continue to live below the poverty line, whatever be the norm for measuring poverty. The rate of unemployment is put at around 7.3 per cent and as the Government of India report acknowledges, employment in the organized sector increased by a mere one per cent per annum for most of the last decade, with almost all of the gains in employment coming from the private sector.

The Planning Commission's vision for the future is to reduce poverty by five percentage points by 2005 and a further 15 per cent by 2012 and a doubling of per capita income over the next decade. These ambitious targets would require growth rates of around eight to nine per cent and a substantial growth of exports.

Are these rates attainable? Although the growth rate of six per cent achieved during the mid-1990s is high by India's historical standards, it decelerated to around four per cent in 2000-01 and the average growth rate for the five years ending in 2001-02 was around 5.25 per cent. Agriculture, which accounts for 22 per cent of GDP and two-thirds of the labour force, grew at around 2.2 per cent per annum over the period 1995/96 to 2001/02 with wide fluctuations around the average. Manufacturing, which contributes 17 per cent of GDP and 6.6 per cent of employment, registered a rate of growth of six per cent per annum, and services which now account for nearly 49 per cent of GDP and 19 per cent of the total workforce, grew at an annual average rate of around 8.6 per cent over the seven-year period. As the report by the Secretariat notes, labour productivity in agriculture is little more than one-third of the national average. Low levels of capital investment, inefficient techniques, absence of scale economies and protection from foreign competition, all account for the low levels of productive efficiency in the sector. The manufacturing sector is dominated by textiles and clothing which account for 20 per cent of industrial output, nearly 30 per cent of India's exports and provides employment to 38 million people. The Secretariat report suggests that labour productivity in textiles and clothing may be higher than the national average.

In general, in the post-reforms period, labour productivity appears to have increased in most industry groups along with an increase in capital-intensity. Total factor productivity, however, appears to have remained unchanged or increased marginally compared with levels achieved during the 1980s. It is, though, noteworthy that new entrants to non-electrical machinery and pharmaceuticals appear to have registered a growth in total factor productivity. The widely cited success story, though, relates to computer software which recorded a total turnover of $10.3 billion and exports of around $9.2 billion by the end of 2004. Indeed, it is the services sector in general which appears to be buoyant in the economy. In recognizing these facts we can draw the following summary as to how India’s trade performance is related with sustainable development of India.
4.1.1. Exports and Development

India's exports have increased since the reforms in 1991. As the Government of India's report notes in the post-reform period the annual rate of growth of exports was around 10 percent and India's share in world exports increased from 0.5 percent in the first half of the 1990s to 0.7 percent in 2000-01. Growth of exports is a factor in the relatively high growth rates of GDP in the post-reform period. Even so, exports have not exhibited the momentum required for them to act as an engine of growth. The composition of India's exports of manufactures has not changed much over the years: textiles and clothing (27 percent), diamonds (14 percent), chemicals (10 percent), account for half of total exports.

Exports of services though have grown rapidly, with the growth of software exports being the major success story. The group of miscellaneous services, which includes software, financial and management services, contributed $14.67 billion to total foreign exchange earnings in the year 2001-02. Exports of software increased from $4 billion in 1999-2000 to $7.2 billion in 2001-02. Total receipts from invisibles in the year 2001-02 amounted to $36 billion, which compares with total receipts of $44 billion from the export of goods. Whilst the service sector in general shows an impressive growth it may be a bit premature to argue that India is destined to be a service economy. Sustained growth of the sector is dependent on world market conditions and also on the development of infrastructure facilities at home.

4.1.2. Comparison with the First Decade and a-half of Reforms

As to the first type of comparison, the conclusion is foregone: that India's exports have maintained an upward trend, and that as compared to the earlier period, the performance has been satisfactory.

4.1.3. Comparison with the Growth of NNP

The share of exports in GDP too has increased over the years, from a mere 3.1 per cent in 1965-66 to about 9.00 per cent in 2002-03. This tendency reflects the growing significance of the export sector in the Indian economy.

4.1.4. Comparison with the Growth of World Exports

India's exports, as compared to the world exports, have been slow to grow. Consequently, India's share in the world exports fell to a low of 0.42 per cent in 1980-81. During the eighties and the nineties of the last century in wake of picking up by India's exports, there has been some improvement in the ratio which has varied between 0.50 and 0.65 per cent, indicating the vast in world exports has inched upwards of 0.8%, and the trend seems to continue. (It is in spite of the country's natural comparative advantages: low wages, and intelligent and educated workforce, raw cotton, and of course, preferential access to OECD markets)

In short, India’s exports have shown a mixed trend. Whereas the rate of growth as measured in terms of past performance or in terms of its share of national income shows an appreciable rise, it presents a picture of poor performance when measured in terms of the share in world exports.
4.1.5. National Income and Trade

a. Imports and National Income

In discussing the level of imports it is useful to observe the relationship between imports and national income. In planned economies the development effort is likely to increase imports faster than national income because investment as a proportion of national income is stepped up and the import content of investment is high in the early stages of development. This, together with the increased requirements of raw materials, intermediate and capital maintenance imports, more than offsets the restrictions on consumer imports. The relationship between imports and GDP in India has been more or less stable; imports during the first 30 years of planning generally varied between 6.5 per cent and 8.5 per cent of national income. Again, since 1979-80, this ratio has stabilized itself at a higher level; between 8 and 13 per cent. The stability in import ratio would suggest that there has been little change in imports required per unit of domestic product. It is, however, possible that imports required per unit of output have declined in certain categories and increased in others keeping the overall ratio constant.

Figure 7
India’s Exports as Percentage of National Income

b. Exports and National Income

As shown in the figure 7 the share of exports in too has increased over the years, from a mere 3.1 percent in 1965-66 to about 9 percent in 2004-05. This tendency reflects the growing significance of the export sector in the Indian Economy.
4.2. INDIA, WTO, AND MULTILATERAL TRADE NEGOTIATIONS

Five decades of development experience have shown that being open to external trade and investment flows enables India to grow faster economically than otherwise, and that faster economic growth is an effective and efficient means for alleviating poverty. For India to achieve more rapid growth through greater integration with the world economy, a liberal and open global trading and financial system is essential. After eight rounds of multilateral trade negotiations under the auspices of the GATT, trade barriers have been reduced substantially, and the world trading system is now far more open than it was when the GATT was concluded in 1947. The last round, the Uruguay Round (UR), created the WTO as a formal institution with a well-defined constitution to facilitate the implementation of multilateral trade agreements. It also went beyond earlier rounds in successfully negotiating an agreement to liberalize trade in services. Unfortunately it also brought into the WTO framework and disciplines matters that are at best tangentially related to trade, such as Trade Related Aspects of Intellectual Property Rights (TRIPS) and investment measures.

It is against this backdrop that the prospects of attaining a growth rate of eight to nine per cent for the economy are to be judged. As policy makers acknowledge, these growth rates cannot be achieved without radical reforms and a growth in India's share of world trade from the present level of 0.67 to one per cent by 2007, which would require an annual growth rate of exports of 11.9 per cent.

4.3. TRADE POLICY IMPACT ON INDIA’S DEVELOPMENT

The trade policy of India has both positive and negative impact on the Indian economy, which will be interpreted below:

4.3.1. Positive Impact

1. The trade policy touches millions of people who could not have been bothered about such government pronouncements in the past. It seeks to enable Indian farmers, artisans, cottage and small industries-in fact the entire population engaged in any economic activity to venture out overseas and adopt the world as market. In other words, it seeks to convert export into a mass activity from being a class pursuit.

2. The policy provides for a more active role for state governments to participate in the export promotion. It attempts to forge a lasting partnership between the Union government, state governments, exporter and the people at large.

3. The policy proposals are expected to significantly increase India's share in the international trade of agricultural products, even while promoting diversification from the primary sector and boosting rural purchasing power and consequently overall demand.
4. The government has succeeded in reverting back to the old system of import control in a WTO compatible manner. The traditional antidotes to the restrictions like the DGFT licence are not very effective in controlling the menace as the policy is governed by the respective administrative ministry and not the DGFT.

5. The policy focus on development of SEZs, export houses, industrial clusters and EOUs would help in propelling economic activity and promoting exports.

6. The policy focus on procedural simplification in the various export promotion schemes and rebating fully the incidence of duties and facilitation of exports at the port and DGFT offices through better coordination would improve the competitiveness of the exporting community.

7. The move to allow setting up of overseas banking units within the SEZs with no CRR and SLR obligations would encourage lending to units in SEZs at internationally competitive rates. It could result in some of our cities emerging as the nerve centre for financial and trading activities in the near future.

4.3.2. Negative Points

1. Among the fastest growing export products have been the new technology goods; new technology goods formed about half of the total world trade in 1980; two decades later these constitute more than two-thirds. India has yet to make its mark as an exporter of such goods, except for some recent breakthrough in software exports.

2. The trade is generally opposed to compulsory quality and/or pre-shipment inspection. Sometimes, even after quality control and pre-shipment inspection, there have been complaints which suggest that quality control is not thorough. Nothing harms the export market more than a bad reputation for quality.

3. Indian industries till recent past did not adequately feel the need to be cost-conscious as they enjoyed a protected market due to restrictions on imports, high protective duties and a shortage of domestic supplies. Moreover, the productivity in Indian industry is much lower than that of its competitors. Even in labour-intensive products the Indian cost price structure is not competitive. The situation has begun to change since 1991, but much remains to be done.

4. The trade route has also not been exploited. The rigidity in adaptation of the manufacturing structure to the possibilities arising due to reform, higher growth and changing competitiveness in different sectors where the 'lead goods' tired out is reflected in the constancy of the broad export structure.

5. Inadequate transportation and shipping facilities have stood in the way of export promotion.
6. Exports are also hampered by quotas under the Multi-Fibres Arrangement, ceilings under the generalized system of preferences, and 'administrative surveillance' which enables the European side to initiate consultations followed by quantitative restrictions.

7. Exports are also saddled against emerging regional trading blocs like the EU, NAFTA, Asia-Pacific Rim, etc.

8. While the rupee's persistent depreciations had given advantage to the Indian exporters over the years, it has equally given protection to the domestic industries. However, the pursued policy of devaluation of domestic currency has ensured that the basket of India's exports remain more or less unchanged for many years, namely primary products with negligible value addition. Besides, it has contributed towards growing number of inefficient businesses thriving on protection.

4.4. ENFORCEMENT

India’s trade policy should concentrate on the following remedial measures to overcome from the trade bottlenecks.

1. India's exports have suffered due to a shortage of supplies and inadequate exportable surpluses. If India is to exploit the situation in the world markets to her best advantage, supplies should not only match demand, but should also leave a cushion in capacity, especially in products where we have a price advantage.

2. In order to benefit from growing world trade, India's export basket has to diversify, change towards higher-valued products and more importantly, to products which have higher technology content.

3. Considering the factors responsible for poor trade performance, issue for trade reforms is to have integrated long-term national export policy which can coordinate production, infrastructure and marketing (export) activities. To remove infrastructural bottlenecks, substantial investment in infrastructure should be made to encourage investment by private sector in infrastructure, by providing an opportunity to trading/export houses to invest in infrastructure and removing handicaps faced by private sector in these areas.

4. Marketing is the most important constituent of export promotion strategy. India's exports have to be geographically diversified in view of declining importance of developed nations. Export strategies should be adopted country-wise.

5. India would have to explore new sources of imports and new markets for its products in a fast globalizing world.
6. Due to removal of QRs, there is need for institutional mechanism which is required to study, analyze and recommend tariff structure to maintain a balance between the interests of producers and users/consumers. Tariff commission and anti-dumping cell should be strengthened. Adhocism in export policy must come to an end. Indian Government, no doubt, created Special Economic Zones (SEZs) and involved State Governments in export promotion on Chinese pattern, but there is nothing new about these zones. Already there existed 7 EPZs and 371 EOUs in India but their contribution to total exports in less than 4 percent and in China, SEZs contributed 40 percent of exports. Simply by changing the name of the zones, the country cannot promote exports. India should try to remove inadequacies faced by existing EPZs in the form of infrastructure bottlenecks, restrictions to entry of FDI and regulations. In the wake of limited impact of import liberalization on export performance, role of State agencies through market-friendly policies like consultancy and guidance could be fruitful.

7. Apart from these measures, labour laws should be made flexible, financial sector and various other service sectors be liberalized, investment be made in human resource development and macro-economic stability be maintained to attain and sustain high rates of export growth.

8. Needless to say, the performance of India's external sector will also depend crucially on reforms and productivity increases in the woefully weak infrastructure sectors and the financial sector. Improvements in these areas are essential for spurring economy-wide investment and growth, as well as enhancing external sector competitiveness.

4.5. CONCLUDING REMARKS

This paper concludes that while much has been accomplished during a decade of external sector reforms, much remains to be done. This is true because import-weighted mean tariffs began to rise from their 1996 levels and in 2003 were at a level much higher than those prevailing in China and East Asia. This rise in tariffs coincided with a significant slowdown in the growth of exports relative to the first years after the reforms. Thus, while India’s share of the growth of world exports increased, India’s competitors did even better. Even in the area of FDI, where significant liberalization has occurred, India’s share of FDI flows to developing countries peaked at a paltry 2 percent in the 1990s.

Needless to say the cause for spurt in growth of exports and imports over the years, may be attributed to India’s involvement, either forced and cannot be avoided or willing and voluntary—in the globalization, liberalization and privatization which lead the economy to somewhat speaking position in world economy and consequential higher economic development in India.


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