The International Context

16.1 There has been a phenomenal growth in the exports of both goods and services during the Tenth Five-Year Plan period. With the accelerated pace of liberalisation and globalisation in the world economy, India has benefited from the increased opportunities especially in the information technology (IT), IT-enabled services (ITES), knowledge related sectors and the increasing move towards global sourcing of manufactures. One of the main benefits of trade liberalisation has been a marked increase in the pace of modernisation and technological upgradation of Indian industry. The consequent improvements in efficiency have enabled Indian industry to increase its share in world exports, which has substantially mitigated the adverse effects of the domestic cyclical slow down. Another beneficial effect of trade liberalisation has been to keep inflation under check. The possibility of import of goods from abroad after quantitative restrictions were lifted introduced an additional competitive dimension in Indian markets and eased domestic supply constraints. In addition, access to cheaper import of raw materials and intermediates has led to reductions in domestic production costs and prices, which has further strengthened efficiency in Indian industry. Consequently, during the last year, exports in April- February 2004-05 have grown by 27 per cent in US dollar terms on top of an export growth rate of 15.5 per cent in the previous year.

16.2 **Trade and investment policy reform:** Since the introduction of economic reforms in 1991-92, impressive trade policy reforms have been carried out in the country. The peak level of tariff on industrial products had already been brought down from 300 per cent prevailing in 1991-92 to 35 per cent in 2001-02. During the Tenth Plan, the general peak rate has been further reduced in successive years. In the Union Budget for 2005-06 it has been brought down to 15 per cent on all non-agricultural products, with a few exceptions. These changes have further reduced the tariff average from 22.4 per cent in 2004-05 to 18.3 per cent in 2005-06. However, as shown in Table 16.1, despite these reductions, the average applied tariffs in India are still higher than those of most developing countries at a comparable stage of development and much higher than those of the Organisation of Economic Cooperation and Development (OECD) countries.

16.3 At the commencement of economic reforms, import controls were withdrawn on virtually all raw materials, intermediates and capital goods. With effect from 1 April 2001, virtually all the remaining quantitative restrictions had been eliminated, except those maintained for protecting human, animal or plant life and for other reasons specifically provided for in the World Trade Organisation (WTO) Agreement. The process of liberalisation continued during the Tenth Plan and 83 products were placed on open general licence (OGL) in 2002-03, 69 in 2003-04 and 42 in 2004-05. Cash Compensatory Support for exports was given up in 1991-92 itself and the phase-out of income tax rebate for profits from exports, under 80HHC of the Income Tax Act, commenced shortly thereafter. The phase-out of the income tax benefit for export profits was completed in 2003-04 and after that the main export incentives being continued are those that are aimed at ensuring that indirect taxes and charges are either not levied on exports or are fully rebated.

16.4 One aspect of trade policy, though fully WTO compatible, has invited adverse comment. There was a big increase in the use of anti-dumping measures in the country. From

Table 16.1
Country profile of trade and tariff

Country	Trade to GDP (%)	Bound Tariff (%)			Statutory/Applied Tariffs (%)		
		All Goods	Agri. Goods	Non-Agri.	All Goods	Agri. Goods	Non-Agri.
India @	**30.7**	**49.8**	**114.5**	**34.3**	**18.3**	**36.9**	**15.5**
Argentina ~	25.1	31.9	32.6	31.8	14.2	10.3	14.8
Australia ~	42.9	9.9	3.2	11.0	4.2	1.1	4.6
Brazil#	26.2	31.4	35.5	30.8	13.8	11.7	14.1
Canada#	83.6	5.1	3.5	5.3	4.1	3.1	4.2
Chile ~	64.1	25.1	26.0	25.0	6.0	6.0	5.9
China#	50.9	10.0	15.8	9.1	12.4	19.2	11.3
EU*	28.7	4.1	5.8	3.9	4.2	5.9	4.0
Indonesia#	77.0	37.1	47.0	35.6	6.9	8.2	6.7
Japan#	21.1	2.9	6.9	2.3	3.2	7.3	2.7
Korea Rep. of ~	73.0	16.1	52.9	10.2	11.6	42.1	7.0
Malaysia +	218.1	14.5	12.2	14.9	7.3	2.1	8.1
Pakistan ~	39.1	52.4	97.1	35.3	17.1	20.4	16.6
S. Africa#	58.7	19.1	39.8	15.8	5.8	9.1	5.3
Thailand +	124.5	25.7	35.5	24.2	16.1	29.0	14.2
U.K.*	55.8	4.1	5.8	3.9	4.2	5.9	4.0
U.S.#	24.1	3.6	6.9	3.2	3.9	5.1	3.7

Source: WTO Website Statistics Database
+ Applied Tariff Rates for 2001. # Applied Tariff Rates for 2002. @ Applied Tariff Rates for 2005
- Applied Tariff Rates for 2003. * Applied Tariff Rates for 2004.

an average of five cases initiated annually in the period 1994-96, the number had risen to 30 every year in the period 2001-03. In both 2001 and 2002, India was the leading user of anti-dumping measures among WTO members. In 2002, it accounted for about 25 per cent of the cases initiated, the second being the United States at about 11 per cent. However, the trend has now reversed and the number of initiations fell to 14 in 2003-04 and further to 9 in 2004-05 (up to 2nd November 2004).

STATUS OF THE EXTERNAL SECTOR

Exports

16.5 The Tenth Plan had projected that exports would increase from $ 44,915 million in 2001-02 to $ 80,419 million by 2006-07, showing a compound growth rate of 12.4 per cent during the Plan period. In 2003, India stood at 31st position with a share of 0.7 per cent of world exports (Table 16.2). This follows a growth rate of over 20 per cent achieved in each of the previous two years. The trend indicates that India's exports will exceed the target set in the Tenth Plan. The destination pattern of India's exports shows that exports to Asian countries increased sharply, indicative of the role of improvement in the macro-economic performance in the region in generating demand. Among the advanced economies, exports to France, Germany, the United Kingdom increased sharply. Exports to the United States also increased, although at a slower pace. Exports to Japan declined, while exports to China grew rapidly (Table 16.3)

16.6 India's merchandise exports are predominated by manufactured items, which

Table 16.2
Leading exporters in world merchandise trade 2003

Rank	Country	Value(Billion $)	Share (%)
1	Germany	748.3	10.0
2	United States	723.8	9.6
3	Japan	471.8	6.3
4	China	437.9	5.8
5	France	386.7	5.2
17	Russian Federation.	134.4	1.8
25	Brazil	73.1	1.0
31	**India**	**56.0**	**0.7**
38	South Africa	36.5	0.5
50	Kuwait	19.4	0.3
	World^	7503.0	100.0

^ includes significant re-exports
Source: International Trade Statistics, 2004, WTO

Table 16.3
Export Destinations

(Value in $Million)

Country			Percentage	
	2002-03	2003-04	Growth	Weight
United States	10895.76	11459.97	5.18	18.06
UAE	3327.48	5079.98	52.67	8.01
Hong Kong	2613.33	3250.32	24.37	5.12
United Kingdom	2496.41	3033.24	21.50	4.78
PR China	1975.48	2959.22	49.80	4.66
Germany	2106.68	2522.39	19.73	3.98
Singapore	1421.58	2116.54	48.89	3.34
Belgium	1661.84	1805.84	8.67	2.85
Japan	1864.03	1714.34	-8.03	2.70
Italy	1357.08	1703.82	25.55	2.69
Bangladesh	1176.00	1646.08	39.97	2.59
Sri Lanka	920.98	1320.39	43.37	2.08
Netherlands	1047.91	1277.73	21.93	2.01
France	1074.09	1289.80	20.08	2.03
Indonesia	828.08	1123.22	35.97	1.77

Source: Deptt. of Commerce

accounted for more than three-fourths of its total exports during the 1990s. This is also the pattern of global trade. Within manufactured items, there has been a considerable change in the relative importance of different products; the products which increased their share were chemicals and allied products, engineering goods, readymade garments, textile yarn, fabrics, made-ups and gems and jewellery. With increasing confidence in manufacturing, there has been a decline in the exports of primary products since the 1990s and India has been moving up the value chain. The unit labour cost of manufacturing exports in India is one of the lowest among the developing countries and this comparative advantage has been enhanced by the productivity growth since the 1980s, which has outpaced the real wages in this sector. With sizeable growth in exports of auto-parts and pharmaceutical products it has been demonstrated that India has an emerging competitiveness in skill intensive manufactures.

16.7 Prospects for future growth in manufacturing are promising. In a study commissioned by the Confederation of Indian Industries (CII) in October 2004, it has been estimated that exports of manufactures can be raised from the level of $ 40 billion in 2002-03 to $ 300 billion by 2015. An additional spin-off of export production is that it would generate additional employment and domestic demand for manufactured goods by the new income earners. The overall manufacturing output including export has been estimated in that study to grow from $ 360 billion in 2002-03 to $ 1,400 billion by 2015. Consequently, the estimate of job creation in the manufacturing and allied sectors is of the order of 75-100 million jobs over the next 12 years or approximately 6-8 million jobs per annum.

16.8 Growth of manufacturing, whether for export or domestic consumption, has the additional benefit of providing employment to persons with different levels of skills, including even the unskilled workers. This is because manufacturing has backward and forward linkages with mining, electricity generation and construction activities, all of which can absorb unskilled workers from rural areas with minimal training.

Table 16.4
Leading importers in world merchandise trade 2003

Rank	Country	Value (Billion $)	Share (%)
1	United States	1303.1	16.8
2	Germany	601.7	7.7
3	China	413.1	5.3
4	United Kingdom	390.8	5.0
5	France	390.5	5.0
6	Japan	382.9	4.9
15	Singapore	127.9	1.6
24	**India**	**70.7**	**0.9**
30	Brazil	50.7	0.7
35	South Africa	41.1	0.5
50	Morocco	14.2	0.2
	World^	7778.0	100.0

^ Includes significant imports for re-exports.
Source: International Trade Statistics, 2004, WTO

Imports

16.9 Apart from demand factors, changes in tariff levels strongly influenced imports. India's imports during 2003-04 are valued at $ 77,032 million representing an increase of 25.4 per cent over the level of imports valued at $ 61,412 million during 2002-03. In 2003, India was ranked 24th, with a share of 0.9 per cent of world imports (Table 16.4). The country's effort to diversify its trade is reflected in the more rapid growth of imports from non-traditional sources. Imports from USA, UK, France and Germany increased by less than 45 per cent, while imports from other countries has been growing much faster (Table 16.5).

External Sector Projections

16.10 The Tenth Plan had projected 8 per cent growth in gross domestic product (GDP) with increase in investment rate to 32.3 per cent by 2006-07 as against the base year investment rate of 24.3 per cent. The savings ratio was expected to increase to 29.4 per cent by 2006-07, as against a level of 23.5 per cent in 2001-02. The implied current account deficit seen in terms of the gap between investment requirement and domestic savings was an estimated 2.9 per cent of GDP by 2006-07 and an average 1.6 per cent for the Plan as a whole.

16.11 During the first two years of the Tenth Plan period, the growth in GDP at market prices has been 6.4 per cent. As per the present projections, the GDP is expected to grow at an average 7.26 per cent during the remaining years of the Plan period. On this basis, the required investment rate would be 25.8 per cent by 2006-07 and the savings ratio is expected to increase to 26 per cent.

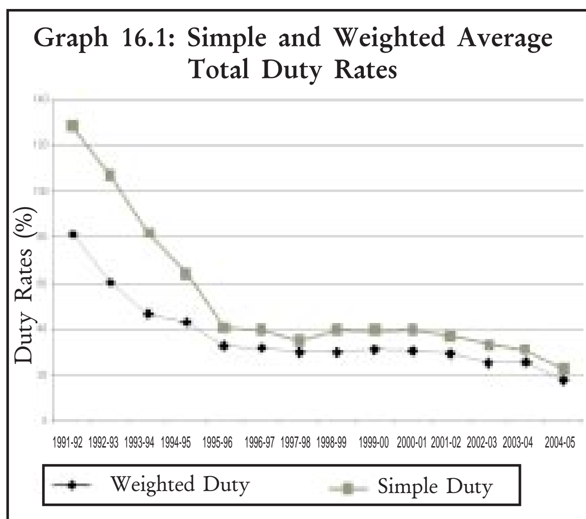
16.12 Looking at the behavioural side of the current account balance (CAB) and the trend in exports and imports during first two years

Table 16.5
Import origins

($ million)

Country	Value		Percentage	
	2002-03	2003-04	Growth	Weight
United States	4443.6	4862.6	9.43	6.31
PR China	2792.0	4048.3	45.00	5.26
United Kingdom	2777.0	3176.0	14.37	4.12
Germany	2404.5	2911.3	21.07	3.78
Japan	1836.3	2642.3	43.89	3.43
Australia	1336.8	2620.4	96.0	3.40
Korea RP	1522.0	2453.6	61.21	3.19
Indonesia	1380.9	2096.2	51.81	2.72
UAE	957.0	2059.7	115.23	2.67
Malaysia	1465.4	2045.2	39.56	2.65
Singapore	1434.8	2030.0	41.48	2.64
Hong Kong	972.6	1492.6	53.46	1.94
France	1094.2	1054.5	-3.62	1.37
Russia	592.6	959.5	61.91	1.25
Saudi Arabia	504.7	737.2	46.06	0.96

Source: Deptt. of Commerce



Graph 16.1: Simple and Weighted Average Total Duty Rates

of the Plan, projections have been re-worked for the remaining years of the Plan period. The determining variables for exports and imports are the same as those taken earlier for the Tenth Plan period and results given in Table 16.6. Here the growth in GDP at factor cost and at current prices has been taken at the rate of 7.47 per cent, 7.66 per cent during 2005 to 2007 respectively along with a year-to-year inflation of 5 per cent.

16.13 Graph 16.1 shows the trend in customs tariffs during the period 1991-92 to 2004-05. It may be seen that the simple average of total duty rates has been reduced substantially from 128 per cent in 1991-92 to 18.3 per cent in 2005-06. With reduction in duty rates, the gap between simple and weighted average duty rates has narrowed. The weighted average duty rate was 81.4 per cent in 1991-92 and has come down to 14.3 per cent in 2005-06. The projections in Table 16.6 indicate that imports would increase to $ 1,40,207 million by 2006-07 if average tariffs are reduced to 15 per cent. This would imply an increase of 20 per cent average for the Tenth Plan period as a whole, with an elasticity of 1.6. Exports would increase to $ 94,896 million by 2006-07, i.e. at an average 16.2 per cent during the Plan period and elasticity of 1.3. The rates of growth of imports and exports are higher than projected at the beginning of the Plan period. The trade balance is worse than that projected initially owing to the faster growth of imports.

16.14 However, it is important to note that there has been substantial spurt in oil prices from an average landed cost of $ 20.73 a barrel in 2001-02 to an average of $ 36.20 a barrel in the first six months of 2004-05 and further to $ 43.4 a barrel in October 2004. As on 14 March 2005, the Organisation of Petroleum Exporting Countries (OPEC) Reference Basket prices (arithmetic average of seven selected crudes) have increased to $ 49.59 from the

Table 16.6
Current account balance

(US $ Million)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	Total	Growth Rate (%)
GDP	436459	461019	548352	617628	694646	782588	3104232	12.4
Exports	44703	53774	64723	72468	82512	94896	368374	16.2
Imports	56277	64464	80177	102912	121331	140207	509091	20.0
Trade Balance	-11574	-10690	-15454	-30444	-38819	-45311	-140718	
Trade Balance/GDP	-2.7	-2.3	-2.8	-4.9	-5.6	-5.8	-4.5	
Invisibles – Receipts	36737	41925	52982	59210	67401	73300	298972	14.8
Invisibles – Payments	21763	24890	26967	29165	32082	35290	149377	10.4
Invisibles (Net)	14974	17035	26015	30045	35319	37610	146023	20.2
Current Account Balance	3400	6345	10561	-399	-3500	-7701	5306	
Current Account/GDP	0.8	1.4	1.9	-0.1	-0.5	-1.0	0.2	

Table 16.7
Inflow on capital account

(US $ Million)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	Plan Average
External Assistance (Net)	1117	-3128	-2742	1410	1329	1572	-312
Commercial Borrowings (Net)	-1585	-1692	-1526	3200	-3740	4400	128
Non-resident Deposits (Net)	2754	2978	3642	2500	2750	2750	2924
Rupee Debt Service	-519	-474	-376	-600	-600	-600	-530
Foreign Direct Investment (Net)	4734	3217	3420	4300	4950	5600	4297
Portfolio Investment	1952	944	11356	8500	6500	7500	6960
Foreign Investment Inflows (Net)	6686	4161	14776	12800	11450	13100	11257
Other Capital Flows (Net)	781	578	2759	1000	1000	1000	1267
Capital Account Total (Net)	8551	10840	20542	20310	12189	22222	17221

peak observed in October 2004. An average crude oil price of $ 40 a barrel for 2004-05 as a whole and also in the remaining two years of the Tenth Plan has been assumed. In this scenario, the oil imports would increase to $ 31.3 billion by 2006-07, as against of $ 16.2 billion the initial Plan estimate at oil prices that prevailed in 2001-02. Correspondingly, the total import bill may reach $ 156.2 billion.

16.15 The projections for flow of invisibles are based on an eight-year trend growth of 14.8 per cent for receipts and 10.4 per cent for payments. The growth in receipt of invisibles at an average 20 per cent during the first two years has somewhat compensated for the trade deficit. In fact, there has been a current account surplus at present although a deficit may arise during the last two years of the Plan. The average CAB for the Plan as a whole is projected at $ 7,540 million and a CAB to GDP ratio of 0.46.

16.16 The projections of inflow on capital account are at Table16.7 and are broadly in line with the future commitments and resource utilisation. The foreign direct investment (FDI) inflows are expected to reach $ 5,600 million in 2006-07 from the present level of $ 3,420 million in 2003-04. There has been a huge surge in the relatively volatile portfolio investment during 2003-04, reaching $ 11,356 million, but it is expected to stabilise at $ 7,500 by 2006-07. The total inflows on capital account are expected to reach $22,222 million in the last year of the Plan period. Key indicators on the balance of payments are given in Annexure 16.1.

FOREIGN INVESTMENT

16.17 One of the most significant developments in the world economy in the 1990s has been the high level of capital flows. This has taken place due to factors like greater financial liberalisation, improvement in information technology, emergence and proliferation of institutional investors such as mutual and pension funds etc. Private capital flows are concentrated in a few key emerging market economies (EMEs), but India is now viewed as part of this group and has, therefore, benefited from these flows. In recent years, the country's dependence on aid has greatly diminished and the capital account has been dominated by flows in the form of FDI, portfolio investments including American Depository Receipts (ADR)/Global Depository Receipts (GDR) issues, external commercial borrowings, non-resident deposits and special deposit schemes such as India Development Bonds (IDBs), Resurgent India Bonds (RIBs) and India Millennium Deposits (IMDs). With liberalisation and structural adjustment since 1991, the country has embarked on a policy of encouraging capital flows in a cautious manner.

Table 16.8
FDI: country-wise and industry-wise inflows

(US$ million)

Country / Industry	2001-02	2002-03	2003-04 (P)	2004-05**
Total FDI	**2,988**	**1,658**	**1,462**	**744**
Country-wise Inflows				
Mauritius	1,863	534	381	279
United States	364	268	297	184
United Kingdom	45	224	157	41
Germany	74	103	69	26
Netherlands	68	94	197	5
Japan	143	66	67	2
France	88	53	34	24
Singapore	54	39	15	17
Switzerland	6	35	5	46
South Korea	3	15	22	0
Others	280	227	218	120
Industry-wise Inflows				
Chemical & allied products	67	53	46	38
Computers	368	297	151	121
Engineering	231	262	274	90
Electronics & electrical equip.	659	95	103	52
Finance	22	54	4	6
Food & dairy prod.	49	35	63	10
Pharmaceuticals	69	44	79	132
Services	1,128	509	431	196
Others	395	309	311	99

* : Data in this table exclude FDI inflows under the NRI direct investment route through the Reserve Bank and inflows due to acquisition of shares under Section 5 of the FEMA, 1999.
P : Provisional ** April-July SOURCE: RBI.

The strategy has been to encourage long-term capital inflows, and discourage short-term and volatile flows, in view of their non-debt creating and non-volatile nature. Details regarding country-wise and industry-wise inflows of FDI are given in Table 16.8.

Liberalisation of FDI Policy

16.18 FDI flows are generally regarded as much less volatile than certain other types of capital inflows and there has been a steady liberalisation of policy towards FDI over the past 15 years. The National Common Minimum Programme (NCMP) has endorsed the importance of FDI and has set the target of doubling or trebling this category of flows. A number of steps towards further liberalisation have been taken in the Tenth Plan. A beginning in allowing FDI in agriculture was made when it was permitted up to 100 per cent in the tea

sector, including plantations, through the Foreign Investment Promotion Board (FIPB) route, subject to compulsory divestment of 26 per cent in favour of an Indian partner or the Indian public within five years. The time limit for royalty payment for foreign technology collaboration by joint ventures was removed on 2003-04. In the service sector, the FDI limit has been raised to 100 per cent on the automatic route for petroleum product marketing, oil exploration and petroleum product pipeline and on the FIPB route for natural gas/LNG gas pipeline. For private banking the foreign investment (FDI+FII) limit was raised from 49 to 74 per cent under the automatic route. Foreign banks regulated by a banking supervisory authority in the home country and meeting the Reserve Bank of India (RBI) licensing criteria were allowed to hold 100 per cent equity to enable them to set up a wholly owned subsidiary in India.

16.19 The FDI limit has been eliminated in all except a few areas in the negative list in the manufacturing sector and in the majority of sub-sectors in the service sector. Key service sub-sectors still subject to FDI ceiling are basic telecom services (49 per cent), insurance/insurance-related services (26 per cent), banking and other financial services (26 per cent) and air transport services (49 per cent with no FDI from foreign airlines). Important areas where FDI is not allowed at all are selected business services (legal, accounting and taxation) and retail services.

FDI and FII

16.20 FDI inflows into India are often compared with the much larger FDI inflows to China. However, as various international studies have shown, the FDI flows into India are understated compared to China, because of definitional differences. A committee with representatives from RBI, Department of Industrial Policy and Promotion and the Ministry of Finance, constituted in May 2002, has tried to correct the definition of FDI in India to bring it into conformity with international practice. Earlier, the data on FDI reported in the balance of payments statistics used to include only equity capital. The revised definition includes three categories of capital flows under FDI: promoters' equity capital, reinvested earnings and other direct capital. Even after the revision, inflows into India are about one-tenth of inflows to China. As per the revised figures, FDI during 2001-02 was $ 6.1 billion. FDI flows to India remained subdued during 2002-03 ($ 5.1 billion) and 2003-04 ($ 4.7 billion) in line with the slowing down of FDI flows to the developing countries in general. However, the overall environment in 2004-05 appears to have improved with FII inflows rising sharply.

16.21 Another aspect that needs to be borne in mind is that there are much higher portfolio inflows into India than into China. In 2003-04, portfolio investments into India were of the order of $ 11.36 billion. When a foreign portfolio investor buys shares in the secondary market, the capital of the Indian seller is released for investment elsewhere. Thus the total investible resources for investment into businesses would increase on account of both the FDI and FII inflows. As portfolio investment by FII in well run businesses is also of a quasi-permanent nature, one needs to take a holistic view of total foreign investment as a supplemental source of investible resources in the country.

16.22 The flow of foreign investment is influenced by the overall investment climate in the country. Various indicators of the investment climate have been identified and a number of international organisations rank countries on different criteria. Transparency International ranks countries on Corruption Perception Index and the World Economic Forum ranks countries on the basis of investment friendliness. In the latest World Development Report, 2005, the World Bank estimated a number of investment climate indicators based on expert polls and other surveys. The time taken for certain investment related activities in a few countries are given in Table 16.9. This should be viewed keeping in mind the caveat of the World Bank that "while averages are reported, there are significant variations across firms. The data are not intended for the ranking of countries".

Table 16.9
Investment climate indicators

Time required For	**India**	China	South Korea	United States
Starting a business (Days)	**89**	41	22	5
Enforcing a contract (Days)	**425**	241	75	250
Registering property (Days)	**67**	32	11	12
Resolving insolvency (Years)	10	2.4	1.5	3

Source: World Development Report 2005, World Bank

Utilisation of Foreign Exchange Reserves

16.23 The level of foreign exchange reserves has steadily increased from less than $ 1 billion as of end-June 1991 to $ 140.4 billion on 11th March 2005. This has been fuelled by FII inflows and remittances from workers, the latter being $ 23.2 billion in 2003-04. In terms of the adequacy indicators of trade-related reserves, India's foreign exchange reserves are adequate for about 17 months of imports. The accretion to foreign exchange reserves, particularly in the context of the falling value of the US dollar, creates an opportunity for providing a part of the huge financial requirement for creating world-class infrastructure. The extent to which we can draw down foreign exchange reserves for this purpose will depend upon our perception of the need for reserves to cover balance of payments risks and the possibility of utilising them in a non-inflationary manner.

Trade and Exchange Rate Policy

16.24 The Tenth Plan document recognised that the most important pre-condition for a more open economy is the creation of an expanding production base which can not only withstand external competition but also provide the surplus necessary to ensure sufficient export earnings to meet the import needs of the country. Another is to create conditions under which the export market becomes equally attractive as the domestic market, as this would encourage both a shift from producing principally for the domestic market and developing capacities to specifically target export opportunities. The reorientation of the incentives structure towards investment in tradable goods and services combined with improvement in relative profitability of exports vis-à-vis domestic sales, were the focus areas indicated in the Plan for this purpose.

16.25 The roadmap for achieving export growth in the medium term has been indicated in the Medium Term Export Strategy (MTES). The Strategy aims to increase the country's share in world trade to 1 per cent by 2006-07. For achieving this, the MTES has incorporated product and market identification for exports as well as focus on sector-wise, micro and macro strategies for identifying potential sectors based on the assessment of the changing global trade scenario and revealed comparative advantages. The Export-Import (EXIM) Policy for 2002-07 emphasised export market diversification with special focus on unexploited regions like Sub-Saharan Africa and the Commonwealth of Independent States (CIS). However, the maximum growth in exports can be expected from the largest trading partners i.e. the United States and European Union. It has also stressed on a farm-to-port approach for exports of agricultural products, and upgrading the export infrastructure for hiking Assistance to States for Infrastructural Development for Exports (ASIDE). The policy has been further fine-tuned in the Foreign Trade Policy (1st September, 2004 - 31st March, 2009). The new Foreign Trade Policy is built around two major objectives – to double India's percentage share of global merchandise trade within the next five years and to act as an effective instrument of economic growth by giving a thrust to employment generation.

EXPORT INCENTIVE PROGRAMMES

16.26 The export incentives programmes of the Government are mainly in the nature of schemes that are aimed at ensuring the tax neutrality of the exported products. Details of the various schemes are given in Box 16.1.

16.27 Over the past few years, the importing countries such as the European Union, United States and Canada have treated some of the above schemes, particularly the DEPB scheme, as subsidy practices and levied countervailing duties on such imports from India. In particular, rebate of duties on capital goods under the EPCG scheme as well as under other schemes of the Department of Commerce have been targeted as such rebate is treated as an actionable subsidy under the WTO Agreement. The rule that makes the rebate of duties on capital goods countervailable is, however, an apparent flaw in the WTO Agreement on Subsidies and Countervailing Measures (ASCM), as it is arguably against the intent of the relevant rule in GATT 1994. For this reason, in the Doha Round of negotiations, the Department of Commerce is pursuing the proposal to suitably amend the ASCM Agreement. Under the WTO Agreement, duty drawback or substitution drawback schemes are non-actionable provided the payment is not in excess of the levies actually paid on inputs. Substitution drawback implies the use initially of domestic inputs and subsequent imports of the same inputs. The duty drawback scheme of the Department of Revenue has never been countervailed. However, the DEPB scheme is being countervailed as the related certificates can be used to pay customs duty for any import and not necessarily imports of inputs used in the production of exported product. Absence of the requirement to import the very inputs that have been used in the exported product makes the DEPB payments countervailable in terms of WTO rules. It is therefore necessary to consider suitable modification in the scheme to make it non-countervailable, or, better still, to subsume it under the duty drawback scheme.

Box 16.1
Export Incentive Programmes

Duty Drawback Scheme: Provides for refund of duties of customs and central excise on basic inputs like raw materials, components, intermediates and packing material used in the manufacture of the exported item.

Duty Entitlement Pass Book (DEPB) Scheme: The exporter may apply for duty credit as a specified percentage of the free on board (fob) value of exports. The DEPB credits are freely transferable and, importantly, they may be utilised for payment of customs duty on any item, which is freely importable except capital goods.

Advance License Scheme: Allows duty-free imports of inputs, which are used to produce the exported product. A variant of the scheme is the Advance Release Order.

Duty Free Replenishment Certificate Scheme (DFRC): Import of inputs used in the manufacture of exported goods is allowed without the payment of the basic customs duty but on payment of the additional duty equal to the excise duty.

Export Promotion Capital Goods (EPCG) Scheme: It allows import of new capital goods at 5 per cent total customs duty, subject to the importer undertaking an export obligation equivalent to a multiple of the cost, insurance and freight (cif) value of capital goods, to be fulfilled over a specified period from the date of issuance of the license. Imports of capital goods are subject to Actual User condition until the export obligation is completed.

Special Economic Zone (SEZ) units, **Export Oriented Units** (EOU), **Export Processing Zones** (**EPZ**), etc. are entitled to buy their requirements of capital goods and other materials from the Domestic Tariff Area (DTA) free of internal taxes.

SPECIAL ECONOMIC ZONES

16.28 The Exim Policy effective from 1st April 2000 introduced a provision for setting up Special Economic Zones (SEZs), with a view to providing an internationally competitive and hassle free environment for export production. The policy provides for setting up new SEZs in the public/private/joint sector or by state governments, but not by the Central government.

16.29 It was also envisaged that the existing Export Processing Zones (EPZs) may be converted into SEZs. The government has since converted eight existing EPZs at Kandla and Surat (Gujarat), Santa Cruz (Maharashtra), Kochi (Kerala), Chennai (Tamil Nadu), Noida (Uttar Pradesh), Falta (West Bengal) and Visakhapatnam (Andhra Pradesh) into SEZs. There were 711 units in operation in these eight EPZs and their export performance in recent years is given in Table 16.10.

16.30 At present, each state can enact legislation to create SEZs in its territory. Six states, which have converted EPZs into SEZs, have enacted legislation in this regard. Approvals have also been given for setting up of 27 SEZs; at Positra, Dahej and Mundra (Gujarat), Navi Mumbai and Khopta (Maha Mumbai - Maharashtra), Kulpi, Salt Lake and Calcutta Leather Complex (West Bengal), Paradeep and Gopalpur (Orissa), Bhadohi, Kanpur, Greater Noida and Moradabad (Uttar Pradesh), Kakinada and Visakhapatnam (Andhra Pradesh), Indore (Madhya Pradesh), Vallarpadam/Puthuvypeen (Kerala), Hassan and Baikampadi (Karnataka), Jaipur and Jodhpur (Rajasthan), Ranchi (Jharkhand) and Ennore, Mahindra City and Nanguneri (Tamil Nadu).

Table 16.10
Export performance of SEZs

Year	Exchange rate of one dollar in rupee terms	SEZs performance ($ million)
2001-02	47.692	1926.8
2002-03	48.395	2078.0
2003-04	45.952	3047.5

Note: Exchange rate value from RBI

16.31 Apart from concessions relating to taxes these states have also exempted the units in SEZs from the application of some labour laws. If the SEZ programme has not taken off so far, it is mainly because a Central legislation granting further fiscal concessions was awaited. The SEZ bill was passed by Parliament in May, 2005. The legislation envisages a single administrator and a time-limited holiday from income tax in addition to exemption from Central excise, customs duty and Central sales tax which are already available. It must be pointed out, however, that the quality of physical infrastructure, both within and outside the SEZ, is as important as fiscal incentives. SEZs should be large, with a full-fledged township having world-class physical infrastructure. Attention has also to be given to the peripheral infrastructure, like power, roads and ports in particular.

WTO ISSUES

16.32 A major development in international trade relations was the decision of the Ministers of the WTO Members in November 2001 at the Qatari capital of Doha to launch a new round of multilateral trade negotiations with an ambitious agenda. While the commencement of negotiations in agriculture, services and non-agricultural market access and the rules area was generally welcomed, the inclusion of new subjects, viz., investment, competition policy, transparency in government procurement and trade facilitation, gave rise to disquiet in India and many other developing countries. Differences on the inclusion of new issues in the agenda of the new round and on the level of ambition for the liberalisation of agriculture led to the collapse of the Ministerial Session at Cancun in September 2003 and a disruption of the negotiating process. But by the end of July 2004 there was a sufficient meeting of minds among Members to allow the negotiations to go forward. The Framework Agreement in July 2004 at Geneva provides important gains for India and other developing countries because it virtually excludes investment, competition policy and transparency in government procurement from the multilateral negotiating

agenda and in agriculture there is agreement to work, inter alia, towards the elimination of all forms of export subsidies.

16.33 **Non-agricultural Market Access (NAMA):** At the last round of tariff negotiations in the Uruguay Round, India did not undertake tariff commitments in respect of a large proportion of its non-agricultural tariffs. Even after the tariff commitments on textile and clothing items undertaken subsequently, India's commitments covered only 69 per cent of the tariff lines at the commencement of the Doha Round, and 70 per cent of these are bound (committed against an increase) at the level of 40 per cent ad valorem As against this, India's general peak tariff on non-agricultural products has autonomously been brought down to 15 per cent. What is more, with economic efficiency in mind, the government remains steadfast in its resolve to bring down further the level of tariffs, a process that began autonomously with the economic reforms of 1991-92. Once tariffs have been reduced there can be little impediment in taking the next step to bind them in the WTO if, in return, we get reduction and binding of duties by our trading partners including in areas other than NAMA. The WTO Agreement provides for adequate safeguards to raise duties temporarily or even permanently if the situation warrants such action in future. All this gives India considerable leverage in the ongoing negotiations for seeking tariff reduction by its trading partners.

16.34 Two important points need to be considered in the context of the NAMA negotiations. First, while the average level of tariffs has come down to very low levels in the industrialised countries, they are still quite high on labour-intensive products, such as leather and textile items, which are of export interest to India. Second, the proliferation of regional trading arrangements (RTAs) has a direct implication for India in the multilateral trade negotiations. The European Union, which is the oldest and biggest RTA, has recently grown from 15 to 25 members, and is likely to become a part of the Euro-Mediterranean Free Trade Area by 2010. The North America Free Trade Agreement (NAFTA) came into being in 1995 and more recently (December 2003-January 2004) the United States has concluded the agreement for the Central America Free Trade Area (CAFTA). In the near future, the Free Trade Area of the Americas linking both the continents, may also come into being. In Asia too, there is a build-up of regional arrangements and, as will be detailed later in the section on Regional Trading Arrangements, it is not unlikely that India eventually becomes a part of an FTA embracing South and South East as well as East Asia. However, an Asia-wide FTA may take time to emerge. In the meantime, India's trade with the industrialised countries, including Japan, would be affected adversely by their strengthening regional alliances. In textiles and clothing in which quotas have been eliminated on 1st January 2005, preferential trading arrangements (PTAs) will strongly influence trade flows into the major industrialised countries. In this situation India's strategy must clearly be to try to minimise the trade diversion potential of the existing and future RTAs by securing the maximum reduction in WTO, in the non-discriminatory MFN tariffs worldwide.

16.35 There is already some convergence on the idea of making the formula approach the central modality for securing reduction of tariffs in the current negotiations (Box 16.2). Here, a harmonisation formula such as the Swiss formula must be preferred as it can secure reduction of tariffs peaks and high tariffs by a proportion that is greater than for lower tariffs. Equally importantly, India must try to ensure that due weight is given to the bound tariff average of individual WTO Members in determining the extent of reduction to be undertaken by each of them. This is a good way of taking into account the sacrifices in past negotiations, the dependence of high tariff developing countries on customs duty for their revenues and at the same time for achieving tariff compression.

16.36 Sectoral elimination of tariffs in some product groups has also been proposed in conjunction with the formula reduction. It is attractive in some sectors but it can be acceptable to India only if, as a developing country, it is permitted to maintain tariff at

the modest level of, say, 5 per cent. Unless this flexibility is given, adoption of the modality would result in negative protection for finished products in those cases in which duty is maintained on raw materials falling outside the specific product group, even if it is at a low level.

16.37 **Agriculture:** India has entered into the negotiations on agriculture also from a position of strength, in view of its proven international competitiveness as an exporter over a range of tropical products. In temperate zone agricultural products, India has demonstrated competitive strength as an exporter in rice, wheat and some varieties of cotton. Whenever the international price of sugar has firmed up, India has been an exporter of substantial quantities of sugar. More recently, India has been exporting skimmed milk powder in increasing quantities. There is, thus, considerable evidence that if the current level of distortions in international markets due to the market access barriers and subsidy practices in the major industrialised countries is corrected, India could emerge as a major exporter of a number of temperate zone agricultural products. Studies have shown that India is import competitive in all agricultural products with the exception of some edible oilseeds and oils. India, thus, has high stakes in the negotiations on agriculture and has much to gain if the outcome of the negotiations is fundamental reform. India's bargaining capacity in the negotiations is considerably enhanced by the wide gap between the applied and bound levels of tariff on agricultural products, the low level of domestic support programmes as a percentage of the value of agricultural production, and the government's inability due to fiscal constraint, to engage in competitive subsidisation with the major industrialised countries.

16.38 The accord at Geneva in July 2004 on the framework for the negotiations (July Framework) has broken the impasse in the negotiations in the area. The agreement in principle to eliminate export subsidies, export credits beyond 180 days, trade distorting practices of exporting State Trading Enterprises and food aid that causes commercial displacement is a significant achievement. However, to consolidate this gain it would be necessary to secure agreement on very substantial reduction of trade distorting domestic support, as such support can be a substitute for export subsidies for enabling suppliers to capture third country markets and for displacing domestic producers in importing countries, beside impeding imports into the subsidising country. There is agreement in the July

Box 16.2
Formula approaches in tariff negotiations

Formula approaches envisage uniform application of a method by all members resulting in comparable commitments. Several types of formulae have been used. These include Linear Formula, which envisage an agreement among governments to reduce their tariff levels by a fixed percentage, or Non-linear Formula that addresses the issue of differential levels of tariffs and compresses the range of a country's tariff rates.

A typical example of a Non-linear Formulae is the well-known **Swiss Formula** –

$$Y = \frac{AX}{A+X}$$

- X is the tariff before reduction;
- A is the coefficient which has to be assigned a particular value; and
- Y is the reduced tariff

The Swiss formula brings down higher tariffs more steeply and all the resultant tariffs would be lower than the coefficient A.

Box 16.3
Domestic support in Agreement on Agriculture

Amber Box: Domestic support measures that have trade distorting effects or effects on production and are subject to reduction commitments.

Blue Box: Direct payments to farmers under production–limiting programmes that are exempt from reduction commitments.

Green Box: Measures listed in Annex 2 of the Agreement on Agriculture which are exempt from reduction commitments, as they are deemed to have 'no, or at most minimal, trade-distorting effects or effects on production'.

Aggregate Measurement of Support (AMS): The AMS is the monetary measure of the annual level of trade and production -distorting support. Total AMS means the sum of all domestic support provided in favour of agricultural producers, whether on product specific or non-product specific basis.

Framework that the overall base level of all trade distorting support and the Total Aggregate Measure of Support would be reduced by a tiered formula, but there is no indication of numbers. Also the Green Box measures need much greater attention than has been given so far. It cannot be denied that fully decoupled income support, for instance, is less distorting than Amber Box and Blue Box measures (Box 16.3). However, while the changeover to decoupled income payments improves the allocation of resources in agriculture within the country concerned, the reduction in negative effects on world markets is very small. What is needed is reduction in agricultural subsidies in the aggregate, and not merely their re-instrumentation.

16.39 In market access, the principal target must be the very high tariffs in the major industrialised countries. The ad valorem equivalents of specific duties maintained on several key agricultural products in these countries are in multiples of 100 per cent. There is fundamental good sense in the stand taken by India that it can undertake to reduce tariffs only if the developed countries agree to reduce not only tariffs but domestic support and export subsidy levels as well. Doing otherwise would be exposing Indian agriculture to undue risks. Even so, there is a need for India to adopt a bolder approach in the negotiations, since India has so much to gain from the reduction of subsidies and market access barriers in the industrialised countries. It should seek to wrest the leadership in the negotiations by indicating the extent of reduction of tariffs that it would be willing to undertake if its objectives for securing reduction of tariffs and subsidies in the developed countries are met.

TRADE IN SERVICES

16.40 India's main negotiating objective on trade in services has been clear from the time of the Uruguay Round. It is to secure maximum liberalisation by its trading partners over a wide range of services in Mode IV (the movement of natural persons) to enable temporary relocation of skilled professionals in those countries. Since developments in telecommunications and IT have made it possible to deliver a wide range of services across borders, Mode I (cross-border supply of services) and Mode II (consumption abroad) have also emerged as modes of supply in which India has a deep interest (Box 16.4).

16.41 In the Uruguay Round and in the resumed negotiations after the Round, the commitments by WTO Members in Mode IV remained highly circumscribed and subject to many limitations and qualifications. Binding commitments were made mainly in respect of intra-corporate transferees, business visitors and executives, managers and specialists linked to

Box 16.4
Modes of delivery of services recognised by GATS

Mode-I – *Cross Border Supply.* Only the service crosses the border. The delivery of the service can be done, for example, through IT or other means of communication.

Mode-II – *Consumption Abroad.* Consumers travel outside the country and consume services abroad. like a tourist availing of services abroad.

Mode-III- *Commercial presence* The service provider establishes its presence in another country through branches or subsidiaries, for example, banking services supplied by a subsidiary of a foreign bank.

Mode-IV –*Movement of natural persons.* When an individual has moved temporarily into the territory of the consumer to provide a service, whether self-employed or as an employee, for example, computer consultancy services or the temporary employment of construction workers.

commercial presence. There was very little commitment relating to the movement of independent professionals in which India's main interest lies. In practice, temporary movement of independent professionals gets caught up in the generally restrictive approach towards permanent movement of labour on the part of the immigration authorities and labour market regulators. Wage parity requirements are a severe constraint. What is more, a large number of WTO Members have indicated in their commitments that the entry of independent service suppliers would be subject to an economics needs test. The ability of professionals to supply services in developed country markets is severely limited on account of lack of recognition of professional qualifications and licensing requirements. The requirement in the developed countries that foreign professionals working there must pay social security contributions, even if they are not eligible for the benefits because of the short period of their stay, is also a big impediment in the movement of natural persons. India is already vigorously pursuing proposals to address all these restrictions. An important proposal made is for the creation by WTO Members of a separate category of Service Provider's Visa to facilitate the entry of service providers into their territories.

16.42 The commitments made by WTO Members in Modes I and II are not as limited as those in Mode IV, but they are far short of the existing regime, which is very liberal, particularly in the developed countries. Recent initiatives in the United States to curb business process outsourcing relating to government contracts have brought home the value of locking in the existing regimes in Modes I and II by means of WTO commitments. India has already initiated discussions in the Doha Round to obtain agreement on broad-based commitments in respect of these two modes of supply. As noted earlier, there has been a sea change in India's policy towards FDI since the time the Uruguay Round negotiations were held. It already permits up to 100 per cent investment by foreign investors in most service sectors and the policy is being continually reviewed to provide additional openings. Since India has an abundance of skilled professionals over a wide range of services, it can reap immense benefits if the world's major economies liberalise access to temporary flows of these professionals. In order to induce the industrialised countries to make meaningful concessions in Mode IV, particularly in respect of individual service providers, India should put on the table the existing regime in all service sectors for binding commitments. Indeed, India should be willing to do more and even offer to open up the FDI policy further in some of the areas in which it is restricted at present, if such efforts can tempt the industrialised countries to respond to Indian proposals favourably. In Mode I, it would be worthwhile to explore the possibility of securing across-the-board binding commitments (except for very limited service sectors such as

financial services) from WTO Members on business-to-business supplies.

REGIONAL TRADE AGREEMENTS:

16.43 In the last two years, India has joined the global trend towards intensification of economic integration arrangements and entered into a number of new free trade area (FTA) arrangements. Framework Agreements envisaging FTAs have been signed with the Association of South East Asian Nations (ASEAN) and Thailand in 2003. Both these agreements contain early harvest programmes whereby selected products will be given duty free treatment early. Two more agreements envisaging the creation of FTAs were signed in 2004 – the Framework Agreement on a South Asia FTA (SAFTA) and Framework Agreement on BIMST-EC (Bangladesh, India, Sri Lanka and Thailand Economic Cooperation). The various PTAs and FTAs in which India is involved are given in Box 16.5.

16.44 While evaluating the preferential arrangements, a distinction must be made between agreements that envisage an exchange of concessions by way of preference by a few percentage points on a relatively small list of products and those in which the intention is to eventually create a FTA. The Bangkok Agreement, the Generalised System of Trade Preferences (GSTP) Agreement, the SAPTA Agreement, the Indo-Afghanistan Agreement and the Indo-MERCOSUR Agreement fall under the first category, as could the proposed agreements with the South African Customs Union (SACU), the Gulf Cooperation Council and Egypt. The difficulty with limited preferential agreements is that they do not result in trade flows of any significance, even as the multiple levels of tariff and complex rules of origin resulting from them impose considerable additional burden on the customs administration. For these reasons, it is necessary to exercise some caution before entering into any further agreements that envisage limited trade preferences.

16.45 FTAs and Customs Unions are acceptable in economic terms if the trade creation exceeds trade diversion. That is more

Box 16.5
India's current engagement In RTAs

- Bangkok Agreement (1975)
- Bilateral Non-Reciprocal Treaty with Nepal (1991)
- South Asia Preferential Trade Agreement (SAPTA) (1993)
- Bilateral Non-Reciprocal Treaty with Bhutan (1995)
- India-Sri Lanka FTA (1998)
- Generalised Scheme of Trade Preferences (GSTP) (1998)
- Framework Agreement on Comprehensive Economic Co-operation between the Association of South East Asia Nations (ASEAN) and India – 8th October 2003.
- Framework Agreement between India and Thailand- 9th October 2003
- Agreement on South Asian Free Trade Area (SAFTA) – 6th January 2004
- India-MERCOSUR PTA – 25th January 2004.
- BIMST-EC FTA – 8th February 2004
- India-GCC (Gulf Cooperation Council) Framework Agreement – 25th August 2004
- India-Singapore Comprehensive Economic Cooperation Agreement (CECA)
- India-Sri Lanka Proposal for Bilateral Comprehensive Economic Partnership Agreement
- India-SACU (Southern African Customs Union) Framework Agreement
- Joint Study Group (JSG) with Mauritius
- Joint Study Group with China
- Joint Study Group between India and Republic of Korea
- Joint Study Group between India and Japan
- India-Egypt PTA

likely to happen if the agreement aims at comprehensive liberalisation. One argument in favour of regional agreements is that they help to prepare the ground for MFN liberalisation. In any case, economic integration among geographically contiguous countries has become a geo-political imperative in modern times, and India has to continue to pursue FTAs in the SAARC region as well as with the South East Asian and East Asian countries. The bigger the FTA, the greater will be the benefit for India and other partner countries. When negotiating FTA agreements, the objective must be to eliminate the barriers to trade comprehensively and progressively over the agreed time frame. Early harvest by way of elimination of duties in a short period on a limited number of products should be avoided as such a step can lead to negative protection in India on account of the existence of substantial tariffs on raw materials, intermediates and capital goods. For the FTA with these countries to be successful, it must be ensured that India's MFN tariffs are not far out of line with their tariffs. If there are large tariff differentials, especially on capital goods and raw materials, Indian manufacturers would be placed at a disadvantage, as their competitors in partner countries would have access to cheaper inputs. To prepare for the Indo-ASEAN FTA, it would be necessary that Indian tariffs are speedily reduced to 'ASEAN levels'. A complicating factor is that there is considerable difference in the tariff levels in the large ASEAN countries. The simple average of MFN applied duties for non-agricultural products was 8.4 per cent in Indonesia (1999), 8.1 per cent in Malaysia (2001), 6.8 per cent in Philippines (2001), zero in Singapore (2001) and 15.5 per cent in Thailand (1999). Further, these countries have agreed to eliminate all tariffs within a limited period as a part of their commitment in the Asia Pacific Economic Cooperation (APEC) context (the Bogor Goals). In the circumstance, it would be necessary for India to reduce its MFN tariffs to a very low level in preparation for the FTA with the ASEAN. It is desirable that a target range of 5 per cent to 10 per cent is set to be achieved within two years. A longer period would be considered for products with high tariffs.

PROSPECTS FOR TRADE

16.46 A sustained GDP growth of 7-8 per cent or more requires that every potential of the economy for growth be tapped. The opening up of the economy to increased international trade since mid-1991and the restructuring that followed creates the potential to cater to a vast world market. Restructuring has been successfully completed across a wide swathe of Indian industry and this is attested to by the good export performance in a number of sectors, notable among them being auto components, motor vehicles and chemicals. Growth in exports has been robust and it has been consistently over 20 per cent since 2002-03.

16.47 The export optimism that seems to have permeated Indian industry has coincided with the beginning of the growth phase in two of the largest economies – the United States and Japan. The growth of demand in these economies has also coincided with the declared intention of the Chinese authorities to slow down their growth rate to cool their over-heated economy.

16.48 The current period is also one in which the global image of India has improved, beginning with the success in the IT sector, and now extending to manufacturing. In order to provide the growth momentum to the economy, it is necessary to take advantage of this confluence of favourable circumstances.

16.49 Globalisation is the defining characteristic of the world economy and there is a growing trend among multinational corporations (MNCs) to build global supply chains and source-manufactured intermediates from low-cost countries. About 80 per cent of world merchandise trade is of manufactured products, of which about 80 per cent is of medium technology products. With its diversified industrial base and skilled engineering and design manpower, India is well placed to take advantage of the liberalisation of domestic and foreign trade to increase its share in global trade. Efficient manufacturers can leverage India's low wage rates at all levels of skills, to gain international

competitive advantage. The restructuring that has taken place across much of Indian industry has given it the confidence to look at export possibilities with much greater enthusiasm. A very large proportion of Indian industry has also taken ISO certification, thereby increasing its credibility with foreign buyers.

16.50 In the coming years, the progressive correction of the anti-trade bias in India's policies would need to be carried forward, particularly with the accelerated reduction and rationalisation of import tariffs. The attainment of a current account surplus over the last three years suggests that tariff reductions could be carried out faster without posing any significant risk to the balance of payments. The restructuring of Indian industry and its resultant export thrust, sets the stage for lowering tariffs further in the very near future, with a few exceptions. A degree of calibration would be required as far as agricultural products are concerned and it would be premature to bring them down even before the major industrialised countries have taken steps to reduce their subsidies and market access barriers. However, industrial tariffs must be reduced to a maximum of 10 per cent within two years.

16.51 It is necessary to deepen the trade reforms in the country by redoubling efforts for customs modernisation, streamlining of documentary requirements, automation and electronic data interchange (EDI). This second generation reform for trade facilitation is essential for deriving the full benefits of trade liberalisation. By simplifying customs procedures and speeding up customs clearance, both for exports and imports, Indian manufacturers can be enabled to take advantage of the growing opportunities for participating in global supply chains, which are extremely sensitive to timely delivery. The consequent reduction of transaction costs for exports would go a long way in improving competitiveness and in achieving the country's target of doubling exports by 2008-09. These measures would also make the country more attractive for FDI.

16.52 In the context of the strategic export promotion policies being designed to guide an aggressive export effort, it is necessary to broaden coverage to a large number of non-traditional items and markets, which are expanding faster than the world average. The export-led growth experience of the South East Asian countries provides valuable lessons for India; export performance needs to be regarded as the key to the health of the balance of payments. Their experience also suggests that technology-intensive items will provide momentum to the export drive. In the past, India's export promotion policy had been broadly neutral in respect of technology upgradation, and not particularly focused on specific areas of technological advantage. Moreover, some elements of industrial policy, such as emphasis on indigenisation and the thrust on adaptation rather than innovation, considerably restricted technology intensification in exports. In this context, a conscious choice to 'leapfrog' from low and medium technology to high technology exports has to be made. Given that India is a late entrant in the race for export markets, it can well leapfrog to high technology, particularly as high technology capital goods are computer controlled and manual discretion in their operations is minimal. However, the employment-creating potential of export manufacturing also needs to be fully exploited. Manufacturing and its linkages with mining, electricity and construction can provide employment to relatively lower skilled and even unskilled workers from rural areas.

16.53 The export promotion policy needs to utilise the natural complementarity of FDI with export activity, particularly access to markets. In the final analysis, it needs to be recognised that definitional issues notwithstanding, administrative and procedural complexities remain major impediments to larger FDI inflows. The time lag involved in converting investment intentions to actual flows of foreign exchange, technology and know-how, must be reduced to compare favourably with investment destinations, which have proved their attractiveness on account of the ease of investing. The global reach and marketing abilities that FDI gives access to could be effectively utilised to provide a cutting edge to the export effort. The infrastructural

services, particularly power and transportation, need significant improvement in order to build the environment conducive to FDI flows. The restrictive labour laws, especially the constraints on the ability to adapt the size of the work force to changing situations, also need attention in order to stimulate FDI flows. While all these steps are necessary to enable the foreign investors to take full advantage of the already existing liberal rules on FDI, it is imperative to also continue the process of liberalisation by further relaxing the ceiling on FDI in telecom, financial services and civil aviation and by allowing FDI in areas such as retail trade which remain excluded from its purview.

16.54 There is a strong case for opening up FDI in modern retailing, in which it is not yet permitted. The entry of major global retailers would act as a catalyst for building capability to meet international standards and supply to global retail outlets. Building the domestic supply chain would assist in integrating the domestic market. The quality maintenance at all stages of procurement and processing that is ensured by global players, could help develop India as a sourcing hub for exports thereby scaling up domestic producers' capability and prepare the ground for making Indian products acceptable in international markets. This would be particularly important in developing export markets for agricultural and agri-food products thereby enabling Indian farmers to benefit from the process of globalisation. The fear of large adverse effects on domestic retailing appears to be grossly exaggerated, as small retailers and corner stores continue to thrive even in developed countries.

THE WAY FORWARD

- Calibrate the reduction of agricultural tariffs to the progress made by the major industrialised countries in bringing down the level of subsidies that hugely distort international markets. Reduce industrial tariffs to a maximum of 10 per cent within the next two years and an average which is lower.
- Intensify autonomous action for introducing trade facilitation measures to reduce transaction costs and the time taken for customs clearance, for both import and export consignments, in order to make industry more competitive.
- Cut administrative and procedural hurdles that delay the fruition of FDI intentions; enhance investment in power and transportation infrastructure and make changes in the restrictive labour policies. Continue the process of liberalisation by further increasing the ceiling on FDI in telecommunications, financial services and civil aviation and allowing FDI in areas such as retailing, which remain excluded from its purview.
- Exercise caution in entering into new RTAs with limited preferences, as they result in negligible trade flows, while adding considerably to the administrative burden on customs. On the other hand, joining comprehensive FTAs with South, South Eastern and East Asian countries is necessary for geo-political reasons.
- Adopt a proactive approach in WTO negotiations in order to improve market access for Indian goods and services in international markets through ambitious non-discriminatory trade liberalisation of world trade. In non-agricultural market access, press for the average tariff level of each country being taken as a factor in the harmonisation formula to be adopted as the core modality for tariff reduction. As for sectoral approach in product groups of interest to developing countries, India should press for them being allowed to retain tariff at the modest level of 5 per cent while others eliminate tariffs.
- Seek a fundamental reform in world agriculture, with the major industrialised countries eliminating all forms of export subsidies and bringing

about very substantial reduction in domestic support (not only amber and blue box but green box measures as well) and improvement in market access. India should table substantial offers on market access which should be conditional on the industrialised countries bringing down the levels of support and market access barriers to the desired extent.

- Pursue the proposals for liberalisation of Mode IV in the negotiations on services and, in return, be willing to put on the table the existing regime in all service sectors for binding commitment as well as to make additional liberalisation efforts. India should also seek to lock in, to the maximum extent possible, the somewhat liberal regime that now exists in the industrialised countries in respect of Modes I and II, by proposing across-the-board binding commitments in the area by all WTO members.
- Pursue the proposal, in the negotiations in the area of rules, for making non-actionable the rebate of duties on capital goods used in the production of exported products. Separately the DEPB scheme of export incentives should be redesigned so as to make it non-countervailable by conforming to the requirements of a substitution drawback scheme as laid down in the WTO Agreement

Annexure 16.1

Balance of Payments: Key Indicators

(US $ million)

Item/Indicator	2003-04	2002-03	2001-02	2000-01	1999-2000	1990-91
1	2	3	4	5	6	7
i) Trade Balance	-15454	-10690	-11574	-12460	-17841	-9437
ii) Invisibles, net	26015	17035	14974	9794	13143	-243
iii) Current Account Balance	10561	6345	3400	-2666	-4698	-9680
iv) Capital Account, net	20542	10840	8551	8840	10444	7056
v) Overall Balance #	31421	16985	11757	5868	6402	-2492
Indicators (in per cent)						
1. Trade						
i) Exports/GDP	10.7	10.5	9.3	9.9	8.4	5.8
ii) Imports/GDP	13.3	12.6	11.8	12.7	12.4	8.8
iv) Export Volume Growth	20.4	20.3	3.9	23.9	15.5	11.0
2. Invisibles						
i) Invisibles Receipts/GDP	8.8	8.2	7.7	7.1	6.8	2.4
ii) Invisible Payments/GDP	4.5	4.9	4.5	4.9	3.8	2.4
iii) Invisibles (Net)/GDP	4.3	3.3	3.1	2.2	2.9	-0.1
3. Current Account						
i) Current Receipts@ /GDP	19.4	18.7	16.9	17.0	15.1	8.0
ii) Current Receipts Growth@	23.0	17.6	4.5	14.8	12.9	6.6
iii) Current Receipts@/Current Payments	109.3	106.6	103.8	96.4	93.0	71.5
iv) Current Account Balance/GDP	1.7	1.2	0.7	-0.6	-1.0	-3.1
4. Capital Account						
i) Foreign Investment/GDP	2.6	1.2	1.7	1.5	1.2	0.03
ii) Foreign Investment/Exports	24.8	11.2	18.2	14.9	13.8	0.6
5. Others						
i) Debt-GDP Ratio	17.6	20.2	21.0	22.6	22.1	28.7
ii) Debt-Service Ratio	18.3	15.1	13.9	17.2	16.2	35.3
iii) Liability - Service Ratio	19.1	16.1	14.9	18.4	17.0	35.6
iv) Import Cover of Reserves (in months)	16.9	14.2	11.5	8.8	8.2	2.5

Includes Errors and Omissions @ Excluding official transfers.
Source: RBI.