

INDIA'S TRADE WITH THE WORLD:
RETROSPECT AND PROSPECT

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Even prior to Indian independence, the Congress party and its leaders made achievement of economic development and higher living standards a central objective for independent India. They clearly recognized that trade policy would be inextricably linked with the strategy for achieving rapid economic growth,² and trade policy has consequently been central ever since.

Early trade policy aimed at developing new industries within India, but very quickly the objective became to finance the imports deemed most essential to sustaining development in light of chronic foreign exchange shortages after sterling balances, accumulated during the Second World War, were largely drawn down. While the import-substitution (IS) strategy remained central, the emergence of chronic foreign exchange shortages forced a shift to reliance on the trade regime to allocate scarce foreign exchange to those imports deemed most critical. While it was intended that the IS policies would foster economic growth, they in fact served as a major drag. It was not until the reforms, first in the latter half of the 1980s of exchange rate policy, and then starting in the 1990s of regulations and restrictions governing foreign trade that trade policy and performance fundamentally altered as a major contributor to accelerated growth in India.

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² They did not, however, appreciate the extremes to which trade policy would have to go, nor the high economic costs that such a trade policy would entail.

Montek Ahluwalia's central role in the economic reforms is well known, and it is a pleasure and a privilege to assess Indian trade policy and Indian trade prospects since the reforms in a festschrift in his honor. His contribution has been enormous, as he combines a keen strategic sense and understanding of what is needed with an ability to move the agenda forward and to recognize the limits to what is politically feasible. His insights, ability, and perseverance make him one of the heroes of India's economic reforms.

An understanding and appreciation of the reforms and of where India's trade regime and trade performance stand today is only possible in the context of the policies (and their results) that were pursued through the first thirty years after independence. This essay therefore starts with an overview of the early trade regime and its effects. There follows an analysis of the reforms to the trade and payments regime, as well as those domestic economic policy reforms that have had a major impact on trade. Next, the performance of India's trade, and especially exports, since the 1990s is examined. In light of the changes and the evolution of trade and payments flows in recent years, current policies are assessed with a view to the sustainability of current, or even higher, rates of growth of trade and real GDP. A final section then summarizes and assesses future prospects for India's trade.

TRADE POLICY AND PERFORMANCE FOR THE FIRST THIRTY YEARS

At independence, agriculture was the predominant economic activity, and it was thought that development should occur through the rapid growth of industrial activities in the Indian economy. That rapid growth, in turn, was regarded as feasible only with government-guided introduction and expansion of new industrial activities behind a wall of protection from foreign competition (usually justified by some variant of the infant industry argument). In part, this belief was based on the perception that India was behind the industrial countries and that new

industries would be disadvantaged initially and thus require protection; but in part it was an outcome of the rejection of the colonial past and a consequent reluctance to let the Indian economy be at all “dependent” on the rest of the world.

Starting with the Second Five Year Plan³, emphasis was placed on rapid industrial development and, under the influence of Mahalanobis’ thinking, on “machines to make machines” as the strategy to reduce reliance on the rest of the world. While tariffs were already in place, the sharp upward shift in demand for imports of capital and intermediate goods (and the exhaustion of the sterling balances) resulted very quickly in a balance of payments crisis in 1956-57. Measures were immediately taken to restrict imports further than might have been required for the IS strategy that had been adopted. These included both raising tariffs and licensing of all imports. Foreign exchange was “scarce”, but the authorities were unwilling to adjust the exchange rate, largely in the belief that that would make investment goods imports more expensive and thus reduce total investment (ignoring the fact that the binding constraint on imports was foreign exchange availability).⁴ Instead, comprehensive import licensing was adopted, with a view to allocating scarce foreign exchange to the activities regarded as most important.⁵

Import licensing was highly restrictive: the intent was virtually to eliminate “consumer goods imports” and replace them with domestically-produced goods (or to prevent their consumption in the case of items classified as luxury goods). Distinctions were then made between imports of raw materials and intermediate goods that were imported by the firm using

³ The First Five Year Plan was drawn up in 1949-50 when undoing the ravages of partition was a major concern. The First Plan was therefore primarily an assessment of the economic situation and an enumeration of the projects (mostly infrastructure) and programs currently underway.

⁴ As T.N. Srinivasan pointed out, there was also unwillingness to use the exchange rate or tariffs because of distrust of markets and because quantitative restrictions enabled the bureaucrats to use “discretion” and became a major source of corruption.

⁵ For an account and analysis of the trade regime during the 1960s and 1970s, see Bhagwati and Srinivasan (1975).

them in their production process as contrasted with distributors; further distinctions were made between capital goods imports and items needed to sustain or increase production domestically (as for example for components for assembly industries).

Although the nominal exchange rate was adjusted from time to time (as discussed below), the adjustment was generally insufficient until the 1980s to offset the differential between Indian and worldwide inflation. As excess demand and the implicit premium on foreign exchange mounted, adjustments were made to tariff rates as well as to the quantities of imports permitted under license. During the period prior to 1990-91, the general trend in the restrictiveness of the import regime (including both licensing and tariffs) was upward (see Pursell, Kishor and Gupta 2007).

Table 1 gives the rates of protection (both legal and taking into account tariff exemptions) prevailing for 1990-91 (immediately before the crisis) and for 1993-94. As can be seen, average tariff collections⁶ on most products were very high in 1990-91: 113 percent for agriculture, 100 percent for mining and 126 percent for manufacturing. But the (unweighted) tariff collection rate was a combination of the legal rate and the rate for those obtaining exemptions. Thus, many importers were subject to the standard rate, which was even higher.

Very rapidly, the system became exceedingly complex, as the authorities were attempting to differentiate between bone fide import license applications and those that were either inflated or entirely intended to enable imports for profitable resale. Although tariffs were raised, the very slow growth of export earnings (below the rate of growth of real GDP) meant that the excess demand for foreign exchange, and hence the “premium” on import licenses, was rising over time. The result was very high and variable effective rates of protection (actual tariffs and the

⁶ Average tariff collections are defined as the customs revenue reported collected on the item and the recorded value of the item.

protection-equivalent of quantitative restrictions) with no apparent rationale. Since it was the quantitative restrictions that were binding (as importers would have purchased even more at the high tariff rates had they been able to), those receiving import licenses profited substantially.⁷

The effects of the very high levels of protection and of the licensing system were certainly detrimental to economic growth prospects and performance. On one hand, exports grew very slowly, as incentives (in large part because of protection) were highly skewed toward producing for the domestic market,⁸ while the appreciated real exchange rate discouraged exports.⁹ Thus, export earnings increased at a rate below the rate of growth of real GDP. But the demand for imports grew more rapidly than real income because the new industries demanded intermediate goods and raw materials for production (and were “import-intensive”) and because of efforts to spur investment (again import intensive) in both the private and the public sectors.¹⁰

At the same time, especially in the period prior to the mid 1960s, the nominal exchange rate was held constant over long periods and then adjusted less than the domestic rate of inflation. The nominal exchange rate was pegged at 4.8 rupees per U.S. dollar from independence until the devaluation of 1966 when it changed to 7.6 rupees per U.S. dollar. It

⁷ Smuggling was also highly profitable. Since some smuggling occurred by including extraneous items in licensed imports (a second engine in a tractor, for example), customs inspections were further drawn out to attempt to insure that the goods imported were only the items stated on the import license.

⁸ This was the result both of the virtually-assured profitability of producing import substitutes and because of the relative unattractiveness of developing or expanding export industries resulting from the increasingly overvalued exchange rate (see Table 5 below) and the high cost and/or uncertain availability of needed inputs for exportable industries.

⁹ For analysis of the role of the real exchange rate, see Srinivasan and Wallack (2003).

¹⁰ In the early 1950s, industrial activity was separated into three groups: strategic industries in which only the government could produce; industries in which both private and public sector entities could engage in production; and others left to the private sector. The state-owned enterprises (SOEs) absorbed more than half of industrial investment until at least the 1980s. They exported very little, and are therefore largely left out of the discussion of the evolution of trade. It is enough to note that the industries in which SOEs operated were usually ones in which India would not a priori have been expected to have comparative advantage and, in addition, were often high cost. Another early policy decision was Small Scale Reservation, which reserved a large number of economic activities for the “small-scale sector”. It was intended to enable small, labor-intensive firms to survive by preventing the entry (or expansion of existing larger firms) into small scale industries. These industries were accorded special tax treatment and exempt from much regulatory oversight provided they remained small. The SSR policy was an important factor influencing the evolution of Indian trade and is discussed further below.

remained pegged at that rate to the U.S. dollar until 1971, when the peg was switched to the U.K. pound. Thereafter, there was a basket peg until the reforms of 1991-2. Joshi and Little (1994, Pp. 282-3) estimate that an index of the real exchange rate (with 1978 = 100) had appreciated by about 12 percent in the early 1980s, then moved back to its 1978 level in 1986 and thereafter depreciated further (see Table 5). Broadly speaking, the real exchange rate had appreciated from Independence until the mid-1980s, after which the real exchange rate depreciated somewhat, although macroeconomic policy in the latter 1980s was highly expansionary, offsetting some part of the effects that might have otherwise been felt.¹¹

Since foreign exchange was scarce and exports were underperforming, a large number of ad hoc export incentive schemes were adopted over the years. Concessional tariffs were granted to imports of machinery to make products for export; duty exemptions were extended in a number of cases, concessions were granted on taxes¹², and large exporters were granted “export house” status which enabled them to receive import licenses for goods that could then be resold at a profit. There were several special export zones, but exports from these zones amounted only to 3 percent of total exports. Some exports (including petroleum products and some agricultural products) were exportable only by public enterprises. These “canalized” goods constituted only about 5 percent of total exports.

Table 2 gives data on export earnings in India, China and Korea for the years after 1953.¹³ As can be seen, Indian export growth was sluggish, and India’s share of world export markets decreased, falling to a low of 0.5 percent in the late 1970s and early 1980s. By contrast,

¹¹ See Pursell (2005) and Joshi and Little (1994), pp. 266 ff. for analyses of nominal and real exchange rate behavior.

¹² Companies were generally exempt from income tax on export income if export proceeds were deposited in convertible currency. The marginal income tax rate was 65 percent, so this amounted to a substantial incentive. See GATT (1993), Vol. 1, P. 123.

¹³ The data in Table 2 are on a calendar year basis in order to achieve comparability with data from the other countries. The Indian fiscal year starts on April 1. Data corresponding to the fiscal year are indicated by using both years in the heading.

Korea's exports grew from US\$40 million in 1953 to \$64.9 billion in 1990, increasing in share of world trade to just under 2 percent by that time. The fact that India's share of world trade was declining is further indication that it was the supply of exports from India, rather than world demand, that accounted for much of India's loss of share and for failure of exports to grow more rapidly.

Throughout the period prior to the 1991 crisis, India incurred current account deficits. These deficits were determined, not by market forces, but by the availability of financing. The authorities forecast the likely available foreign exchange from export earnings, other current account receipts, and capital flows. They then issued import licenses based on the estimated availability of foreign exchange. Because some licenses were unutilized, and because forecasts of available foreign exchange were not always accurate, the realized current account balances differed from those planned; usually the forecast of availability of foreign exchange proved overly optimistic.¹⁴ In the latter half of the 1980s, current account deficits were around 3 percent of GDP, with foreign indebtedness mounting over the period. Excess demand for foreign exchange was clearly much greater than the current account deficit would indicate. Of course, capital controls were tight, especially on outflows. But the restrictiveness of the system and other factors resulted in very small capital account transactions, and especially very small private capital flows.¹⁵ The major capital inflow was foreign aid, which had constituted around 2 percent of GDP in the 1950s, but became relatively smaller with the passage of time.

¹⁴ There may also have been periods during which the authorities overestimated availability in the expectation that more foreign aid might be forthcoming.

¹⁵ There was also deep suspicion of foreign investments, and restrictions surrounding it (including such things as the maximal percentage of the business which could be foreign-owned, the number or fraction of employees and management who had to be Indian nationals, and even stipulations as to the release of proprietary information) served as a major disincentive to foreigners contemplating investment in India.

For present purposes, an important point is that the poor performance of the trade sector and the resulting inefficiencies in the economy were a major constraint on economic growth. The trade and payments regime was inextricably linked to the development strategy (of import substitution), and it was impossible to analyze economic growth without putting international transactions at the center of the analysis

Discussion here has focused on those aspects of Indian economic policy that were aimed directly at the trade and payments regime. But many policies designed to impact domestic economic activity also affected incentives for exporting and competitiveness. These included the “license raj” and the poor state of infrastructure, which have already been discussed to some extent, macroeconomic imbalances, policies toward agriculture, and treatment of labor markets. There has been much less reform in these arenas, and they still affect trade. For that reason, fuller discussion is deferred until discussing prospects going forward.

. THE CRISIS OF 1991 AND THE REFORMS

In January 1991, the situation came to a point where the Government of India’s reserves had fallen so much that foreign exchange reserves covered less than three weeks of imports, and commercial debt obligations needed to be rolled over but lenders were refusing to accommodate, There had been sales of gold (an action much more repellent to Indians than to many others) from reserves and from confiscated gold (because smuggled), and an IMF program. But the situation had continued to deteriorate.

The proximate cause of the crisis was the refusal of international creditors to roll over Indian debt. India’s fiscal deficit had averaged 10.1 percent of GDP for the period from 1985/6

to 1989/90, and, if deficits of SOEs were included, the number was 12 percent.¹⁶ The two Gulf War-related events – workers’ remittances had dropped and deterioration in India’s terms of trade - plus the increasing debt ratios precipitated the refusal. This was the culmination of a build-up of public debt to finance the fiscal deficits of the 1980s.

However, one can argue that the underlying problems lay in the effort to achieve growth through heavy protection in the trade and payments regime. In the words of Joshi and Little (1996, Pp. 14-15)

“The roots of the crisis can be traced back to India’s reaction to the earlier crisis of 1979-81 when world oil prices doubled. This exogenous shock changed India’s current account position from near balance in 1978 to a deficit of 2 percent of GDP (30 percent of exports) in 1981. Remarkably, there was hardly any current account adjustment for the rest of the decade despite favorable developments...The current account deficit averaged 25 percent of exports from 1982 to 1984; from 1985 to 1990 it averaged no less than 40 percent of exports. These deficits were covered by heavy borrowing.... From 1982 to 1985 the persistence of current account deficits was the result of the almost complete stagnation of exports which was in turn largely the result of an inappropriate exchange rate policy....From 1986 exchange rate policy became more flexible and the real exchange rate depreciated substantially. Exports revived strongly in response and grew in real terms at 10 per cent per annum between 1986 and 1990. But by then the export boom was insufficient to outweigh the combination of rising interest payments on external debt and the rapid growth of imports induced by fiscal deterioration.”

¹⁶ As Srinivasan (2000, pp 32-33) points out, the “true” magnitude of debt service was understated, because banks were required to hold up to 38.5 percent of their assets in government paper and were subject to a cash reserve ratio of 15 percent. The interest rate charged on public debt therefore understated the true cost of borrowing.

Regardless of underlying problems,¹⁷ the first task of the government was to bring the fiscal accounts into balance, which required a sharp cut in expenditures. An IMF program was initiated which provided liquidity and reassured creditors that the public finances would improve.

Thus, fiscal and monetary tightening, combined with a 19 per cent nominal devaluation were the major macroeconomic changes initially undertaken. The central government's fiscal deficit fell from 8.3 per cent of GDP in 1990-91 to 5.9 per cent¹⁸ in 1991-92 and to 5.7 percent the following year. Thereafter, however, it began rising again. Since focus here is in the trade sector and its prospects, analysis of the factors underlying the continuing fiscal problems is not attempted here. But, as will be seen below, reining in inflationary pressures and restoring a more balanced fiscal situation will be crucial to India's future trade and growth prospects.

If the changes in monetary, fiscal and exchange rate policy were all that had happened in the aftermath of the 1991 crisis, it is likely that growth would have reverted to its rates of earlier years. But a new government, which assumed power in June 1991, committed itself to structural reforms.¹⁹

While the "forcing variable" was the potential inability to service public debt, the reforms actually undertaken went well beyond those necessary to restore a semblance of macroeconomic balance. While there had been some reforms in the 1980s, they had generally been piecemeal and halfhearted. The basic structure of government controls with respect to economic activity had remained largely unchanged.

¹⁷ Public debt virtually tripled between 1983-84 and 1990-91, but debt to private creditors rose even faster, from about 17 percent of the total to about 30 percent. That meant that debt service payments owed in 1990-91 were more than triple those 7 years earlier.

¹⁸ There are several different measures of the fiscal deficit, including that of the consolidated center and states. The figure used here is the GOI's official statistic. By all measures the fiscal deficit fell 2-3 per cent of GDP in the first year after the crisis (and more if it is recognized that cuts began before the beginning of the fiscal year).

¹⁹ A significant contributor to the long run-up to crisis was the fact that India had five prime ministers in the years between 1986 and 1991.

The same was not true of the reforms following the 1990-91 crisis. After the initial measures,²⁰ attention turned to liberalizing the import regime and providing incentives for exports. The nominal exchange rate was moved from an annual average rate of Rs.17.9 per US dollar in 1990/91 to Rs. 24.5 in 1991/92 and Rs. 30.6 in 1992/93 (see Table 5). That represented an export weighted depreciation of the real exchange rate of about 19 percent.²¹ Thereafter, the nominal exchange rate moved sufficiently to maintain the real exchange rate within a band of about 10 percent. Since 2005, there has been some real appreciation, estimated to have been 8 percent for the year up to February 2008, the last month for which data are available at the time of writing. Contrasted with earlier years, however, would-be exporters have had reasonable assurance that the exchange rate would not be subject to long periods of real appreciation.

In another set of measures after the crisis, changes were made to make it simpler for exporters to obtain their desired imports and to increase the attractiveness of exporting. Some large importers were granted licenses to import some consumer goods, and licenses could be sold at a premium. Imports of capital goods for exporters were permitted under a special plan at concessional (often zero) duty rates. An export rebate scheme gave exporters access to duty-free imports.

While these changes undoubtedly improved incentives for exporters (as is reflected in the rapid increase in exports in the years immediately following the changes), it nonetheless appeared that “their complexity, administrative cost, and the inevitable persistence of some anomalies, are strong arguments for a trading regime which requires no such complications to render it free of bias against exports” (Joshi and Little, 1996, P.70).²² Over time, as the trade and

²⁰ Fiscal expenditures were initially cut drastically as well. Here, focus is on the trade regime.

²¹ There was a period of almost a year during which there was a dual exchange rate system.

²² Panagariya (2008, P. 270) cites a report in 2003 that an exporter in India needed to obtain 258 signatures and present 118 copies of the required information.

payments regime was simplified (and tariff rates came down – see below), the importance of some of these incentives diminished, although a large number of controls and regulatory obstacles to efficiency remain. (see the discussion below).

Since the late 1990s, the GOI has entered into a number of preferential trade arrangements (PTAs),²³ first with Sri Lanka, and then with other countries and groups of countries in the region. To date, only the PTA with Sri Lanka is fully in force and the impact on trade flows has been marginal. Other regional PTAs have been negotiated and are in process of implementation.

In part to remove the burden of remaining controls and disincentives for export, in 2005 the GOI decided to introduce “special economic zones”. Firms were enabled to acquire land and, within it, produce goods for export without being subject to all of the regulations and bureaucratic procedures to which producers for the domestic market were subjected. Although the initial intent was to release producers in SEZs from the requirements of India’s labor laws, the decision was highly controversial and quickly reversed. Controversy over relaxation of labor market regulations, mechanisms used to acquire land, and other difficulties have delayed take-up of the scheme, although a large number of applications were initially received, and there was clearly producer interest in using SEZ provisions.

On the import side, changes were even more dramatic. Tariffs were cut in a series of steps. Table 3 gives the data. As can be seen, even the 1997/98 numbers are much below those prevailing (Table 1) prior to the crisis. But tariff reductions continued thereafter. Indian tariffs thus fell dramatically after the crisis. By 2006/7, the average tariff was 15 percent: tariffs on imports of manufactures had dropped dramatically, although there was some offset as tariffs on

²³ The GOI is strongly supportive of the multilateral trading system and appears to have entered into PTAs with neighboring countries largely as a defensive move, given the mushrooming of PTAs in much of the world. However, within the WTO, the GOI has been more a proponent of special and differential treatment for developing countries than a participant in multilateral trade liberalization. In the Doha Round, the GOI has thus far balked at binding tariffs at their current levels, and has opposed any liberalization of its agricultural trade.

imported agricultural goods rose. There were still a few items at very high duty rates: the peak was 182 percent, as reported to the WTO (2007, P. 40). The GOI has stated its intention to lower tariffs still further, to ASEAN levels by 2010. It should be recognized, however, that the tariff rates reported in Table 3 are tariff rates in force, but they are not bound under WTO rules, which means that the GOI can raise these tariffs to bound levels; the simple average bound level was still 48.6 percent at the time of the 2007 Trade Policy Review (WTO 2007, P.38).²⁴

But, as was seen, tariffs were often not the binding constraint on imports pre-crisis: quantitative restrictions had limited amounts that could be imported. That, too, changed after 1990/91. Initially, quantitative restrictions were removed on imports of capital goods, intermediate goods and raw materials, but retained for consumer goods. In 2001, however, the WTO found India's quantitative restrictions on consumer goods imports in violation of her obligations as a member, and they, too, were dismantled. By 2006/7, quantitative restrictions applied to about 3.5 percent of all tariff lines, covering such items as arms and ammunitions, live animals, and mineral products. The reported degree of tariff reduction clearly understates the liberalization of the import regime, as the removal of quantitative restrictions was surely even more significant for many items.

After the decision to remove import prohibitions on consumer goods imports, there was considerable anxiety within India as to the possible impact of removal of QRs on Indian industry. Two sets of measures were taken. On one hand, about 300 products were designated as "sensitive", and a "war room" was established in the Ministry of Commerce to monitor imports of these items. These included such items as cotton, edible oils, automobiles, and products

²⁴ Some tariffs have in fact been raised, as is evident by the increase in tariffs on imports of agricultural goods. Binding Indian tariffs at the actual applied rates would increase certainty for producers, but the GOI has thus far insisted on maintaining its latitude and not binding its tariff rates, a point of contention in the Doha Round of trade negotiations. Tariffs are legislated annually in the Indian budget. The simple average bound tariff for agricultural products was 114.2 percent, while that for nonagricultural products was 32.9 percent.

produced by small-scale industry. Over time, anxiety diminished and monitoring seems to have diminished, if not entirely halted.

The other set of measures had more effect. Resort to anti-dumping (AD) remedies accelerated markedly. For the years 2002 through 2005, there were 176 AD investigations and AD measures imposed in 163 of them. Of these, there were 80 initiations in 2002, and fewer than 25 in 2004 and 2005, with 8 cases initiated in 2006. The resort to AD measures appears to have dropped substantially. Over the 2002-2005 period, the largest number of AD cases was for chemicals and chemical products (41 percent of the total), and the country most targeted in AD cases was China (22 percent of the cases).

Whereas the Indian economy had been one of the most closed in the world prior to 1991, the removal of quantitative restrictions, the reduction in tariffs, the managed float maintaining the real exchange rate, and other measures all made India far more open. The additional incentives for exporting provided by the removal of quantitative restrictions on needed imports, the much-lowered tariffs and the more attractive exchange rate all contributed to a sea change.

But the trade regime was not the only aspect of economic policy that changed. A number of measures were adopted for the domestic economy which increased efficiency for all economic activities, and thus made export producers more competitive. These included financial reforms, improving the functioning of the financial system, telecoms reform, elimination of restrictions on large industrial houses (the MRTPA), gradual removal of industries from the SSR list, relaxation of restrictions on foreign direct investment, removal of requirements for firms to have investment and capacity licenses, tax reforms (including importantly the shift from excise tax rates ranging from single digit to 40 percent to a single VAT rate of 16 percent with relatively few

exceptions²⁵) and some simplification of export and import procedures. Many of these proceeded in several steps, the first steps coming in the early 1990s. Others took place later: some in several steps, others in one major step: telecoms reform, for example, was successfully implemented in 2001 (after a false start earlier); while some other reforms constituted a gradual loosening of controls, telecommunications were completely transformed after 2001.

Some controls and regulations from the old system, however, remain firmly entrenched. Those include the labor laws, discussed earlier, public ownership of manufacturing enterprises and commercial banks where a few, but not many, steps were taken; and agriculture. Even after reforms, imports of most grains (Food Corporation of India), oil (Indian Oil Corporation), and urea remained canalized.²⁶ Tariffs remain at rates higher than those in most emerging markets, and a large, although reduced, number of procedures and bureaucratic controls still exist. Infrastructure capacity, especially in power and transport, remains inadequate. Commercial banks are almost entirely in the public sector.

Before attempting an assessment of current policies and potential changes needed for sustaining or accelerating growth, it is worthwhile to examine the evolution of the trade sector to date.

THE EFFECTS OF REFORMS

In a domestic (or global) economy where many changes are taking place simultaneously, it is always difficult to single out the role of individual policy changes. Conditions in the world economy, demographic changes, delayed reactions to earlier policy shifts, and even changes in per capita income all affect economic outcomes. That generalization is valid for any assessment of the role of reforms in the trade and payments regime in India's subsequent economic

²⁵ See Acharya (2006), Chapter 5 for a comprehensive account.

²⁶ The WTO TPR (2007) for India reports that no information was notified to them after 2001. (P. 60) 67% of all imports had been canalized in 1980-81, and by 1996-97 19 percent were canalized.

performance. It is not possible to assign any percentage of the improved Indian economic performance to any single reform or set of reforms. What is certain, in the Indian case, is that the Indian economy changed from being one of the more autarkic in the world to being reasonably open, and that the growth rate accelerated markedly. The performance of exports of goods and services, and other receipts in the balance of payments, clearly could not have happened without the changes that were made in the trade and payments regime, and were no doubt improved by other reforms that were undertaken. The result was that the trade and payments regime and its effects were no longer the binding constraint on Indian economic growth. Beyond that, of course, they contributed to increased efficiency and productivity in resource use.

In this section, the performance of exports and imports of goods and services is first reviewed. Thereafter, the behavior of the major components of the capital account is examined.

A good starting point is the overall growth of foreign exchange earnings. The response of merchandise exports, as seen in Table 2, was marked, as they rose from US\$18 billion in 1990/91 to US\$120 billion in 2006/7. That constituted an average annual rate of growth of dollar export earnings of just over 13 percent. Export growth was significantly above the rate of growth of GDP: exports as a percentage of GDP rose from about 6 percent at the time of the crisis in the early 1990s to 13.5 percent by 2006/7.

But, rapid as the growth of merchandise exports was, the growth of service receipts was even more so. As can be seen in Table 4, receipts from services rose from less than \$5 billion in the early 1990s to well over \$75.4 billion by 2006/7. The composition of merchandise and service exports and imports is discussed further below.

Of course, growth of imports was rapid, too. This was in response both to rising real incomes and to import liberalization. After 2002/03, imports of goods and services grew at an

average annual rate of over 25 percent, and by 2007/8 stood at about 26 percent of GDP (data from Economic Survey 2007/8, Table 0.1).²⁷

The increase in foreign exchange receipts changed the current account from a deficit of around US\$4 billion (in the 1990s) to a surplus of over US\$8 billion by 2003. By 2005, with rapid growth of imports of goods and services, the current account had turned negative once again, but foreign exchange receipts from capital inflows exceeded the current account deficit. Indeed, foreign exchange reserves built up (to US\$300 billion in 2008) to a very comfortable position.

Manufactures constituted 69.8 percent of total merchandise exports by 2005/6 (WTO 2007, P. 15), while agricultural exports had fallen from over a quarter of exports in the 1980s to just below 10 percent by 2006/7. . Indeed, the share of manufactures in exports fell after 2000: it had been 76.5 percent in 2000/01. The top exports were nonmetallic mineral manufactures (SITC 66, 14.9 percent)²⁸, textiles and apparel (SITC 65 and 84, 21.0 percent), petroleum and products (SITC 33, 6.3 percent) and miscellaneous manufactured articles (SITC 89, 5.2 percent).²⁹ These were much the same groups of commodities that were the largest exports in earlier years.

Although manufactured exports have grown rapidly, no particular category or categories of manufactures had experienced markedly rapid growth. Indian exports have continued to grow in most categories, but there has been no evident “engine of growth” among them. It is noteworthy that exports of goods produced using relatively large amounts of unskilled labor have

²⁷ Trade data from the Reserve Bank of India (balance of payments data) and customs data from the Directorate General of Commercial Intelligence and Statistics (DGCI&S) diverge, sometimes markedly. In 2000/01, for example, RBI data showed imports to have been US\$57.9 billion while DGCI&S showed imports to have been US\$50.5 billion. See Table 6.3 of Ministry of Finance 2006-07 for a comparison over 9 years. For comparability over time, Ministry of Finance data were used.

²⁸ In Indian statistics, gems and jewelry are reported separately, and constituted over 15 percent of exports in 2004/5 and 2005/6. In international statistics, much of this shows up in nonmetallic mineral manufactures.

²⁹Data are from Panagariya (2008, P. 265) and are not entirely consistent with WTO (2007) data.

not grown more rapidly than they have. We return to this consideration in assessing future prospects and the needs for further reforms.

On the import side, in 2005/6, capital goods constituted 12.1 percent of total merchandise imports, fuel 36.2 percent, food and allied products 3 percent, and other manufactures 45.6 percent. Oil and its derivatives have sharply increased their share of total imports with the price increases of the past few years, and are estimated to have been about one third of total imports by the April-October semester of 2006-7, although growth seems to have slowed down thereafter.

The dramatic changes in components of international transactions, however, came with services and with the capital account, as seen in Table 4. In 2006-07, software services constituted 42.9 percent, and non-software business services were 25.3 percent of total services.³⁰ The spectacular growth of IT exports of services (often referred to as outsourcing) was the most rapid and most visible change in India's position vis-à-vis the world. Unlike manufactures, the growth rate was spectacular, and India's growth rate of 36 percent was the highest in the world in 2006, having by that time a 2.4 percent share of the world market and having become the 13th largest supplier in the world.

The success of business service exports has been widely heralded. India's share of global commercial services exports was 2.7 percent in 2006 and it was ranked tenth in the world. By 2006/7, commercial services were about 60 per cent of the value of merchandise exports. The future prospects for commercial services exports remain excellent, although complaints are beginning to be heard about a shortage of sufficiently skilled workers and congestion in cities such as Bangalore.

³⁰ In 2006/07, services exports of travel and transport were respectively 12.0 and 10.6 percent of the services total. Financial service exports were less than 4 percent of total exports in 2006/7 but were growing very rapidly: the growth rate was 136 percent in 2005/6 and 140.9 in 2006/7.

The IT industry began developing in India in the late 1980s, and rapidly became a highly visible symbol of India's emergence into the world economy. It is difficult to assess the reasons for the success of the industry. The fact that it was not heavily dependent on Indian infrastructure (being able to transmit services via satellite) certainly gave it an advantage over manufacturers who might otherwise have had to depend on roads and ports to export their goods. But other factors also contributed. Also, the reforms of telecoms were important for the industry. Because it was a start-up industry, few of the controls and regulations surrounding other Indian economic activities were relevant for IT firms.³¹ The reforms in telecommunications were clearly important. In addition, the labor needs of the IT sector consisted largely of skilled workers, coming largely from the Indian Institutes of Technology. Regulations surrounding the employment of labor were therefore largely not binding because of the skill levels of the requisite employees.

Imports of services have grown alongside the growth of merchandise imports, but growth has been steady and there has not been a standout component, as has been true on the export side. India has persistently run surpluses on trade in services. Overall, invisibles (services, investment income, and transfers) have increased in importance. For 2005/06, receipts were 6.9 percent of GDP (having risen steadily from 2.4 percent of GDP in 1990/91) while payments were 6.9 percent of GDP.

Just as virtually all components of the current account have shown significant growth since the reforms, capital account transactions have also grown rapidly. It will be recalled that foreign direct investment (FDI) regulations were relaxed considerably after 1990/91. Changes included gradually increasing the percentage of foreign ownership permitted until it finally

³¹ Once the IT firms started exporting, they were exempted from a number of regulations and received the same privileges as other exporters.

reached 100 percent, the speed with which new investments were approved, and the expansion of the list of industries in which FDI could occur so that investment can take place in all industries except for a few on a “negative list”. Similarly, for portfolio investment, there were tight restrictions on equity ownership until the crisis, with portfolio investment standing at just 2.8 percent of the total in 1992. Restrictions were greatly relaxed thereafter, however, and Indian companies may raise capital through both the American and European markets.³²

The result was a gradual increase in private capital inflows, although they have remained small relative to capital inflows in some other rapidly growing emerging markets, notably China. In 2006/07, it is estimated that total net capital inflows, at US\$46 billion, were 5.5 percent of GDP, up from 3 percent the preceding year. Whether this increase reflected a change in trend, or was a continuation of large year to year fluctuations, remains to be seen. In addition to capital inflows, there have been some headline-making acquisitions of foreign firms by Indian companies, and India’s participation in international capital markets is widely recognized.

Thus, India’s integration into the world economy in 2007/08 was much greater than had been the case in earlier years. That the reforms were successful in inducing larger volumes of flows of goods, services, and capital not only absolutely but as a share of GDP cannot be questioned. Whether they have been sufficient to assure sustained growth is a question to be addressed in the next section.

Indian economic growth has certainly accelerated: after experiencing growth rates of over 7 percent in the mid-1990s and then a slowdown, growth rates have again increased and averaged above 8 percent over the past five years. The Indian economy has become one of the most rapidly growing in the world. A reasonable conclusion is that the reforms following the 1990/1991 crisis succeeded in altering the Indian economy’s structure and relationship with the

³² Panagariya (2008, P. 200).

rest of the world and that the reforms of the trade and payments regime were a necessary condition for the improved performance of the Indian economy.

FUTURE PROSPECTS

The rapid growth of exports of both goods and services has undoubtedly contributed significantly to overall Indian economic growth. The performance of the tradables industries was the result both of reforms (exchange rate, dismantling of quantitative restrictions and other impediments to imports, tariff reductions, reduced paperwork, and others) directly affecting the sector and reforms in the domestic economy (such as telecoms) that enabled all producers to become more efficient.

In assessing future prospects for tradables and their contribution to growth, the question is whether growth rates similar to, or above, those of recent years can be achieved under the existing policy regime, or whether a significant portion of growth to date has been the result of once-and-for-all catch-up and sustaining growth will require further measures. There can be no definitive answer to this question, but there are a number of reasons for believing that the rapid growth rate of foreign exchange earnings from goods and services currently being experienced cannot long be sustained without further reforms.

Two background considerations should be borne in mind. First, while Indian economic reforms have been taking place, so, too, have those in other countries. For that reason, achieving competitiveness internationally is not a once-and-for-all activity: it is a moving target as other countries rationalize their economic structures. Second, as per capita incomes rise (and some sources of inefficiency are reduced or eliminated), the economic costs of some remaining distortions grow. For example, when 70 percent of the Indian population derived its livelihood from agriculture, the poor performance of the telecommunications industry, while costly,

nonetheless was far less a constraint on growth than it became in later years. Hence, reforms that may not have been high on the list of efficiency-enhancing measures in earlier years can increase in importance with changes in economic structure.

Some of the issues affecting future trade prospects pertain directly to the tradable sector. Some are highly interrelated with domestic economic concerns, but have a significant impact on the efficiency of actual and potential Indian exportable production. Here, focus is on six: macroeconomic balance; labor market regulations; agricultural interventions; bureaucratic red tape; infrastructure, and the level of tariffs still in effect.

The first concern, macroeconomic balance, has been an issue ever since the early 1990s. While the consolidated (center and states) fiscal deficit fell in the first few years after the crisis, it began rising again after 1996/97, reaching 10 percent of GDP in 2001-2002, and then falling gradually, with a goal of 5.5 percent of GDP in the 2007-08 budget.³³ Government debt as a percentage of GDP rose to 80 percent by 2004-5, and fell slightly thereafter as rapid growth offset increases in debt, but is estimated to remain above 70 percent at the time of writing. As of mid-2008, government expenditures have been set to increase by more than in the budget, due to the increase in civil servants' compensation mandated by the report of the Pay Commission, a decision by the government to forgive a substantial amount of farmers' debt, increased subsidies on fuel and food (to let the state enterprises absorb a major portion of the price increases), and rising interest rates (as the Reserve Bank attempted to counter inflationary pressures).³⁴ The exchange rate has been allowed to depreciate (vis a vis the U.S. dollar) to offset some of the pressure that would otherwise be felt by exporters.

³³ Data from Government of India 2007, Pp. 59-60.

³⁴ As of mid-June, the weekly consumer price index had been announced at over an 11 percent annual rate. Part of this was because of the pass-through of a small part of the oil price increase, but even before that, there was concern with rising inflation. The prospects appear somewhat worse because an election must be held before May 2009.

Much of the government debt is held by Indian banks, and only a small percentage is held abroad. The GOI has, to date, been willing to take the necessary measures to reduce inflation, including fiscal adjustment. Should it do so again in ways that do not compromise the real exchange rate, macroeconomic balance would not be a major consideration for the future of Indian trade and payments. For present purposes, it is therefore assumed that macroeconomic balance will be restored and then maintained in ways that do not reverse the reforms of the trade and payments regime achieved to date. Should that assumption not hold, it would augur poorly not only for the growth of foreign exchange earnings, but for the entire Indian economy.

Labor market regulations were basically untouched among the reforms since the early 1990s. In 2004, there were 46 central and 200 state-labor laws in place (OECD P. 14). Some, such as the basic Industrial Disputes Act and its subsequent amendments, are evidently much more important than others. Nonetheless, even the complexity of labor legislation must represent a hurdle for many firms.

Even when it was decided to permit the states to relax these regulations in the Special Economic Zones, political opposition was great. There are several disturbing indications that labor market regulations are still a significant constraint on the potential contribution that exports could make to overall growth. The first of these is the very small fraction of the labor force employed in the “organized sector”. Employment in private firms in the organized sector was 84.52 million in 2005³⁵, down from a peak of 86.98 million in 1999. Even then, less than 4 percent of the labor force was employed by firms with more than ten employees. (OECD, P. 13) This contrasted with 180 million employed by the public sector (all organized). Organized sector employment, public and private, was around 6 percent of total employment. Moreover, while overall employment was rising, employment in the organized private sector was falling. The

³⁵ Data are from Government of India (2007), Table 3.1. P. A-52.

OECD reported that in industry, there was an average annual 6.5 percent growth of employment between 1997 and 2004, but that there was a net loss of employment in the organized sector of 1 percent per year.³⁶

These numbers imply that since the crisis much of private investment taking place, especially in the organized sector, has been in capital-using, labor-saving technology. These numbers are also consistent with the observation that the composition of Indian exports has not notably shifted toward unskilled labor-using products. India had had a Small Scale Reservation (SSR) policy for years before the crisis, under which over 1100 specified activities were “reserved” for small scale units.³⁷ These units had to have fewer than a specified amount of capital invested cumulatively (the number was changed from time to time and depended on whether the unit used electric power). If they qualified, they were exempt from many bureaucratic regulations and procedures applied to larger firms and benefited from a number of privileges, including preferential credit allocations, preferential procurement, provision of technical services and support by the government, and so on. Larger firms were not permitted to enter into these unskilled-labor using activities or, if they were in them when SSR began, they were not permitted to expand unless a very large share of their increased production was to be exported. Reductions in the list of SSR industries started in the late 1990s and continued in the present decade,³⁸ although there are still about 300 listed SSIs. Because exporting many unskilled-labor intensive goods requires considerable fixed costs and fairly large scales of output

³⁶ Data from OECD (2007, Table 1.6 and P. 121).

³⁷ See Mohan (2002) for an excellent analysis of SSR.

³⁸ Recall that there remain more than 300 items reserved to small-scale producers. But more than 700 items have been dereserved.

it is possible that there will be a delay between the time SS regulations were relaxed and exporting activity increases.³⁹

It is also possible, and perhaps more likely, that the restrictions on employment of labor in the organized sector make starting and/or expanding production of goods using unskilled-labor intensive techniques unattractive. The OECD undertook an extensive survey of labor markets in conjunction with its economic survey and concluded that “India’s federal EPL [employment protection legislation] is highly restrictive for the organized sector that it covers, given its interference in a number of important respects with firms’ hiring and severance decisions.” The OECD also noted, however, that labor turnover was somewhat higher than might have been expected, given the labor laws, but that most turnover was outside the organized sector. It noted the “tendency for large firms to restrain job creation...associated with a marked substitution of capital for labour that is not seen in small firms.” (OECD P. 125) The relative capital intensity of large firms had increased by 21 percent over the period 1998-99 to 2003-04, while in smaller firms it had dropped by 14 percent. The capital intensity of large firms was almost twice that of small firms. The OECD survey also found that the labor share of value added had fallen from 36 percent in the early 1990s to 31 percent in 1999/2000 and 29 percent in 2003/04, with a steeper drop in large firms. It also noted the incentive for firms to remain small (some to take advantage of the privileges of SSR and others to avoid labor laws), and the very skewed distribution of firm size: “...The size distribution of businesses in India is highly skewed toward small units with visible peaks in the distribution of plant sizes at 10 and 20 workers.”⁴⁰ Considerable anecdotal

³⁹ There was also a Monopolies and Restrictive Trade Practices Act which prohibited the 20 largest firms from expanding in all but exceptional circumstances. This meant that some of India’s most efficient enterprises could not expand for export. That legislation was removed from the books in the 1990s.

⁴⁰ Small-scale units are on average much less productive than large-scale ones.

evidence illustrates the extent to which entrepreneurs deliberately disintegrate their business activities into small-scale units.” (OECD, P. 128)

On the basis of the OECD survey and comparable research in other countries, the OECD concluded that “laws governing regular employment contracts in India are stricter than those in Brazil, Chile, China and all but two OECD countries.” (OECD P. 13)

Labor laws that are sufficiently restrictive so that firms avoid employing workers and substitute capital for labor beyond the point at which it is economic are always a source of concern. But when, as in India, a large pool of potential workers are left in low-productivity agriculture and small-scale activities, a huge potential for sustained growth is lost to the detriment of precisely those segments of the labor force most in need of more productive employment opportunities.⁴¹ Poverty reduction could have been more rapid had employment opportunities expanded more rapidly.

Some analysts have suggested that, given the success and rapid growth of the IT sector, India may be “leapfrogging” over the stage of growth in which manufacturing increases its share of value added and employment. However, IT activities do not employ unskilled workers in great numbers.⁴² The rate of absorption of India’s labor force into more productive activities has been relatively slow.⁴³ An acceleration of growth of output and employment in unskilled labor-intensive activities in significant part for the export market could contribute to sustaining, if not accelerating, economic growth and rising living standards.⁴⁴

⁴¹ If labor laws were relaxed, there would remain a challenge of upgrading educational opportunities.

⁴² In any event much of the restrictive labor legislation applies only to manufacturing activities..

⁴³ The OECD estimated that productivity per worker in 2003 (in thousands of Rs. In 1999-2000 prices) was 17.4 in agriculture, 44.7 in other informal sector activities, 432 in private companies, an 320 in public enterprises. The average for the entire economy was 46.5. (OECD, P. 72)

⁴⁴ One of the potential “pluses” for future Indian economic growth is that the Indian labor force will age less rapidly than that in many other countries. For the several decades in which the proportion of the population of working age is rising, India could benefit relative to other countries where the labor force is aging and then declining. However, for that asset to be realized, workers have to be brought in to the more productive sectors of the economy.

It is notable that India has not succeeded in attracting foreign investors to use India as an export platform in many of the unskilled-labor intensive industries that have been attracted to east and southeast Asia. While there is no way of analyzing the reasons for this failure, labor regulations almost certainly have been a significant deterrent.

Such an outcome could also lead to a more rapid reduction in the share of the population dependent on agriculture. But, at the same time, there needs in all circumstances to be improvement in agricultural productivity. Historically, Indian economic policies have discriminated against agriculture. Until the 1990s it is estimated that the producer subsidy equivalent for most Indian agricultural commodities was negative, implying that the prices actually received by farmers was less than they would have been at free trade. While the extent of discrimination against agricultural commodities seems to have diminished somewhat, there is still concern that agricultural policy is not conducive to more rapid productivity growth. There is already some concern that the rate of growth of production of cereals fell below the population growth rate for the period 1990-2007 (Ministry of Finance, 2007-8, P, 156). The average tariff equivalent on imports of agricultural commodities is above 40 percent, and has risen since the crisis. Tariffs of such heights distort production away from crops in which India has a comparative advantage. Measures that increase yields, or that induce changes in cropping patterns toward more profitable commodities, will themselves contribute to rising real incomes and growth rates.⁴⁵

But if, in addition, unskilled labor can be attracted away from agriculture into more productive employment in other sectors, that would contribute still further. With average labor productivity or the whole economy estimated to have been Rs 44,000 (in prices of 1999-2000) in

⁴⁵ Subsidies further distort production. Urea fertilizer is heavily subsidized and used excessively, while potash and nitrate fertilizers are underutilized. The pattern of water usage is also significantly distorted.

2003, productivity in agriculture was estimated to have been Rs.17,000 in that year. If investment were to take place in more labor-using industries, new entrants to the industrial labor force would certainly not have average productivity of Rs. 431,000, but surely it would be well above the productivity of those leaving agriculture. Indian policies toward agriculture seem to have been developed piecemeal. The cumulative result has been that there are subsidies on inputs (which have represented more than 1 percent of GDP in many recent years), while output prices are mostly below international prices.⁴⁶ While agriculture's share of GDP has dropped rapidly over the years, the fraction of the labor force still in agriculture (or in informal sector rural activities) has fallen very slowly. This potentially important resource needs to be utilized more fully, which would entail labor and product market changes, but also the rationalization of agricultural policy itself.⁴⁷

The third concern is that, despite the large strides made in reducing the scope and power of the license raj, there are still a number of hurdles for operating a business and even more for exporting. The World Bank's annual Doing Business 2008, ranked India 120th out of 180 countries in the ease of doing business. India was rated very poorly in dealing with licenses where there are 20 procedures taking 224 days, and costing more than 5 times per capita income. Delays in contract enforcement, and the costs and time involved in closing a business were also areas in which India scored particularly badly. The costs and complexities of the tax structure are also ranked relatively poorly. The labor market restrictions, discussed above, are another area where India does not show up well.

⁴⁶ See Mullen et al (2005) for an analysis and estimate of producer subsidy equivalents by commodity.

⁴⁷ Space limitations preclude a discussion of India's stance in the WTO and the Doha Round of trade negotiations. Despite the evident need for rationalization of agriculture, the GOI has insisted that it requires special protection for farmers and their incomes. Yet, as a whole, agriculture is negatively protected, as already seen. Rationalization of world agricultural production would doubtless enhance India's opportunities in the context of Indian agricultural liberalization. See Mattoo and Stern (2003) and the papers therein for an analysis.

India has moved up in the rankings on ease of doing business since the evaluation was first published, but other countries are reforming so that improvements must be made simply to stand still. For improving India's competitive position, changes would need to be made even more rapidly.

The inadequacies of India's infrastructure could also negatively affect India's trade prospects and are a cause for concern.⁴⁸ High costs and long durations of transport to ports and in shipping and offloading cargo obviously raise costs to Indian firms and make them less competitive than they otherwise would be. The most extreme problems relate to the supply of electrical power. Brownouts and outages have been a constant feature of economic life in India, but their severity appears to be increasing, and efforts to increase capacity must be dramatic to maintain the pace of the growth of demand at the present juncture. Most businesses resort to installing their own generators, which adds to their costs and reduces competitiveness and productivity. For improving international competitiveness, as well as for economic growth in all lines of activity, this will have to be addressed. Without an acceleration in the rate at which infrastructure capacity is increasing, costs of congestion, delays, power outages, and other infrastructure bottlenecks would likely increase, and act as a brake on economic growth.

Since the focus of this essay is on the trade sector and its role in the Indian economy, it is appropriate to leave needed further reforms in the trade sector until last. As already seen, the transformation of the trade and payments regime has been huge. The disappearance of import licensing itself was of enormous importance. Reduction of tariffs has taken India from near-autarkic status to being in the middle of the pack with respect to trade openness. But, as officials themselves recognize, further reductions in trade barriers are needed. Reaching ASEAN levels of

⁴⁸ For a more detailed discussion of the impact of poor infrastructure on India's trade, see Srinivasan and Tendulkar, (2003), pp.112-123.

tariffs by 2010 would certainly further spur the growth of exports and imports. Further reductions in paperwork and approvals needed for importing and exporting would also have a high payoff.⁴⁹ And tariffs in agriculture remain high. In each of these arenas, reforms would contribute to sustained growth of output and improvements in productivity in the traded goods sector.

CONCLUSIONS

There is no doubt that India's economy has been transformed since the early 1990s, and there is perhaps no dimension of economic activity that has been as profoundly affected as international trade. The very fact that exports now constitute close to 15 percent of GDP, contrasted with their former 6 percent, is sufficient proof. But the facts that quantitative restrictions are a thing of the past, that tariffs have been reduced to small fractions of their earlier rates, that the exchange rate regime has been much more stable and realistic for traders, and that foreign investment is now substantially freer than it was are all testimony to the changes that have occurred.

The real questions concern the next level: whether current policies will remain largely unchanged, or whether further reforms can be implemented. If the former, it is likely that the growth rate of foreign exchange earnings will taper off, although there is little or no significant risk of returning to the autarkic regime of earlier times. If the latter, and reforms are undertaken

⁴⁹ India has been an active supporter of the multilateral system, but has been a leading spokesman for the "rights" of developing countries to liberalize slowly and of special and differential treatment. In the Doha Round, India has insisted that poor farmers should not be hurt by having to lower Indian tariffs, ignoring the fact that for many agricultural commodities, domestic prices are below international prices.

A far better stance for the country would be to offer more aggressive lowering (and binding) of tariffs and agricultural protection, but to insist on further market access and reduced protection for all activities in the industrial countries.

India has, since about 2000, begun entering into preferential trading arrangements. To date, these have been in the negotiating or early implementation phase, and most agreements have anyway been with relatively small trading partners. India's future interests clearly lie in an open and growing multilateral trading system.

especially in the areas just indicated, there is every reason to believe that India's current economic performance could even be surpassed.

Table 1. Structure of Tariffs (pre-crisis) 1990/91 and 1993/94

	1990/91		1993-94	
	Standard	Collected	Standard	Collected
Average (percent)				
All goods (unweighted)	144	125	85	71
Agriculture	134	113	83	43
Mining	127	100	85	70
Manufacturing	145	126	85	73

Source: GATT, Trade Policy Review. India. 1992, Volume 1. P. 36

Table 2. Growth of Exports and Shares in World Trade,
India, China, and Korea, 1953 to 2006

(US\$ billions for exports; shares in percentage)

Year	Indian Exports		Chinese Exports		Korean Exports	
	Value	Share	Value	Share	Value	Share
1953	1.1	1.4	1.0	1.3	.04	.05
1960	1.2	1.1	2.5	2.1	.03	.02
1965	1.7	1.0	2.6	1.5	.17	.10
1970	2.0	0.7	2.3	0.8	.83	.28
1975	4.4	0.5	7.7	0.9	5.1	.6
1980	8.6	0.5	18.1	0.9	17.5	.9
1985	9.1	0.5	27.3	1.5	30.3	1.7
1990	18.0	0.5	60.9	1.8	64.9	2.0
1995	30.6	0.6	149	3.0	125	2.5
2000	42.4	0.7	249	3.9	172	2.7
2003	59.0	0.8	438	5.8	194	2.6
2006	120.0	1.0	969	8.0	325	2.7

Source: International Monetary Fund, International Financial Statistics Yearbook, 1983, 1991, and International Financial Statistics May 2008. All data are from World Tables, Exports.

Table 3. Tariffs in 1997/98, 2001/2 and 2006/7

	1997/8	2001/2	2006/7
Average unweighted tariff			
Agriculture	26	41	43
Mining	27	na	na
Manufacturing	36	31	14
Whole Economy	35	32	16
Average weighted tariff	35	32	15

Source: WTO, Trade Policy Review. India. 1998, P. 46; 2002, P. 32-3 and 2007, P. 39.

Note: Table 1 gives standard and collected (average revenue to take account of exemptions).

By 2001/2 some exemptions had been eliminated and as tariff levels were reduced the value of exemptions was less. They continued, however, and the WTO reported that applied tariffs in 2006/7 averaged about 10 percent..

Table 4. Balance of Payments, 1990 to 2007

(percent of GDP)

Year	<u>Exports of</u> Goods and Services	<u>Imports of</u> Goods and Services	Current Account	Capital Account
1990/1	7.3	9.9	-3.1	2.3
1991/2	8.8	9.3	-0.3	1.5
1992/3	9.2	11.1	-1.7	1.6
1993/4	10.2	11.5	-0.4	3.5
1994/5	10.2	12.8	-1.0	2.8
1995/6	11.2	14.5	-1.7	1.3
1996/7	10.8	14.4	-1.2	3.0
1997/8	11.0	14.5	-1.4	2.5
1998/9	11.5	14.1	-1.0	2.0
1999/0	11.9	15.0	-1.0	2.5
2000/1	13.5	15.9	-0.6	1.9
2001/2	13.0	14.7	0.7	1.8
2002/3	14.6	16.0	1.2	2.1
2003/4	14.9	16.4	1.7	2.1
2004/5	13.4	18.7	-0.4	4.5
2005/6	14.3	21.4	-1.3	3.4
2006/7	15.4	23.0	-1.2	5.6
2007/8				

Source: Ministry of Finance, Economic Survey 2007-08.

Table 5 Nominal and Real Exchange Rates 1985 to 2007

(1993-94=100)

	Nominal	Real
1985	341.7	194.3
1986	284.2	175.3
1987	250.7	164.1
1988	225.5	156.4
1989	202.3	143.3
1990	176.8	132.3
1991	136.3	113.8
1990/91	169.1	128.8
1991-92	127.9	109.1
1992-93	107.4	98.7
1993-4	100.0	100.0
1994-5	98.9	104.3
1995/96	91.5	98.2
1996/97	89.3	96.8
1997/98	92.0	100.8
1998/99	89.1	93.0
1999/2000	91.0	96.0
2000/01	92.1	100.1
2001/02	91.6	100.9
2002/03	89.1	98.2
2003/04	87.1	99.6
2004/05	89.8	100.1
2005/06	89.9	102.4
2006/07	85.9	98.5
2007/08		

Sources: 1985 to 1993-4 from Acharya (2006) Table 3.12. 10 country index. His data taken from Economic Survey 2001/2. 1994-5 to 2007-08 36 country index. Weights are India's exports to each country.

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