CHAPTER 4

EXTERNAL SECTOR DIMENSIONS

4.1 The acceleration in the growth rate proposed for the Tenth Plan cannot take place without tapping the opportunities offered by the international economy in terms of markets, investments and technologies. The macro-economic exercises carried out in chapter 2 clearly indicate that the demand constraints afflicting Indian industry warrant greater focus on external sources of demand if growth opportunities are not to be missed. Concurrently, resource requirements and efficiency enhancement involve larger flow of external funds and technologies. Equally important, the inflow of foreign direct investment (FDI) has been identified as a critical component in raising the level of corporate entrepreneurial activity in the country. Thus, both demand and supply considerations for growth acceleration dictate a significantly higher degree of engagement with the international economy than in the past. But in so doing, vulnerabilities have to be identified and addressed.

4.2 The twin processes of globalisation and liberalisation are shaping a new system of international economic relations in which the changing pattern of investment, production and trade, the global span of finance and the central role of technology are dominant. The increased interaction with the world economy is expected to be facilitated by the overall reduction in the cost of transaction and communication. The accelerating pace of liberalisation and globalisation in the world economy has increased opportunities for growth and development, but it has also added new complexities and risks in the management of global interdependence. The ability of the developing countries to influence the pace and direction of global policy initiatives is still weak, while their vulnerability to the economic policy decisions taken by major developed countries, and more so by major market institutions, has increased.

4.3 Inter-linkages between trade, investment, money and finance, services, technology, commodity markets and the environment have, no doubt, made policy formulation more complex. The problem is compounded by weak commodity markets, decline in Overseas Development Assistance (ODA), heavy debt burden, uncertainties in capital flow, and restrictions on and high costs of technology transfer. In order to benefit from globalisation, developing countries like India will need to engage themselves more actively in shaping the contours of the international economic order. Passive acceptance of and reactive adjustments to decisions made elsewhere and on other considerations will not suffice. India continues to play an active role in various international organisations and multilateral fora to draw attention to important economic issues, especially in the context of developing countries. But the ambit has to be widened. In particular, the voices of the domestic civil society and commercial interest must not only find articulation in our international positions, but they must become major actors in the process of determining our stand. Unfortunately, the institutional mechanisms for eliciting such participation are still weak, despite considerable progress in recent years. The autarchic mind-set appears to afflict our private sector even more than the government. It is hoped that the projections for the immediate future will convince the private sector decision-maker that enlightened self-interest dictates not just active engagement with the government, but also investment of resources in research and mutual consultations.

4.4 The importance of reforming and revitalising the institutional structures governing our international economic relations cannot be overstressed. A defensive and *status-quo*ist position has to give way to a more aggressive and proactive position. This cannot be done without a closer interaction between the agencies concerned with trade and investment, including those in the private sector, and those in charge of our external relations. Indeed, international commerce cannot any longer be treated as a mere hand-maiden of diplomacy. Quite the opposite, in fact. Diplomacy must today support, as well as sub-serve, the commercial interests of the country. There will, undoubtedly, be situations in which political and commercial interests may come into conflict. Resolution of such differences will have to rank high on the political agenda.

4.5 This chapter first examines the external economic situation faced by the country in the emerging global context. Detailed analyses of the status of balance of payments position, trade and tariff policy and important World Trade Organisation (WTO) related issues are subsequently presented. Based on the overall situation, the projections about various dimensions relating to the balance of payments in different scenarios that have been made for Tenth Plan period are also presented in the chapter.

RECENT EVENTS IN INTERNATIONAL ECONOMY

4.6 During the Ninth Five Year Plan, there have been a number of events in the international economy that have influenced the behavioural pattern of the international economic relationship significantly, especially from the Indian point of view. These include the East Asian crisis of 1997-98, global slow-down since 1999-2000, and the September 11, 2001 event. Some of these are outlined in this section.

(a) East Asian Crisis

4.7 Prior to the Ninth Five Year Plan, the East Asian Countries were visualised as the harbinger of economic growth – their performance being described as the East Asian Miracle. The scenario, however, changed in 1997 when financial and corporate sector weaknesses combined with macro-economic vulnerabilities sparked off a crisis. The weakness can be explained as exposure of financial institutions to a variety of external threats including decline in asset values, market contagion, speculative attacks, and a reversal of capital flows. Formal and informal currency pegs, which discouraged lenders and borrowers from hedging, contributed to the problem. Capital inflows had helped rapid credit expansion while lowering the quality of credit, thereby leading to asset inflation. The inflated asset prices encouraged further capital inflows, lent often by weakly supervised non-bank financial institutions. Highly leveraged corporate sectors and large unhedged short-term debt made the crisis ridden countries vulnerable to changes in the market sentiments in general, and exchange rate changes in particular.

4.8 The initial priorities in dealing with the crisis were to stabilise the financial system and to restore confidence in economic management. Forceful measures were needed to stop bank runs, protect the payment system, limit central bank liquidity support, minimise disruptions to credit flows, maintain monetary control and stem capital outflows. In the crisis-ridden countries, emergency measures, such as the introduction of blanket guarantees and bank closings, were accompanied by comprehensive bank restructuring programmes and supported by macro-economic stabilisation policies.

4.9 India could escape the contagion because the management of our external sector was governed by parameters indicated by the High-level Committee on Balance of Payments (Rangarajan Committee) such as a flexible exchange rate, sustainable current account deficit, preference to non-debt creating resource flows, limits on the quantum, use and cost of external debt and a highly restrictive approach to short-term debt.

Box 4.1

Lessons learnt from the Asian Crisis

- Any currency could come under speculative attack if its exchange rate is out of alignment with the fundamentals for a prolonged period of time.
- Once the speculative attack is launched on any currency, the neighboring currencies are also vulnerable, no matter how sound their policies may be.
- The overvaluation of the currency acts as a catalyst when there is a run on the currency, as all the market players base their action on the information that the currency is due for correction.

4.10 Since efficient markets cannot always overcome speculative activities, it is necessary to remain ever vigilant on the performance of economic parameters both on domestic and external front. Efficient micro and macro-economic management, transparency, putting in place an appropriate regulatory framework and government's effective and timely intervention in case the markets dither, are necessary measures to avoid the occurrence and impact of such crisis in India.

(b) Global Slow-down

4.11 While the East Asian crisis was being resolved, the prospects for global growth weakened significantly, particularly during recent times due to a slow- down in the United States, a stalling recovery in Japan, and a moderate growth in Europe and in a number of emerging market economies. The growth rate of global output increased from 3.6 per cent in 1999 to 4.7 per cent in 2000, but declined to around 2.2 per cent in 2001. The projections for 2002 and 2003 are 2.8 per cent and 3.7 per cent respectively (World Economic Outlook, IMF, September 2002).

4.12 In the context of the world economic outlook, the following observations are worth noting:

- In an environment of slowing global growth, commodity prices may decline. Oil prices have retreated from their late 2000 high though their volatility remains a matter of concern and continues very much to depend upon the production decisions of the Organisation of Petroleum Exporting Countries (OPEC), though the risks may be on the downslide.

- Non-fuel prices are expected to remain broadly unchanged; but if global demand slows down more than expected, prices may decline, affecting adversely commodity producers, including many poor countries.

- With the possibility of oil prices declining and wage increases remaining moderate, inflation levels are likely to stabilise. This would allow fiscal maneuvering in many countries.

- While a number of countries continue to face serious difficulties, external and financial vulnerabilities in emerging markets have been generally reduced since the 1997-98 crisis, and the shift away from soft exchange rate pegs has improved their ability to manage external shocks.

- Over the past several years the strong expansion in the US economy has been instrumental in stabilising global activity in the face of weak demand elsewhere. Unfortunately, with the recovery in Japan stalling, and its potential growth being still modest, the present slow-down in the US is likely to be offset by higher demand growth elsewhere. In these circumstances, there would be greater risk of spillovers to other countries through financial market and confidence effects.

- Given that financial risks often tend to be underestimated in periods of rapid expansion, lower growth could expose fragility of financial markets. Further, downward revision to expectations of corporate profit growth could intensify pressures on equity markets in the United States and elsewhere, with adverse effects on wealth, investment, confidence and risk aversion.

- In emerging markets, prospects depend critically on maintaining investor confidence. External financing conditions have recently deteriorated. Given the global outlook, and continued economic difficulties in some emerging market countries, economies are likely to remain volatile in the period ahead. This underscores the need to maintain prudent macro-economic policies and to press ahead with corporate, financial and institutional reforms.

(c) Post September 11, 2001 Situation

4.13 Even before September 11, 2001, world's major economies had been witnessing a slow-down. In USA, growth rates had dropped to near-zero due to weakening consumption growth, declining investment and reduced imports, coupled with a dwindling manufacturing sector growth. Japan witnessed deflationary pressures and Europe's growth rate was slowing sharply. The events of September 11, 2001 further hit the global economy at a vulnerable point when it had fewer buffers to offer and its resilience to absorb new shocks was suspect. As a result, world trade growth is anticipated to decline from 12.6 per cent in 2000 to (–) 0.1 per cent in 2001, 2.1 per cent in 2002 and 6.1 per cent in 2003 (World Economic Outlook, September 2002).

4.14 Insofar as India is concerned, the post-September 11 developments have affected a few important sectors adversely. The Nasscom had first estimated the software exports to grow by 52 per cent during 2001-02, but the actual rate came down to only 13 per cent during the year. The civil aviation sector has also been hit, apart from fall in demand, hike in insurance costs has increased the operational cost. India's tourism industry, which serves 2.6 million tourists a year, has been adversely affected. The flow of remittances has also declined during 2001-02.

4.15 Adverse external developments after September 11, and their effect on India's financial markets, necessitated a quick response to provide appropriate liquidity and overall comfort to the markets. In order to stabilise domestic financial markets, the Reserve Bank of India (RBI) ensured that interest rates are kept stable with adequate liquidity. The RBI also undertook sale/purchase of foreign exchange as and when it was necessary to meet any unusual supply-demand gap. In view of the extraordinary circumstances in the government securities market, the RBI opened a purchase window for select government securities on auction basis. Indian companies were permitted to increase the foreign institutional investment (FII) limit. A special financial package was announced for large value exports of six select products, which were internationally competitive and had high value addition.

4.16 The above measures had the desired effect of moderating possible panic reactions and reducing volatility in financial markets, particularly in money, foreign exchange and government securities markets. While financial markets are generally stable, liquidity is adequate, and interest rate environment is favourable so far, the outturn of industrial output has been limited. This continues to be a matter of serious concern. It is hoped that as global markets gain back momentum after some time, it will have a favourable impact on the investment climate in India as well.

4.17 The series of international disturbances, however, throw open a window of opportunities that can be harnessed. The interest rates have been cut several times in the USA giving an opportunity to off-load the interest burden. Excess capacity afflicts virtually every capital goods sector across the globe, which presents an opportunity to import machines and equipments at bargain prices. It may be possible for India to attract higher FDI under the circumstances. This is a time for the Indian multinationals to look for cheap global acquisitions. When US companies resort to cost-cutting exercises, they may also resort to outsourcing, due to which the IT-enabled services sector such as call centers, back-office operations, transcriptions, payroll accounting services etc., will get a boost.

STATUS OF THE EXTERNAL SECTOR

4.18 During the Ninth Plan period, India's balance of payments position remained mostly comfortable. The current account deficit narrowed down and on the average was 0.8 per cent of gross domestic product (GDP), less than one half of the 2.1 per cent envisaged in the plan. The growth of exports in dollar terms during the Ninth Plan period has been 5.6 per cent as against the targeted growth rate of 11.8 per cent. During the same period, import growth has been 3.3 per cent as against the target of 10.8 per cent. The country has withstood the East Asian Crisis of 1997-98 and the recent global slowdown. Invisible receipts have been buoyant. Foreign exchange reserves have increased significantly to around $ 54 billion by the end of March 2002. The exchange rate of the Indian rupee, in terms of the US dollar, has depreciated by 6 per cent. The external value of the rupee seen in terms of real effective exchange rate (REER) has, however, appreciated slightly. Foreign direct investment inflows have increased while foreign institutional investments have gone down. The key indicators of external debt have improved considerably as a result of better management of external debt. It is some of these trends that are discussed in greater detail in this section.

Exports

4.19 The Ninth Plan had envisaged a growth of 11.8 per cent per annum in exports, against which the actual growth was 5.6 per cent (in dollar terms) during the Ninth Plan period. Even this unsatisfactory performance was accompanied by high volatility. Exports had recorded a negative growth of 3.9 per cent during 1998-99. The year 2000-01 witnessed a high growth of 19.6 per cent but declined sharply to 0.05 per cent in 2001-02. The Ninth Plan had also envisaged that the export-GDP ratio would be 10.4 per cent, but the likely outcome would be lower, at around 9 per cent.

4.20 The drastic reduction in growth rate of exports during 2001-02 was primarily due to structural constraints operating on the demand as well as on the supply side. The recessionary tendencies across the world affected the demand for our exports as well. As mentioned in para 4.13, world trade in goods and services is projected to record a negative growth of 0.1 per cent in 2001 as against a growth rate of 12.6 per cent during 2000. Such slow-down and contraction of world trade also resulted in emergence of protectionist policies by developed countries in some sectors in the form of barriers of technical, environmental and social standards, affecting market access and disrupting our exports.

4.21 Movements of the exchange rate also affected export performance. Major supply constraints that continued to hamper our exports include infrastructural constraints, high transaction costs, reservation for small scale industries, labour inflexibility, constraints in attracting FDI in exports sector and maintenance of product quality.

4.22 Changes in the composition of exports during the Ninth Plan may be seen in Table 4.1. It may be observed that the share of agriculture and allied products has been declining, while that of ores and minerals has remained more or less steady. Share of manufactured goods increased during the first three years, but came down during the two later years. Share of petroleum products increased significantly in 2000-01 and more so in 2001-02, while 'others' have shown a gradual rising trend during the Ninth Plan period. It is important to note that the share of processed agricultural exports and manufactured goods must be suitably raised not

Table 4.1

Broad Composition of Exports

S.No.	Commodity Group	Percentage Share 1997-98	1998-99	1999-2000	2000-01	2001-02
1.	Agri.and Allied Products	18.9	18.1	15.2	13.5	13.4
2.	Ores and Minerals	3.0	2.7	2.5	2.6	2.8
3.	Manufactured Goods	75.8	77.7	80.7	78.0	76.1
4.	Petroleum Products	1.0	0.3	0.1	4.2	4.9
5.	Others	1.3	1.2	1.5	1.7	2.8
	Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source : Directorate General of Commercial Intelligence and Statistics (DGCI&S).

only for a sustainable balance of payments position, but also to provide adequate aggregate demand to support the projected growth in these sectors.

4.23 Looking at the direction of these exports, it was observed that the share of our exports to the Organisation for Economic Cooperation and Development (OECD) countries has been declining, especially due to decline in our share to the European Union (EU) and Japan. Share of exports to USA has increased and so has to the OPEC and Latin American countries. It has gone down in the case of Eastern Europe, with slowing down of exports to Russia, while shares of exports to less developed countries in Africa and Asia have remained more or less at the same level. Exports to 'other' countries have increased and need to be further stepped up.

Imports

4.24 The Ninth Plan had envisaged a growth of 10.8 per cent per annum in imports. The actual growth of imports has been 3.3 per cent (in dollar terms) during the Ninth Plan period. Petroleum Oil and Lubricants (POL) imports during the Ninth Plan increased by 6.4 per cent while that of non-POL by 4.9 per cent. Lower import growth of non-POL is a reflection of the slow-down in the domestic industrial activity. The Ninth Plan had also envisaged that the import-GDP ratio would be 12.2 per cent. The actual outcome has more or less been around the targeted level as the average for the Plan period works out to 12.66 per cent. The slow growth of imports was clearly offset by the low growth rate of GDP.

4.25 The broad composition of imports during the Ninth Plan can be seen in Table 4.2. It may be observed that the share of bulk items has increased while that of non-bulk items has declined. Amongst the bulk items, share of POL increased sharply till 2001, which, however, came down in 2001-02. The share of bulk consumption goods in imports, mainly comprising food items, has been fluctuating according to domestic demand. Share in import of other bulk items like rubber, pulp and paper, wood and wood products, fertilizers, metalli-ferrous ores and metal scrap, non-ferrous metals, and iron and steel decreased till 2000-01, although it increased thereafter in 2001-02. Share of capital goods has shown a consistent declining trend. Share of export related items consisting of chemicals, pearls and precious stones, cashew, textile yarn and fabric, leather, raw cotton, silk, wool and jute has remained steady in this period.

Table 4.2
Broad Composition of Imports

		Percentage Share				
S.No.	**Commodity Group**	**1997-98**	**1998-99**	**1999-2000**	**2000-01**	**2001-02 (P)**
1.	**Bulk Imports**	**35.7**	**31.2**	**39.6**	**41.2**	**39.6**
	a. Petroleum and products	19.7	15.1	25.4	31.0	27.4
	b. Bulk Consumption Goods	3.6	6.0	4.9	2.9	4.0
	c. Other Bulk Items	12.4	10.2	9.3	7.4	8.2
2.	**Non-bulk Imports**	**64.3**	**68.8**	**60.4**	**57.7**	**60.4**
	a. Capital Goods	23.6	23.7	18.0	17.7	18.2
	b. Export related Items	16.7	16.8	18.4	15.9	16.1
	c. Others	24.1	28.2	24.0	24.1	26.0
	- Of which Gold and Silver	7.6	12.0	9.5	9.2	8.9

Source : DGCI&S.

4.26 Looking at the direction of our major imports, it may be observed that the OECD countries, and EU in particular, was the major supplier of the import items to India, although it was declining by the end of the Ninth Plan period. Also, share of imports from OPEC and Russia declined while the share of 'others' increased substantially. It may be suggested that the import of POL items increased from this set of 'other' countries and away from the OPEC. The share of imports from Africa, Asia and Latin America remained more or less constant.

Trade Balance

4.27 On account of shortfalls in the export growth, the trade deficit averaged an estimated 3.4 per cent of GDP during the Ninth Plan, almost double of 1.8 per cent, envisaged in the Plan document. However, in absolute terms the trade deficit has moved within a range of $ 12.7 billion and $ 17.8 billion during the Ninth Plan period. In fact, this was only $ 12.7 billion in 2001-02 as against $ 14.8 billion in 1996-97.

Invisibles

4.28 The total invisibles receipts increased from $ 21,405 million in 1996-97 to $ 35,612 million in 2001-02 (i.e. an average growth of 10.72 per cent). Total payments increased from $ 11,209 million in 1996-97 to $ 21,558 million in 2001-02 (i.e. an annual growth of 13.97 per cent). Net invisibles thus increased from $ 10,196 million in 1996-97 to $ 14,054 million in 2001-02 (i.e. a growth of 6.63 per cent). There has also been buoyancy in miscellaneous net receipts and private transfers. Invisible flows were a source of immense strength to the current account. Miscellaneous receipts (net) increased from $ 355 million in 1997-98 to $ 3,774 million in 2001-02, and similarly, net private transfers maintained a higher level, increasing from $ 11,830 million in 1997-98 to $ 12,798 million in 2000-01, but went down slightly to $ 12,125 million in 2001-02. Private transfer receipts remain augmented by the inclusion of local redemption of non-resident deposits since 1996-97. Private remittances account for the bulk of private transfer receipts. Software service exports, included under miscellaneous receipts of non-factor services, have emerged as the second largest item of invisible receipts. Software service exports had grown at an annual rate of about 52.5 per cent during the five years ending 1999-2000. The growth momentum was sustained in 2000-01, when these recorded a growth of 57 per cent from $ 4.02 billion in 1999-2000 to $ 6.3 billion in 2000-01.

Current Account Balance (CAB)

4.29 It is estimated that the CAB would average about (-) 0.8 per cent of GDP during the Ninth Plan, less than one half of 2.1 per cent envisaged in the Plan document. The balance of payments position may be seen in Table 4.3.

4.30 The CAB was $ (-) 5.5 billion in 1997-98, which came down to $ (-) 2.6 billion in 2000-01 and turned positive to $ 1.35 billion in 2001-02. The improvement in CAB was made possible largely because of dynamism in export performance, a sustained buoyancy in invisibles, reflecting a sharp increase in software service exports and private transfers, and partly due to the subdued non-oil import demand.

Foreign Exchange Reserves

4.31 India's foreign exchange reserves comprise foreign currency assets of the RBI, gold held by the RBI and special drawing rights held by the Government of India. Foreign exchange reserves increased rapidly during the last decade, increasing from $ 5,834 million in 1990-91 to $ 42,281 million in 2000-01. The reserves continued to increase to reach the level of $ 54,106 million by March 2002, and $ 62,021 million by mid September 2002. The import cover of reserves increased from 6.9 months in 1997-98 to 8.6 months in 2000-01 and further to almost one year in 2001-02, which is a source of comfort. Besides, it provides a measure of insulation against unforeseen external shocks or exigent domestic supply shortages. It also helps to satisfy the need for liquidity, which instills confidence in the economy among international investors and financial markets.

Table 4.3

Balance of Payment

($ million)

S.No.	Items	1997-98	1998-99	1999-2000	2000-01	2001-02
1.	Exports	35,680	34,298	37,542	44,894	44,915
2.	Imports	51,187	47,544	55,383	59,264	57,618
	- Of which, POL	8,164	6,399	12,611	15,650	13,669
3.	Trade Balance	-15,507	-13,246	-17,841	-14,370	-12,703
4.	Invisibles (net)	10,007	9,208	13,143	11,791	14,054
	Non-factor services	1,319	2,165	4,064	2,478	4,199
	Investment Income	-3,521	-3,544	-3,559	-3,821	-2,728
	Private Transfers	11,830	10,280	12,256	12,798	12,125
	Official Transfers	379	307	382	336	384
5.	Current Account Balance	-5,500	-4,038	-4,698	-2,579	1,351
6.	External Assistance (net)	907	820	901	427	1,117
7.	Commercial Borrowing (net) @	3,999	4,362	313	4,011	-1,144
8.	IMF (net)	-618	-393	-260	-26	0
9.	NR Deposits (net)	1,125	960	1,540	2,317	2,754
10.	Rupee Debt Service	-767	-802	-711	-617	-519
11.	Foreign Investment (net) Of which	5,353	2,312	5,117	4,588	5,925
	i) FDI (net)	3,525	2,380	2,093	1,828	3,904
	ii) FIIs	979	-390	2,135	1,847	2,021
	iii) Euro equities and others	849	322	889	913	
12.	Other Flows (net)+	-606	608	3,940	-2,291	1,412
13.	Capital Account Total (net)	9,393	7,867	10,840	8,409	9,545
14.	Reserve Use (-increase)	-3,893	-3,829	-6,142	-5,830	-10,896

Note : @ Figures include receipts on account of India Development Bonds in 1991-92, Resurgent India Bonds in 1998-99 and India Millennium Deposits in 2000-01 and related repayments, if any, in the subsequent years.
+ Include, among others, delayed export receipts and errors and omissions.

Source : Reserve Bank of India (RBI).

Exchange Rate Movement

4.32 The exchange rate of the rupee has broadly been market determined, except for occasional counter-cyclical operations by the Reserve Bank of India. The movement of exchange rate during the Ninth Plan has been as follows (Table 4.4).

Table 4.4

Exchange Rate (Rs. / $)

Year	Exchange Rate	Depreciation (per cent)
1997-98	37.165	4.48
1998-99	42.071	11.66
1999-00	43.333	2.91
2000-01	45.684	5.15
2001-02	47.707	4.24

Source : Reserve Bank of India.

4.33 The exchange rate market has displayed reasonable stability, with the rupee depreciating by 6.1 per cent from the annual average of Rs. 37.165 per dollar in 1997-98 to Rs.47.707 in 2001-02.

4.34 The world economy experienced one of the worst shocks after the events of September 11, 2001 in the US. Foreign exchange markets in India also became volatile as a consequence, with the rupee showing a depreciation of 1.3 per cent vis-à-vis the dollar during the 10 days period of September 10-20, 2001. In order to stabilise domestic financial markets, the RBI announced some measures during the period September 15-25, 2001. These measures had the desired effect of moderating possible panic reactions and reducing volatility in financial markets, particularly in money, foreign exchange and government securities markets.

4.35 The exchange rate management policy continues its focus on smoothening the excessive volatility in the exchange rate with no fixed rate target, while allowing the underlying demand and supply conditions to determine the exchange rate movements over a period in an orderly way. The RBI monitors closely the development in the financial markets at home and abroad and coordinates the market operations with suitable regulatory measures, as considered necessary from time to time.

4.36 Given the movement of the exchange rate of the rupee and the domestic inflation rate relative to important trading partners, the real effective exchange rate (REER) is reckoned as one of the most important determinants of the country's external competitiveness. The position of the rupee in terms of REER and nominal effective exchange rate (NEER) is given in Table 4.5.

4.37 The REER was 63.81 in 1996-97, which increased to 67.02 in 1997-98 and declined during 1998-99 and 1999-2000, thereafter increasing again during the next two years. This shows the volatility

Table 4.5

Indices of Real Effective Exchange Rate (REER) and Nominal Effective Exchange Rate (NEER) of the Indian Rupee

(36- Country bilateral trade based weights)

(Base : 1985=100)

Year	REER	% Variation	NEER	%Variation
1996-97	63.81	0.3	38.97	-1.9
1997-98	67.02	5.0	40.01	2.7
1998-99	63.44	-5.3	36.34	-9.2
1999-00	63.30	-0.2	35.46	-2.4
2000-01	66.53	5.1	35.52	0.2
2001-02 (P)	68.43	2.9	35.75	0.7

Note : The indices on REER have been recalculated from April 1994 onwards using the new Wholesale Price Index (WPI) Series with base 1993-94 = 100.

Source : Reserve Bank of India.

in the exchange rate of the rupee. This also gives an impression that it is slightly overvalued. With the appreciation of the dollar vis-à-vis the major currencies, the rupee also appreciated in real terms.

Foreign Investment

4.38 In developing countries like India, FDI is seen as a means to supplement domestic investment for achieving a higher level of economic growth. FDI benefits the domestic industry as well as the consumers by providing opportunities for technological up-gradation, access to global managerial skills and practices, optimal utilisation of human and natural resources, opening up export markets and access to international quality goods and services. Towards this end, the FDI policy has been constantly reviewed, and necessary steps taken to make India a most favorable destination for foreign investors.

4.39 FDI inflows depend upon a number of factors like the assurance of safe recovery of capital, regular repatriation of dividends, overall climate, exchange rate and price stability, availability of raw materials and other inputs, skilled manpower, infrastructural facilities and the existence of domestic and export markets. The government policy on FDI since 1991 has aimed at encouraging foreign investment, particularly in the core and infrastructure sectors. The government has permitted access to the automatic route for FDI in most sectors, except for a small negative list. The foreign investors only need to inform the RBI within 30 days of bringing in their investment, and also within 30 days of issuing of shares. Emphasis is given to foreign investment in infrastructure sectors with 100 per cent FDI, including in power, telecom, oil refining, etc.

4.40 Foreign investment inflows increased from $ 103 million in 1990-91 to $ 5,925 million in

Table 4.6
Foreign Investment Inflows

($ million)

S.No.	Items	1997-98	1998-99	1999-2000	2000-01	2001-02
A	**Direct Investment**	3,557	2,462	2,155	2,339	3,904
	a) Govt. (SIA/FIPB)#	2,754	1,821	1,410	1,456	2,221
	b) RBI	202	179	171	454	767
	c) NRI#	241	62	84	67	35
	d) Acquisition of Shares*	360	400	490	362	881
B	**Portfolio Investment**	1,828	-61	3,026	2,760	2,021
	a) GDRs/ADRs@	645	270	768	831	477
	b) FIIs **	979	-390	2,135	1,847	1,505
	c) Offshore funds and others	204	59	123	82	39
	Total (A+B)	**5,385**	**2,401**	**5,181**	**5,099**	**5,925**

Note :
* Relates to acquisition of shares of Indian companies by non-residents under Section 5 of FEMA, 1999. Data on such acquisitions have been included as part of FDI since January, 1996.
@ Represents the amount raised by Indian Corporate through Global Depository Receipts (GDRs) and American Depository Receipts (ADRs).
** Represents fresh inflows of funds by Foreign Institutional Investors (FIIs).
# SIA = Secretariat of Industrial Approval.
FIPB = Foreign Investment Promotion Board.
NRI = Non-resident Indians.

Source : RBI.

2001-02, peaking at $ 6,133 million in 1996-97. Table 4.6 shows the pattern of these inflows during the Ninth Plan period.

4.41 Foreign direct investment flows, after reaching a peak of $ 3,557 million in 1997-98, declined to $ 2,339 million in 2000-01 and increased to $ 3,904 million in 2001-02. The source and direction of FDI remained, by and large, unchanged during the 1990s. The bulk of FDI was channeled into computer hardware and software, engineering industries, services, electronics and electrical equipment, chemical and allied products and food and dairy products.

4.42 Foreign institutional investment inflows increased from a mere $ 1 million in 1992-93, reached their peak of $ 2,135 million in 1999-2000 and have been at $ 1,505 million during 2001-02. The year 1998-99 witnessed FII flows to record a negative of $ 390 million. The policy regarding portfolio investment by FIIs is reviewed constantly and major initiatives are taken, when necessary. In the budget of 2001-02, it was proposed to raise the limit for portfolio investment by FIIs from the normal level of 24 per cent of the paid-up capital of a company to 49 per cent, subject to the approval of the General Body of shareholders by a special resolution. More recently, Indian companies have been permitted to raise the aggregate ceiling for portfolio investment by FIIs through the secondary market from the normal level of 24 per cent up to the applicable sectoral cap levels of the issued and paid up capital of the company, subject to compliance with the special procedure, viz., (a) approval by the board of directors of the company to the enhanced limit beyond 24 per cent, and (b) a special resolution passed by the general body of the company approving the enhanced limit beyond 24 per cent.

4.43 Funds raised through GDRs/ADRs amounted to $ 831 million in 2000-01 and $ 477 million in 2001-02. The Government has been liberalising the guidelines for issue of GDRs/ADRs in a phased manner.

External Debt

4.44 India's external debt was $ 98.14 billion at the end of March 2002 as compared to $ 93.47 billion at end March 1997 and $ 93.53 billion at end March 1998. The stock of external debt increased by 0.98 per cent during the Ninth Plan. The position relating to India's outstanding external debt is given in Table 4.7.

4.45 Despite marginal increase in the external debt stock, the country's external debt position has improved in recent years. The debt-GDP ratio, which shows the magnitude of external debt in relation to domestic output, declined from 38.7 per cent at end March 1992 to 22.3 per cent at end March 2001 and further to 20.8 per cent at end March 2002. Similarly, the debt-service ratio that measures the ability to serve debt obligations, declined from the peak level of 35.3 per cent of current receipts in 1990-91 to 17.3 per cent in 2000-01, and further to 14.1 per cent by end March 2002. The short-term debt to total debt (with maturity up to one year)

Table 4.7

India's External Debt Outstanding (end March)

($ million)

Categories	1998	1999	2000	2001	2002 (P)
Short-Term Debt	5,046	4,274	3,933	3,480	2,746
Long-Term Debt	88,485	92,612	94,330	96,224	95,392
Total Debt	93,531	96,886	98,263	99,704	98,138

Source : RBI.

Table 4.8

External Debt : Key indicators

(Percent ratio)

Items	1998	1999	2000	2001	2002 (P)
Total External Debt to GDP	24.3	23.6	22.2	22.3	20.8
Short Term Debt to Total Debt	5.4	4.4	4.0	3.5	2.8
Short Term Debt to Foreign Currency Assets	19.4	14.5	11.2	8.8	5.4
Concessional Debt as per cent to Total Debt	39.5	38.5	38.9	36.0	35.8

Source : RBI.

declined from 10.2 per cent to 3.5 per cent from end March 1991 to end March 2001 and further to 2.8 per cent by end March 2002. Short-term debt to foreign currency assets has also improved from a high of 382.1 per cent at end March 1991 to 8.8 per cent at end March 2001. The ratio was 5.4 per cent at end March 2002. The share of concessional debt, which was steady around 45 per cent during the first half of the 1990s, declined to 38.5 per cent at end March 1999 and further to 35.8 per cent at end March 2002. India has the highest share of concessional debt among the top 15 debtor countries of the world.

4.46 India's indebtedness position vis-à-vis other economies has improved. In terms of the absolute level of debt, the position improved from the third largest debtor after Brazil and Mexico in 1991 to the tenth in 1999, after Brazil, Russian Federation, Mexico, China, Indonesia, Argentina, Korea, Turkey and Thailand. In terms of the present value of external debt too, India ranks as the tenth largest debtor country. In terms of indebtedness classification, India improved its position from 'close to severely indebted' category in 1991, to 'less indebted' bench-mark in 1999 (Global Development Finance 2001, World Bank).

4.47 The improvement in India's external debt position since 1991-92 is due to a conscious debt management policy that focused on high growth rate of exports, keeping the maturity structure as well as the total amount of commercial debt under manageable limits, limiting short-term debt, and encouraging non-debt creating financial flows. These measures led to a sustained improvement in the external indebtedness position of the country. Efforts are now on to further consolidate the gains already made. A number of new initiatives have been undertaken to meet this objective. This includes increased coverage and computerisation of external debt data, better co-ordination among agencies reporting debt statistics, pre-payments/ refinancing of more expensive external debt and other measures to actively manage sovereign external debt of the country.

EXTERNAL SECTOR PROJECTIONS

4.48 As indicated in chapter 2, the macro-economic dimensions targeting an 8 per cent growth in GDP would lead to an increase in the investment rate to 32.3 per cent by the year 2006-07, as against the present investment rate of 24.3 per cent. It is expected that this growth rate will be achieved with improvement in efficiency in the economy, and by including higher capacity utilisation. The savings ratio is expected to increase to 29.4 per cent by 2006-07, as against a level of 23.5 per cent in 2001-02. For the Plan as a whole, the savings rate has been targeted at 26.8 per cent. The implied current account deficit, seen in terms of the gap between investment requirement and domestic savings by the end of the Tenth Plan, would be an estimated 2.9 per cent of the GDP by 2006-07 and an average 1.6 per cent for the Plan as a whole. This gap is to be met from a combination of inflows of foreign investment, external commercial borrowings and other forms of external assistance. In order to look at the behavioural side of the current account deficit, in this section we look at the projections of exports, imports and flow of invisibles. These projections are built on the experiences of the Eighth and Ninth Plan periods. The actual balance of payments outcome will no doubt depend on developments in the world economy and internal macro-economic balances, but the policy stance regarding external variables will also have an important role to play.

4.49 On the basis of the more liberalised balance of payments policy to be pursued and taking into account past trends in exports and imports as well as other determining variables, projections have been made for exports and imports for the Tenth Five Year Plan period.

Exports

4.50 In the Indian context, exports are still seen to be primarily supply-side determined. Although demand-related factors, like relative prices (including exchange-rate movements) and world incomes, are becoming progressively more important, particularly for specific export items, the dominant factor continues to be the ability of the economy to produce adequate volumes of exportables to address international markets. Analysis of the recent export performance indicates that the share of tradables in GDP continues to exert a strong influence on export behaviour, with exchange rate variations and relative prices also playing significant roles. International income levels still do not appear to matter significantly, reflecting the low share of Indian exports in international trade.

4.51 Using the results of the analysis and taking the projected growth in GDP and its constituents during the Tenth Plan period and certain assumptions for trends in the independent variables during the Ninth Plan period, export projections have been made. The results indicate that if the Tenth Plan growth targets are met, exports are likely to increase from $ 44,915 million in 2001-02 to $ 80,419 million by 2006-07. This would mean a compound growth rate of 12.4 per cent during the Tenth Plan, with an elasticity of 1.5. It needs to be noted, however, that these projections are based on the assumption that the REER will be maintained at more or less the current level. Thus, some flexibility does exist in increasing exports further with a more aggressive exchange rate policy, if necessary.

4.52 On the basis of these projections, the sector-wise export vector has been estimated for about 53 broad commodity groups, as may be seen in Annexure-1. The sector-wise break up is based on shares and growth rates of these sectors during the Ninth Plan period. It may be observed that fishery products, other food and beverages, textiles, readymade garments, other non-metallic minerals (including pearls, precious and semi-precious stones), leather products, petroleum products, chemicals, iron and steel, machinery and communication and electronic items are expected to constitute the highest share of exports. At the same time, the highest growth during the Tenth Plan is expected in petroleum products, followed by communication and electronic equipments, electrical machinery, other non-metallic minerals, chemicals, paints, drugs and cosmetics, textiles, readymade garments, food and beverages, etc. As far as the projections for export of food items is concerned, it may be mentioned that these are subject to availability of surplus, and priority would be given to domestic nutritional requirements. However, with an increase in agricultural production of 4 per cent during the Tenth Plan and with limited domestic demand (due to constraints in purchasing power), efforts would be on to increase export of processed items. This could include exports of horticulture products, particularly processed foods and vegetables, cashew nuts, spices, manufactured tobacco, castor oil and oil meals, apart from dairy products, poultry, processed meat and other processed foods and beverages. The projections for agricultural exports take these aspects into account.

The overall growth in export of agriculture and allied products has been projected to be around 9 per cent.

Imports

4.53 In India, imports are primarily demand determined, and are also very sensitive to changes in average tariffs. The customs tariffs have been reduced gradually as a part of the reforms process. The average tariff duty in 1991-92 was 128 per cent, along with a very large number of separate tariff rates across commodity groups and also coupled with many exemptions. In 1996-97, the average (total) duty rates were 38.6 per cent with a standard deviation of 19. The highest duty rate was in the intermediate goods sector, and with substantial variation. By 2001-02, the average import duty (total) was reduced to 37.1 per cent, which has been further reduced to 33.7 per cent in 2002-03 (the average basic import duty is 28.9 per cent in 2002-03). While there is scope for further rationalisation of tariff structure to bring it in line with other East Asian countries, the sensitivity of imports to the tariff rates demands that care be taken not to place undue pressure on the macro-economic balances. It becomes necessary, therefore, to examine the implications of alternative tariff reform scenarios on balance of payments.

4.54 The behaviour of aggregate import demand in the country is expected to be strongly driven by domestic growth rates. In addition, the average level of tariffs also exerts a strong influence. Unexpectedly, the exchange rate effects were not particularly significant over the recent past. A possible explanation for this is that average tariff rates in India are still too high for the exchange rate to make any material difference in the decision to undertake imports. It is expected that as tariff rates are reduced, exchange rate movements will become progressively more important.

4.55 The projection of imports during the Tenth Plan period has been made on the basis of two likely scenarios. In the first (scenario-1), the average (total) tariff rate is assumed to come down to the East Asian level of 15 per cent in the terminal year of the Plan. In scenario-2, the indicative target announced by the government has been assumed to obtain, which yields an average duty rate of 18 per cent in the terminal year. The time phasing of these two sets of tariff reductions are also different. In scenario-1, tariff reductions are assumed to follow a pattern where the present average of total duty rate is brought down from 33.7 per cent to 27 per cent in the next year, then to 22 per cent and 18 per cent subsequently, and finally to 15 per cent by 2006-07. In scenario-2, the gradual reductions assume 28 per cent in 2003-04, and 24 per cent, 20 per cent and 18 per cent respectively by 2006-07. In both the scenarios, GDP growth has been taken at the Plan target of 8 per cent per annum. Using the results of the analysis imports were projected.

4.56 In scenario-1, with tariffs reduced to 15 per cent by 2006-07, total imports are likely to increase from $ 57,618 million in 2001-02 to $ 1,32,058 million by 2006-07, implying an annual growth of 18 per cent and an elasticity of 2.3. However, if tariffs are reduced only to 18 per cent, the imports are likely to reach up to $ 1,22,846 million by 2006-07, i.e. an annual increase of 16.3 per cent and an elasticity of 2.0.

4.57 The details of the sector-wise projections for imports are provided in Annexure-2. The methodology used for estimation is the same as commodity-wise projections for exports. It is expected that crude petroleum would continue to have the highest share, followed by other metallic (including gold and silver) and non-metallic minerals, chemicals, machinery and transport equipments. Import of food items is projected to be relatively low, except edible oils. The highest growth in imports during the Tenth Plan is likely to be from communication and electronic equipments, followed by electrical and non-electrical machinery, edible oils, non-metallic minor minerals, tea and coffee and leather and leather products.

Trade Balance

4.58 The trade balance, derived on the basis of the projected exports and imports under different scenarios, is expected to increase to $ (-) 1,64,141 million in scenario-1 and to $ (-) 1,41,352 million in scenario-2.

Invisibles

4.59 The net invisibles are projected exogenously and are expected to grow broadly at the rate of 11 per cent from the base position of $ 14,054 million in 2001-02, comprising $ 35,612 million receipts and $ 21,558 million payments. It is expected that the projected net-invisibles would increase to $ 23,716 million by 2006-07.

Current Account Balance

4.60 Based on the projected trade balance and the net invisibles, the status of current account balance is arrived at in different scenarios and given

Table 4.9
Current Account Balance during the Tenth Plan Period

($ million)

Scenario-1 : (GDP 8 % : Tariff 33.7 %, 27 %, 22 %, 18 %, 15 %)	**2001-02**	**2006-07**	**Total**	**Gr.Rate (%)**
GDP	4,37,029	6,42,025	27,37,497	8.0
Exports	44,915	80,419	3,22,863	12.4
Imports	57,618	1,32,058	4,87,004	18.0
Trade Balance	-12,703	-51,639	-1,64,141	
Trade Balance/GDP (%)	-2.9	-8.0	-6.0	
Invisibles – Receipts	35,612	67,077	2,64,542	13.5
– Payments	21,558	43,361	1,67,155	15.0
Invisibles (Net)	14,054	23,716	97,387	11.0
Current Account Balance	1,351	-27,923	-66,754	
Current Account/GDP (%)	0.3	-4.3	-2.4	
Scenario-2 : (GDP 8 % : Tariff 33.7 %, 28 %, 24 %, 20 %, 18 %)	**2001-02**	**2006-07**	**Total**	**Gr.Rate (%)**
GDP	4,37,029	6,42,025	27,37,497	8.0
Exports	44,915	80,419	3,22,863	12.4
Imports	57,618	1,22,846	4,64,215	16.3
Trade Balance	-12,703	-42,427	-1,41,352	
Trade Balance/GDP (%)	-2.9	-6.6	-5.2	
Invisibles – Receipts	35,612	67,077	2,64,542	13.5
– Payments	21,558	43,361	1,67,155	15.0
Invisibles (Net)	14,054	23,716	97,387	11.0
Current Account Balance	1,351	-18,711	-43,965	
Current Account/GDP (%)	0.3	-2.9	-1.6	

Note : Tariffs are total duties and include basic and special additional duty.

Source : RBI for the year 2001-02.

in Table 4.9. It may be observed that the CAB is likely to increase sharply with lowering of tariffs from an average 33.1 per cent in 2001-02 and 33.7 per cent in 2002-03 (the first year of the Tenth Plan), to bring it in line with East Asian levels, i.e. to 15 per cent. Reduction of tariffs to 18 per cent by 2006-07 would be most consistent with this. The CAB would be relatively more manageable if the tariffs are reduced to 18 per cent as may be seen from the status of the CAB/GDP ratios.

Capital Account

4.61 The capital account projections show the financing of the current account balance, as in Table 4.10, which gives the details of foreign savings. These projections for the external assistance and foreign investment during the Tenth Plan estimates are worked out on the basis of the past trends and likely developments in the future. In particular, the repayment of Resurgent India Bonds and the India Millennium Depositories has been fully taken into account.

Balance of Payments

4.62 On the basis of the current account and capital account, the balance of payments seen in terms of change in reserves, has been projected under the two scenarios as may be seen in Table

Table 4.10
Inflow of Foreign Savings

($ million)

	2001-02(P)	2006-07
External Assistance (net)	1,117	1,572
Commercial Borrowings (net)	-1,114	4,400
Non-Resident Deposits (net)	2,754	2,750
Rupee Debt Service	-519	-600
Foreign Direct Investment (net)	3,905	7,500
Portfolio Investment	2,020	5,600
Foreign Investment Flows (net)	5,925	13,100
Other Capital Flows (net)	1,382	1,000
Capital Account Total (net)	9,545	22,222
Debt	2,550	9,122

Source : Planning Commission (September 2001), Report of the Sub-Group on External Aid and WTO Commitments,

Table 4.11
Change in Reserves under Various Scenarios

($ million)

Year	Current Account Balance and CAB/GDP in bracket		Capital Account (Net)	Change in Reserves	
	Sc-1	Sc-2		Sc-1	Sc-2
2001-02	1,351 (0.3)	1,351 (0.3)	9,545	10,896	10,896
2006-07	-27,923 (-4.3)	-18,711 (-2.9)	22,222	-5,701	3,511

Source : Derived from Table 4.9 and 4.10.

4.11. In scenario-1, when the tariffs are brought down to 15 per cent, the change in reserves by 2006-07 is likely to be $ (-) 5,701 million. The change in reserves is likely to be $ 3,511 million by 2006-07 in scenario-2 where the tariffs are brought down less sharply to 18 per cent.

4.63 As may be observed from Table 4.11, the sustainable current account deficit and balance of payments situation at present are likely to be substantially compromised if average tariffs are brought down sharply to East Asian levels. Concerted effort would, of course, be required to increase exports. Since structural changes (in terms of changing share of tradables and relative prices) can be a medium to long-term option, it is the nominal exchange rate that would need to be suitably adjusted from time to time to keep balance of payments under control. It is the financing of the current account deficit that is important for sustained development during the Tenth Plan. Flow of foreign investment into productive sectors is essential. Moreover, as has been learnt from the experience in East Asian countries, the present trend of limited reliance on the 'flighty' short-term debt needs to be continued. Flow of foreign exchange reserves to short-term debt and, even more so, from the short-term debt to export of goods and services, needs to be maintained at viable levels to maintain buoyancy in the international capital markets.

TRADE AND EXCHANGE RATE POLICY

4.64 The trade regime in India till recently, has been very complex, characterised by severe quantitative restrictions on imports and exports, and very high tariffs on imports. Quantitative restrictions on imports were based on a restrictive licensing policy and further complicated by a wide variety of special import schemes. These included the import replenishment scheme for exporters, the actual user policy, government purchase preference and canalised imports for specified items through designated state agencies.

4.65 It is recognised that the most important pre-condition for creating a more open economy is to create an expanding production base of tradable goods and services, which can not only withstand external competition, but also provide the surplus necessary to ensure sufficient export earnings for meeting the import needs of the country. The second pre-condition is to create conditions under which the export market becomes increasingly more attractive, so that there is both a shift from selling in the domestic market to exports, and developing capacities to specifically target such export opportunities. Both these conditions are inextricably interlinked, and involve the reduction and eventual elimination of the anti-export bias that has characterised the Indian economic system in the past and continues to exist to some degree even at present. There are two dimensions to this. First, the incentive structure has to be re-oriented towards investment in tradable goods and services and away from non-tradables. Second, the relative profitability of exports vis-a-vis domestic sales has to be improved. The principal instrument for achieving both these conditions is the exchange rate, which is discussed in some detail.

4.66 With the steady reduction of controls in trade matters, the exchange rate has emerged as a major instrument of policy. It needs to be used firmly but judiciously to achieve steady and sustainable growth of trade, investment and competitiveness. With the introduction of almost full convertibility on the current account and also partial convertibility on the capital account, the exchange rate has already been made more sensitive to the demand for and supply of foreign exchange in the economy. This, however, may have to be tempered occasionally by strategic intervention of the government in order to ensure that the imperatives of macro-economic policy are met. Since exports have a central role to play in the attainment of the Tenth Plan targets and in the present and future development strategy, it is suggested that the exchange rate be viewed primarily as an instrument to affect the behaviour of exports at least until such time as the production base of the economy is sufficiently integrated with the international market and exports are robust enough to withstand periodic fluctuations in the exchange rate and in international prices.

4.67 The exchange rate not only affects the degree of price competitiveness of domestic tradables in comparison to international markets, but also determines the relative profitability of tradables vis-a-vis non-tradables in the domestic economy. In the present context, both the factors are of importance, and the conduct of exchange rate policy would have to take into account the somewhat different considerations that underlie the two objectives. The standard measure of domestic prices relative to international prices, the real effective exchange rate, adjusts the nominal exchange rate by the differential rates of inflation in India and abroad. During the Ninth Plan, the export-weighted real effective exchange rate of the rupee has shown considerable amplitude, combining sharp depreciations with long periods of gradual appreciation, with the effect that at the end of the Ninth Plan (2001-02) the REER was 1.4 per cent above its level in March 1997, which implies that the relative price competitiveness of Indian exports on account of the exchange rate has been eroded to this extent. Matters are worse if the effect of the exchange rate on relative attractiveness of tradables vis-a-vis non-tradables in the domestic economy is considered. The appropriate measure of this is not the REER, but the nominal exchange rate adjusted only by the domestic inflation rate. This measure has appreciated quite substantially over the same period by 35.9 per cent, as shown in Table 4.12. This behaviour of the exchange rate is not conducive to a steady move towards greater export orientation of the economy. During the Tenth Plan, the exchange rate will need to be deliberately depreciated in terms of the average level of prices in the country, which would, given the targeted rate of inflation for the Tenth Plan period, imply a nominal depreciation in the range of 5 to 7 per cent per

Table 4.12

Indices of the Exchange Rate

(Base 1997-98 = 100)

Year	NEER		REER		WPI/NEER	
	Level	% Change	Level	% Change	Level	% Change
1997-98	100.00	-	100.00	-	100.00	-
1998-99	90.83	-9.17	94.66	-5.34	116.65	16.65
1999-00	88.63	-2.42	94.45	-0.22	123.45	5.83
2000-01	88.78	0.17	99.27	5.10	132.06	6.98
2001-02	89.35	0.64	102.10	2.85	135.94	2.94

Note : (1) NEER = Nominal Effective Exchange Rate
= w(i).e(i).e
where : w(i) = x(i)/x
x(i) = exports made in the ith currency
x = total exports
e(i) = index of the exchange rate of the ith currency against $ expressed as the number of units of ith currency per $ 1
e = index of exchange rate of the rupee expressed as the number of units of $ to Re. 1
(2) REER = Real Effective Exchange Rate
= NEER.[w(i).P/P(i)]
where : P = Price Index for India
P(i) = Price Index of ith country
(3) WPI = Wholesale Price Index (domestic)

Source : Economic Survey 2001-02 and Annual Report, RBI, 2001-02.

annum under normal circumstances. Such an exchange rate strategy would, to some extent, correct the bias against tradables, by leaving the relative prices of traded and non-traded goods more or less unchanged, and thereby facilitate the efforts at containing the secular reduction in the share of tradables in GDP. This should also automatically lead to a depreciation of the REER in the 2 to 3 per cent per annum range, assuming that the international rate of inflation does not accelerate from its usual trend rate of 3 to 4 per cent per annum, and thereby improve the price competitiveness of Indian goods and services in the external market.

4.68 There is a point of view which holds that the exchange rate is not only an uncertain instrument of export promotion but it also has the negative effects of generating cost-push inflation and retarding external capital inflows, and that greater reliance should be placed on increase in efficiency and improvements in quality, productivity and technology for attaining greater international competitiveness. While it is no doubt true that in the longer run there is no substitute for efficiency, quality, productivity and technology, these take time to develop and may not be directly affected by public policy during the short to medium run. These attributes are expected to develop steadily over time in the Indian economy as a normal consequence of increased competition and greater integration with the international economy, and the government can play only a facilitative role. The immediate imperative is to encourage a greater degree of outward orientation through policy initiatives, for which the exchange rate is the principal instrument.

4.69 Note, however, has to be taken of the alleged negative dimensions of exchange rate depreciation. The first argument against a policy of steady depreciation is that it is inherently inflationary and, when exports are either import-dependant or face low price-elasticity of demand, it may not stimulate exports in any substantial manner. Thus, the trade-off involved in exchange rate depreciation is between the negative effects of acceleration in domestic inflation and a net export expansion effect. It is true that any effort at altering the relative price structure tends to be inflationary as the various sectors of the economy attempt to protect their relative position. This does not, however, constitute a compelling argument for not making the effort at altering the price relatives when it is desirable as a part of a development strategy. On the other hand, it does underline the need to adopt a stringent anti-inflationary policy stance as a complementary measure, which is in any case an integral component of the Tenth Plan strategy. Furthermore, in the Indian context, there is ample empirical evidence that exchange rate depreciation does have strong export expanding effect. This arises primarily out of the fact that the Indian export basket still has a very low share of differentiated or branded products, which are the category of goods that are less price-sensitive, and the bulk of exports rely principally on price competitiveness. This characteristic of the Indian export basket is likely to continue to obtain in the immediate future, and emphasises the need to follow an active exchange rate policy.

4.70 It is sometimes argued that a stable nominal exchange rate is conducive to attracting greater external capital flows, and an expectation of currency depreciation may deter such inflows by lowering the expected returns denominated in foreign currency terms. But, it should be noted that if the exchange rate gets misaligned due to inflation and macro-economic imbalances, there will be expectations of depreciation, and a prolonged non-adjustment of the exchange rate will only strengthen such expectations resulting in reduced capital flows and eventual capital flight. What is called for is the adoption of appropriate policies to maintain macro-economic balances and not any artificial pegging of the exchange rate. Furthermore, the real benefits of foreign investment can be reaped, only when these investments come in, on the basis of the intrinsic strengths of and the real factors present in the economy, rather than on the basis of the implicit capital gains arising out of an expected appreciation of the currency. The advantage of a depreciating currency is that the foreign investment that does come in under such an expectation will not only be less speculative, but also more export-oriented in its own interest as against the greater inward orientation of investment that relies on nominal exchange rate stability. The possibility of an outflow of existing portfolio investment, arising out of an expected depreciation, adds to the urgency of clearly signaling the future strategic approach to exchange rate management before the stock of such external portfolio liabilities becomes too large to risk any substantial net outflow.

4.71 There is, however, an issue as to whether the exchange rate should be depreciated gradually or devalued sharply to attain some medium-run target value. If the primary emphasis of exchange rate policy is on its effect on external capital flows, then a devaluation is generally to be preferred, since it immediately improves the incentive to export and reduces the probability of generating expectations of further depreciation among foreign investors. However, such a step does not generally create the condition for a sustained shift towards greater export orientation, particularly insofar as new investments are concerned. It may also require much sharper anti-inflationary measures, which may be contractionary in the short run since the fiscal parameters are unlikely to improve sufficiently within the short period. A more gradualist exchange rate stance, on the other hand, not only improves the relative profitability of exports, albeit less than a devaluation, but also affects the pattern of investment in favour of tradables in general, and exportables in particular. It would, however, require strict management in terms of the collateral macro-economic policies, particularly to prevent generation of inflationary expectations that may accompany a process of gradual depreciation. In view of the objectives of the Tenth Plan, it appears preferable to opt for the latter strategy and address the issue of foreign investment through policies aimed at reducing and eventually eliminating the impediments that exist at present.

4.72 In recent years, the ability of the government to determine the behaviour of the exchange rate has eroded quite significantly. Relatively large movements of financial capital and the need for monetary restraint have constrained the extent to which the exchange rate could be used as a policy instrument. In order to re-establish the primacy of the exchange rate as an instrument of macro-economic policy in an open economy, the government has to create the conditions whereby it can intervene in the foreign exchange markets in a meaningful way. For this, binding ceilings not only on ECBs as at present, but also some control on net FPI flows through taxes and other disincentives, appear inescapable, at least until such time as the Indian foreign exchange market achieves sufficient depth and the foreign exchange reserves of the country are sufficiently large to withstand speculative pressures. Such restrictions on the inflow of FDI are, however, unnecessary since they are normally associated with real capital inflows, both physical and in the form of technology and services.

4.73 Exchange rate management, however, is only one of the instruments to affect a greater degree of export orientation in the economy. Tariff reforms is an important component of the efforts at increasing competition and efficiency in the economy, and making Indian exports more competitive both abroad and, also, relative to import substitutes in the domestic market. As has already been mentioned, the Tenth Plan will attempt to achieve international levels of tariffs, while carefully phasing out the changes, keeping in view the larger interests of the economy and the progress made on other fronts. This transition can be made without too much disruption in view of the additional protection to domestic industry that is sought to be provided through the process of exchange rate depreciation during the Tenth Plan period.

DIRECT EXPORT POLICY INITIATIVES

4.74 The policy reforms have aimed at creating an environment for achieving rapid increase in exports to make it an engine for achieving higher economic growth. Depending on the international environment and domestic exigencies, various export policies have been formulated from time to time. More recently, a number of steps have been taken to enhance the export growth. This includes reduction in transaction costs through decentralisation, simplification of procedures and various other measures, which are enumerated in the EXIM Policy 2002. Steps have been taken to promote exports through multilateral and bilateral initiatives, identification of thrust sectors and focus regions. Special economic zones are being set up to further boost the exports. Import of second hand capital goods, which are of less than10 year vintage, have been allowed. In order to encourage export of quality/branded goods, double weightage has been accorded to exports made by units having ISO or equivalent status. Other measures include promotion of agricultural exports, market access initiative, setting up of business-cum-trade facilitation centres and trade portals, strengthening of the Advance Licensing Scheme, Duty Free Replenishment Certificate (DFRC), Duty Entitlement Pass Book (DEPB) Scheme, etc.

4.75 The EXIM Policy 2002 has removed all quantitative restrictions (QRs) on exports, except for a few sensitive items retained for export through the State trading enterprises. The comprehensive policy covers the agricultural sector, cottage and handicrafts and the small-scale sectors. Apart from removing restrictions on agricultural exports, it is proposed that transport assistance be made available for exports of fresh and processed fruits, vegetables, floriculture items, poultry and dairy products, and products of wheat and rice.

4.76 Some of the sector-specific packages in the policy include incentives for export of jewellery, leather and textiles, handicrafts, and other items from the small-scale sector. To elaborate, the package includes reduction of customs duty on import of rough diamonds to zero per cent; abolition of licensing for rough diamonds which should help India to emerge as a major international center for diamonds; reduction in value addition norms for export of plain jewellery from 10 per cent to 7 per cent; and allowing export of all mechanised unstudded jewellery at a value addition of 3 per cent only as part of the effort to achieve a quantum jump in jewellery exports. Further, relaxations have been made in terms of extension of duty-free imports of trimmings and embellishments up to 3 per cent of f.o.b. value, hitherto confined to leather garments to all leather products; and permitting DEPB rates for all kinds of blended fabrics among several other benefits for the textile sector. The policy also marks the launching of a new programme called, Special Focus on Cottage Sector and Handicrafts, keeping in view that the small scale products form 50 per cent of India's exports.

4.77 In addition to merchandise exports, there is tremendous scope for increasing exports from the services sector as India has a highly skilled manpower and a large industrial base. This is being tapped for electronic and computer software, engineering consultancy, banking, insurance, tourism, etc. The Policy is geared towards nearly doubling India's present exports of about $ 45 billion to more than $ 80 billion over the Tenth Five Year Plan by 2007.

4.78 It was also announced that overseas banking units (OBUs) would be permitted to be set up in special economic zones (SEZs). These units would be virtually foreign branches of Indian banks but located in India. These OBUs would be exempt from usual requirements of credit reserve ratio and statutory liquidity ratio. The banks would provide access to SEZ Units and SEZ developers to international finances at international rates. The policy includes various duty-neutralisation instruments for exports such as the Duty Entitlement Pass Book. Export Promotion Capital Goods (EPCG) and all other schemes like Advance Licenses, etc., would continue along with the existing dispensation of not having any value caps. EPCG licenses of Rs.100 crore or more will have 12 years export obligation period (as against 8 years earlier) with a five-year moratorium. A Plan scheme entitled, Market Access Initiative (MAI) was initiated to assist industry in research and development, market research, warehousing and marketing infra-structure. Also, a scheme for participation of States in the export endeavour, Assistance to States for Infrastructure Development for Exports (ASIDE) is being encouraged. Moreover, attention is being paid to aspects of grading and quality control, and scientific packaging methods to meet international standards/ specifications.

4.79 In order to promote exports to Latin America, Africa and the Commonwealth of Independent States (CIS) countries, various programmes have so far been launched. It is expected that in addition to the Focus: LAC programme for accelerating trade with Latin American countries, the new programme called Focus: Africa would give a boost to India's trade with the sub-Saharan African region. In order to strengthen trade ties with the CIS countries, a Focus: CIS programme would be launched in the coming year.

4.80 A Medium-Term Export Strategy 2002-07 was announced in January 2002, with a view to providing a road map for the export sector in the medium term. The aim is to focus on the import baskets of our major trading partners (USA, Japan and EU) in the context of India's export basket, and arrive at *focus products* and *focus markets* for India. A total of 220 items and 25 markets have been identified for special attention based on various criteria, and indicative sector-wise strategies have been formulated. The Export Strategy 2002-07 aims to achieve 1 per cent share in world exports by 2006-07, from a 0.67 per cent in 2000-01. In order to achieve this, there is a continued need to address the domestic problem of infrastructural bottlenecks in the country, mainly relating to transport problem and ports facilities. Further, in order to improve the price competitiveness of our exports, provision is being made for WTO compatible subsidies, transport, pricing and comprehensive tax system especially for exporters, strengthening export oriented small-scale industries, dissemination and extension of information to potential exporters, etc. At the international level, apart from genuine trade fluctuations, restrictive trade practices by some of the trading partners in developed countries need to be negotiated.

4.81 Thus, in order to facilitate promotion of exports during the Tenth Plan, there is need to give further impetus to the major foreign exchange earning sectors of cottage and handicrafts, gems and jewellery and exports from the services sector, including electronic and computer software, engineering, and consultancy. The special economic zones already set up could be allowed greater relaxations from investment restrictions, particularly small scale industries reservations, foreign equity limits, real estate, etc. These zones could be classified as completely duty free enclaves for trade operations and be treated as 'foreign country' insofar as trading conditions are concerned. Relaxations may be given to corporate income tax and other excise and service taxes, and appropriate labour laws made applicable to these enclaves.

FOREIGN INVESTMENT

4.82 The projected balance of payments (BOP) position for the Tenth Plan period given in Table 4.9 indicates that the current account deficit (CAD) is likely to be 2.9 per cent of GDP by the terminal year of the Plan (2006-07). In view of the experience of the late 1980s during which India experienced CADs of above 2 per cent per annum, culminating in the crisis of 1991, there may be some apprehensions about the sustainability of the proposed BOP scenario. On the other hand, there is a point of view which holds that the CAD need not *per se* be a matter of policy concern, and attention should be restricted only to the public component of the external liabilities. The argument is that the private sector can be expected to fully take into account the inter-temporal viability of its liabilities, both internal and external, and hence the private component of CAD would necessarily be self-correcting in the longer run. This is not, however, a tenable position for countries whose currencies are not reserve currencies, and certainly not for countries with non-convertible currencies. The reason for this, apart for the normal failure and default risk present in any commercial activity, is that the individual private sector firm normally evaluates its inter-temporal budget constraint in terms of the domestic currency and not on the basis of the currency in which the liabilities were originally incurred. Thus, the possibility exists that private viability can co-exist with a running down of a country's foreign exchange reserves. International experience, especially the East Asian crisis, provides ample instances of such outcomes.

4.83 Prior to the economic reforms, when foreign investment was virtually non-existent, the sustainable CAD for India was estimated to be about 1.4 per cent of GDP. With the liberalisation of external trade and investment, this figure has risen quite sharply, since foreign investment does not carry the same level of systemic risk as external debt. On the aggregate, therefore, it is felt that the CAD projections are sustainable provided that the foreign investment flows are of the required magnitudes. Nevertheless, there are two factors that need to be taken into account. First, foreign investments tend to require a higher rate of return than the interest rate on debt over the longer run. Therefore, it would not be prudent to raise the CAD target too much unless there is sufficient confidence in being able to maintain relatively high growth rates of exports over an extended period. Second, a distinction has to be drawn between foreign direct investment and foreign portfolio investment in terms of their effects on the economy.

4.84 In general, FDI is preferred to FPI, partly because its returns are closely linked to the performance of the real economy and partly because it tends to be less volatile than FPI. Besides, the most important disadvantage of FPI flows is that it tends to be pro-cyclical, in the sense that it comes in when the balance of payments (BOP) position is seen to be strong and goes out when the BOP position is expected to weaken. Thus, it accentuates the direction of movement of the BOP, which can cause serious problems in macro-economic management. In the case of countries like India, where the foreign exchange markets are very thin as compared to the international financial market, a free FPI regime carries the danger of speculative movements, which can lead to serious disruption in the economy.

4.85 There is another dimension, however, to the relative benefits of FDI over FPI which needs to be taken into account. FDI can make up not only for deficiencies in the availability of savings and foreign exchange – which is true of all external flows – but also for weaknesses in domestic entrepreneurial capacity. In other words, the role of FDI in directly stimulating investment activity in the country can be of great significance. This is particularly important for India during the Tenth Plan period since, as has been pointed out in chapter 2, there is a likelihood that corporate investment activity may not be dynamic enough to absorb the available resources, particularly in those areas which are being vacated by the public sector. In such a situation, the entrepreneurial function played by FDI can have the effect not only of bringing in additional resources, but also leading to better absorption of domestic savings. On the other hand, relatively free access for FDI with restrictions on other forms of external capital may put domestic entrepreneurs at a serious disadvantage. This has not only to do with the access to relatively lower cost external funds, but also in terms of the competition for accessing domestic finance. This disadvantage can be bridged by FPI, which increases the liquidity available to domestically listed companies. Thus, a careful balance needs to be struck between the inflows of FDI and FPI in order to ensure that sufficient foreign entrepreneurship comes in to the country without "crowding out" domestic entrepreneurship. The figures for the various forms of external flows given in Table 4.10 reflect these considerations.

4.86 However, it needs to be borne in mind that these foreign investment figures are targets and not projections. Foreign investments, by their very nature, are supply-driven in the sense that although the country can create the conditions for making such investments attractive, the decision as to whether and how much to invest is made by the foreign investor. This factor is of course well recognised, and there is considerable discussion in the country regarding the creation of a conducive environment for foreign investment. It would be desirable to unequivocally state that much of this debate may actually miss the essential issue – namely, that an investor-friendly climate needs to be created in the country for all investment, and not just for foreign investors. Indeed, it is submitted that if the investment climate in general is improved, no exclusive measures may be needed to attract foreign investors. On the other hand, if a special and differentiated investment regime is set up for foreign investors, it may actually do more harm than good.

4.87 Nevertheless, a certain degree of focus on foreign investors has to exist if for no other reason than as a recognition that they would be treading on unfamiliar waters. There are two dimensions to this which are of particular relevance. First, potential foreign investors have to be specifically targeted at and wooed. Although India's presence has improved significantly in the international investors' radar screen in recent years, there is still a long way to go before it can be taken for granted. This is especially true for a number of sectors in which India's requirements may be at variance with international investor perceptions. Heavy industries are a case in point, especially those which, until recently, were reserved for the public sector. Second, hand-holding operations in the form of an effective investment facilitation mechanism is essential for companies which would be making their first foray into the country. Unfamiliarity with laws, rules and procedures can be a great deterrent, particularly in a country with significant regional variations in these matters.

4.88 Insofar as FPI is concerned, similar considerations apply. The state of the domestic capital market is far more crucial to attracting foreign institutional investors than any special regime or dispensation. The focus, therefore, should be on improving the regulatory and supervisory framework governing the domestic capital markets and on technological modernisation of their operations. There has already been considerable progress in this regard, but it is still some distance away before the full range of financial instruments are introduced in India and innovations are expeditiously permitted. Finally, there is no reason to expect that external investor confidence can be at variance with that of the domestic investor. Therefore, the precondition to attracting greater FPI is the return of the domestic investor to the Indian capital markets.

WTO ISSUES

4.89 India is one of the founding members of the World Trade Organisation (WTO) and participation in the WTO rule based system implies greater stability, transparency and predictability in the governance of international trade. The importance of WTO in promoting multilateral trade is being increasingly acknowledged. The WTO rules envisage non-discrimination in the form of national treatment and most favoured nation (MFN) treatment to our exports in the markets of other WTO members. National treatment ensures that our exports to other member countries would not be discriminated vis-à-vis their domestic products. MFN treatment likewise ensures non-discrimination among various members in their tariff regimes and also other rules and regulations.

4.90 Emerging from continued discussions in various multilateral fora, developmental issues along with trade related issues are being increasingly focused at the international level. Poverty concerns of developing countries along with development and trade policies are also being given cognisance. Need has been felt for integration of trade policies with development strategies, increasing support to areas of finance and debt relief, recognising the importance of technology for development, improvement in market access for developing countries in sectors like textiles, clothing and agriculture, and providing better access to the dispute settlement mechanisms for these countries. The issue of abuse of the anti-dumping procedure, the problems of rules of origin criteria, technical barriers to trade, regional trading blocs, etc., are also being considered at various levels in the WTO.

4.91 The Government of India has taken several steps to implement the policy commitments made under some of the agreements, particularly under the Agreement on Tariffs and Quantitative Restrictions, Agreement on Agriculture (AoA), Trade Related Intellectual Property Rights (TRIPs), Trade Related Investment Measures (TRIMs), General Agreement on Trade in Services (GATS), apart from others. A strategy for tariff negotiations is, however, required. The additional 'non-trade' issues relating to transparency in government procurement practices, trade and competition policy, trade and environment, and trade and labour standards proposed in the Singapore and the Geneva Ministerial need to be addressed for negotiations. The commitments regarding the technical barriers to trade, social agenda covering labour standards and environmental and phyto-sanitary issues also require establishment of certain national standards and technical regulations in a standardised and transparent system.

4.92 At the same time, there are some issues on which India has expressed certain reservations. These are:

- During the implementation of WTO agreements in the last six years, India has experienced certain imbalances and inequities in the WTO agreements. It is found that some developed countries have not fulfilled their obligations in letter and spirit of the WTO agreements, and many of the Special and Differential Treatment clauses, in favour of developing countries, added in various WTO agreements have remained inoperational.
- Taking advantage of the exception clauses provided in the WTO, most industrialised countries are still enforcing various regulations on foreign producers and suppliers.
- Extending the scope of the investment regime in WTO beyond Trade Related Investment Measures and General Agreements on Trade in Services, is not appropriate.
- A multilateral framework cannot guarantee an increase in FDI inflows although it threatens to adversely affect the quality of the inflows.
- There are also other asymmetries present, as the WTO does not address the responsibilities of corporations which often impose trade restrictive clauses on their subsidiaries.
- WTO has not been able to ensure abolition of non-trade barriers being imposed on labour and environmental considerations, including the linkage in certain Generalised System of Preferences (GSP) schemes to these issues.

4.93 The present negotiations strategy is based on the decisions taken at the Doha Ministerial in November 2001. The Doha Declaration focused mainly on TRIPs agreement, public health, trade and environment and the implementation related issues and concerns. Elaborate timetables on work programme for current negotiations in agriculture and services and other issues have been worked out.

4.94 The Doha Conference presented mixed results for India. India's main concern was to speed up implementation of various agreements and to undo the imbalances and inequities present in some WTO agreements. From India's point of view, faster removal of the textile quotas maintained by developed countries like the USA was the most important implementation issue, which was, however, met with limited success. As far as environmental issues are concerned, the Doha declaration has mandated negotiations to clarify WTO rules in the light of multilateral environmental agreements. These negotiations could lead to developed countries raising barriers against goods from developing countries on the pretext of environmental protection. India had also reservations on starting negotiations on four new 'non-trade' areas, namely, multilateral investment, global rules on competition, transparency in government procurement and trade facilitation, i.e., framing of uniform custom's procedures for clearance of goods. India could secure only a two-year respite and the study process would continue for two more years, i.e. up to the Fifth Ministerial Conference, when a decision about negotiations will be taken on the basis of an explicit consensus.

4.95 Apart from mandated negotiations in agriculture and services where the process has already started, negotiations on market access for non-agricultural products is quite important for India, as reduction or elimination of tariffs, tariff peaks and tariff escalation as well as removal of non-tariff barriers will be quite helpful in exports. India would, of course, have to make offers even though the negotiations will be carried out under less than full reciprocity as far as developing countries are concerned.

4.96 The other area where action is required is in regard to extension of protection of geographical indications to products other than wines and spirits under Article 23 of TRIPs and the relationship between TRIPs and the Convention on Biological

Diversity (CBD), and Traditional Knowledge (TK) under Article 71.1. The process of legislation in regard to geographical indications needs to be completed. In the area of TRIPs and access to medicine, where additional flexibility is provided in separate ministerial declarations in terms of compulsory licensing and parallel imports, India can benefit in terms of lower prices of crucial life saving drugs and even promoting exports of pharmaceutical products.

4.97 India and other developing countries should now ensure an average balance of reciprocity in these negotiations. There is need for a continued effort to handle some of the complex issues, as per international requirements as well as our domestic resources and other constraints, during the Tenth Five Year Plan. Some of these issues are briefly examined here in the context of the text of the agreements, some of which are already accepted and others proposed for negotiations.

Agreement on Agriculture

4.98 The Agreement on Agriculture (AoA) aims to have an equitable reform programme for trade in agriculture amongst the member countries, also taking into consideration some non-trade concerns including food security. It is recognised that agriculture is a way of life in most developing economies. It contributes significantly to the overall GDP of these countries and employs a large proportion of the workforce. The policies for agricultural development aim to increase productivity and overall production in the agriculture sector. Rapid growth of agriculture in these economies is essential for food security as well as alleviation of poverty. Food security is defined by the FAO as 'the physical economic access for all people at all times for enough food for an active, healthy life with non-risk of losing such access and as such is directly connected with livelihood in the developing countries'. In this background, the commitments made under AoA are expected to ensure that food security interests of developing countries are primary in relation to the disciplines of market access and domestic support.

4.99 The commitments under AoA mainly relate to product-specific and non-product-specific domestic support, market access and export subsidies. The product-specific support is related to the Aggregate Measure of Support (AMS) given to farmers in the form of subsidies for fertilizers, seeds, pesticides, credit, electricity, etc. The AMS is calculated for each product receiving market support and is based on the prices prevailing in the base period 1986-88. Several categories of subsidies have been exempted from AMS calculations such as for research programmes, pests and disease control, training services, extension and advisory services, marketing and promotional services, and infrastructure development. Apart from this so- called 'green box' areas of support, payments for production limiting programmes and also decoupled income support was exempted.

Issues of Concern

4.100 There are a number of issues under the AoA, which are considered against the interests of developing countries like India. First of all, it relates to minimum access for import of primary goods that flout the basic rule of free trade promotion enshrined under the WTO agreement. The government budgetary support for agriculture is subjected to international discipline. 'Green Box' subsidies and also exports subsidies are required to be identified transparently to be permissible, while the rest is actionable by WTO. In any case, the 'blue box' and 'green box' subsidies, which are exempted from reduction commitments, also lead to distortions in trade. This has been emphasised by developing countries, like India, which have a majority of low cost agricultural producers.

4.101 It has been suggested, on the basis of the experience of implementation of the AoA, that the agreement legitimised the various trade distorting practices of the developed countries in their favour. Further, it has even taken away the right of the developing countries to give some limited export subsidies as otherwise provided under the Subsidies and Countervailing Measures Agreement. Despite fulfilling their so called reduction commitments, the total support being given to agriculture in the OECD countries has gone up from $ 308 billion in the year 1988 to $ 361 billion in the year 1999.

4.102 The other problem relates to distortions emerging from inequity in domestic subsidy discipline due to different base positions. The developed countries, which are heavily subsidising countries, are allowed to retain up to 80 per cent of their subsidies, while developing countries can subsidise their farmers not more than 10 per cent of the total value of agricultural production. The domestic support by developed countries needs to be reduced substantially in absolute terms.

4.103 The domestic support measures relaxed for the purpose of food security and PDS are allowed only in relation to the international market price and to the targeted population. This is a problem for countries like India with high percentage of poor population and also dependent on agriculture, where purchase of agricultural products at international market price is not possible without adverse consequences. Food security that is interlinked with the livelihood security, is extremely important for densely populated countries with a large agrarian economy like India. These countries would need enough flexibility under the Agreement on Agriculture to take care of its food security, rural employment and livelihood concerns.

4.104 India has also argued that low income developing countries such as ours, need to address market access and domestic support discipline such that their food requirements are basically met from domestic sources. The volatile international market can get transmitted to the domestic economy and seriously affect the prices of food grains and food entitlement of the poor. Commodities like wheat, coarse grains, edible oils, sugar, dairy products, fruits and vegetables that are crucial for food security would need to match high levels of export subsidies by developed countries. It is suggested that for development of agriculture in developing countries, diversification of 'green box' subsidies should be encouraged and allowed input subsidies to crops where productivity levels are below the world average. The negative product-specific support may be permitted so as to be adjusted against non-product-specific support.

4.105 The other issue of concern relates to implementation of changes in the tariff regime for agricultural commodities. The peak tariff on agricultural commodities in countries like USA, Canada, EU, Japan, Korea and the Cairns group continues to prevail at very high rates. A study conducted by the WTO with United Nations Conference on Trade and Development (UNCTAD) (1997) has observed that one-fifth of the peak tariffs of the USA, a quarter of those of EU, about 30 per cent of those of Japan and about one seventh of those of Canada exceed 30 per cent. It further reports that the most important areas for developing countries face highest tariff rates and include the major agricultural staple foods, cereals, meat, sugar, milk, butter and cheese as well as tobacco products and cotton. In fact, the study suggests that tariff wedges will continue to be significantly high on account of tariff escalation, which is a major factor preventing developing countries from diversifying and increasing their share of processed agricultural exports.

4.106 In India, agricultural tariffs are much lower compared to these countries, even though industrial and mining tariff rates still prevail much higher. The peak rates for agricultural commodities in developed countries need to be negotiated. These tariff rates are progressively being reduced to bring them in line with rates prevailing in East Asian economies.

4.107 Moreover, support packages by developed countries under production-limiting programmes for retirement of producers, as well as resources employed for production of marketable surplus in the past is still beyond the purview of the subsidy discipline. This needs to be re-negotiated. Also, there is the issue of import access rights by agricultural exporters of developing countries who are restricted on grounds of phyto-sanitary regulations in developed countries. It is important that scientific phyto-sanitary standards are established at the international level so as to prevent protectionist measures by developed countries on this plea.

4.108 Some of these concerns have been given due cognizance at the Doha Ministerial Meet by WTO in November 2001. The Declaration commits to comprehensive negotiations for improvement in market access for developing countries along with phasing out of all forms of export subsidies and other domestic support being given by developed countries. The development needs of countries like India, including food security and rural development have been taken note of. The issue of trade and environment and the aspects impinging on agriculture, however, met with limited success in the negotiations. There is continued need for negotiations prior to the Mexico Ministerial Meet, apart from the requirement of implementation by India on her commitment from 2004.

4.109 It is important that steps are taken to reap benefits of a liberalised trade regime through increased efficiency in agriculture and combat restriction by developed countries arising from sanitary and phyto-sanitary measures. Efficiency would be greatly enhanced with increased investments and land reforms. Also, diversification of agricultural production into agro-foods, horticulture and floriculture products and farm products with maintenance of international quality standards, along with application of sanitary and phyto-sanitary measures could help to increase exports from this sector.

Trade Related Intellectual Property Rights (TRIPs)

4.110 The agreement on Trade - Related Intellectual Property Rights was introduced in the WTO agreements and includes protection through exclusive rights to provide returns for undertaking innovation. At the same time, balance is ensured between the interest of the innovator on the one hand and the users on the other. It is supposed to contribute to the promotion of technological innovation and also dissemination to the mutual advantage of producers and users of the knowledge and to promote social and economic welfare. The agreement covers copyrights, trademarks, geographical indications, industrial designs, patents, lay out designs of integrated circuits and undisclosed information. The implementation of TRIPs is through prescribed laws and regulations and the members are obliged to ensure that their laws commit effective action in their infringement.

Issues of Concern

4.111 Developing countries like India, which are invariably technology seekers, face difficulties in their commercial dealings with technology holders in developed countries. Apart from market imperfections, these developing countries have inadequate experience and skill in finalising appropriate legal arrangements for acquisition of technology. Technology transfers of crucial scientific developments to the third world have been constrained due to the protection given by the intellectual property rights.

4.112 The declaration on the TRIPs agreement and public health recognises the gravity of the public health problems afflicting the developing countries. The WTO members have a right to formulate their public health policies. It is important also to note that technological development of new medicines should be transmitted to developing countries to promote the development of manufacturing capacities of pharmaceuticals, without restraining policies on access to medications. Emphasis has been on ensuring the accessibility of pharmaceuticals and medical treatments used to treat pandemics such as HIV/AIDS, Malaria, TB, etc., as well as their affordability for all, in accordance with international law.

4.113 It has been suggested that even though exclusive rights conferred by patents provide incentive for further investment in R&D of new and effective medicines, the exclusive rights in case of life-threatening diseases should be treated separately at a different level. There is need to ensure access to medicines for such diseases at affordable rates to the vast majority of the population, particularly in countries where the per capita income is low and per capita expenditure on health is abysmally small. The Doha Declaration made a categorical statement on TRIPs and public health and emphasized the rights of WTO members to protect public health and to promote access to medicines for all.

4.114 The impact of the far reaching changes in TRIPs needs to be carefully examined in regard to public health in India as improvement in the health status of the population has been one of the major thrust areas in social development programmes of India. Technological improvements and increased access to health care have resulted in steep fall in mortality but disease burden due to communicable diseases and non-communicable diseases and nutritional problems continue to be high. Inspite of the fact that norms for creation of infrastructure and manpower are similar throughout the country, there are substantial differences between States and districts in availability and utilisation of health care services and health indices of the population. A re-evaluation of the problem of health and impact of the Declaration under TRIPs needs to be done in the Tenth Plan.

4.115 One way of increasing access to medicines in poor countries is through differential pricing of drugs in the developed and developing countries. Some major companies are already pricing their products in such a manner. However, more widespread and sustainable differential pricing can be made feasible provided a right legal, technical and political environment is secured. The most important aspect is to recognise the importance of respecting the balance found in the negotiations of the TRIPs Agreement and the rights of the developing countries to use the flexibility in it, in regard to compulsory licensing and parallel imports to respond to health concerns. TRIPs Agreement is also not against segmenting of the markets through the prohibition of parallel imports. However, adequate provision has to be made for enhanced R&D efforts in India.

4.116 Traditional Medicine (TM) plays a crucial role in health-care or serves the health needs of a vast majority of people in developing countries. Access to 'modern' health care services and medicine may be limited in developing countries. TM thus becomes the only affordable treatment available to poor people and in remote communities. The protection of TM under intellectual property rights (IPRs) raises some issues, the most important being the extent to which it is feasible to protect the existing IPR system. Certain aspects of TM may be covered by patents or other IPRs. There have been many proposals to develop *sui generis* systems of protection. Such proposals are based on the logic that if innovators in the 'formal' system of innovation receive compensation through IPRs, holders of traditional knowledge should be similarly treated.

4.117 The grant of patents on non-original innovations (particularly those linked to traditional medicines), which are based on what is already a part of the traditional knowledge of the developing world have been causing a great concern to the developing world. The governments in the third world as well as members of public are rightly concerned about the grant of patents for non-original inventions in the traditional knowledge systems of the developing world. At the international level there is a significant degree of support for opposing the grant of patents on non-original inventions. In fact, a mechanism has been proposed for disclosure of the source of origin of biological material used in invention and obtaining the consent of the country of origin. At the same time, dissemination of knowledge along with patent rights for seed diversity is crucial for developing countries like India where such a large population is dependent on agriculture for their livelihood. The Doha Ministerial Declaration took cognisance of the compatibility between TRIPs and the convention on bio-diversity during its review of the TRIPs agreement.

4.118 On the domestic front, it is important to recognise the need to urgently implement product patenting in India. Detailed documentation of traditional knowledge areas is required to be undertaken at the earliest. Measures have already been initiated for setting up of the 'Traditional Knowledge Digital Library' by the Council for Scientific and Industrial Research. We need to ensure that when an overseas product is based on Indian resources and Indian medicinal knowledge, India's rights must be protected. Therefore, there is need for a separate government body for (i) facilitating Indian patents abroad, (ii) preventing foreign companies from getting exclusive marketing rights and patents on items of Indian origin, (iii) improved information dissemination to avoid exploitation of Indian consumers particularly of pharmaceutical products and farmers, (iv) better dispute settlement mechanism in consultation with lawyers, scientists and historians, and (v) improved bio-diversity through organised institutions and monitoring of seed economy.

Trade Related Investment Measures, the Multilateral Agreement on Investment and the Singapore Issues

4.119 The agreement on Trade Related Investment Measures mainly applies to trade of goods that take place via Transnational Corporations (TNCs). The agreement aimed to protect conditions applied by an enterprise, like purchase or use of products of domestic origin, volume or value of products and minimum percentage of local production, purchase or use of imported products, export conditions, etc. Similarly, restrictions imposed by host countries on foreign investment were also brought under the purview of this agreement. TRIMs does not cover foreign equity participation in industries and the issue of channeling of investment to particular areas. The agreement does not cover restrictions by government using export performance requirements. The government is expected to have similar trade policies for foreign and domestic companies.

4.120 The developing countries invite TNCs to augment availability of capital and technology. The 'performance clauses' had been added to check their effectiveness. This had led to conflict, as an appropriate code of conduct for TNCs and host countries had not been arrived at. It was against this background that this agreement was introduced in the WTO to combat the problem that had arisen due to large number of countries having imposed restrictions on foreign investment and trade in goods taking place through TNCs. However, since controls on the operations of the TNCs were required to be removed under this agreement, it has been felt that developing countries may not be in a position to direct their operations to critical areas requiring technological and financial support, without adversely affecting foreign exchange flows. The importance of FDI in developing countries cannot be undermined but selectivity of investment flows continues to be relevant as may be learnt from the foreign investment policy of China (vis-à-vis policies of some of the African and even Latin- American countries).

4.121 Since the establishment of the WTO certain members have been trying to introduce non-trade issues into its agenda. At the First Ministerial Conference in 1996 at Singapore, members like EU and Japan pushed the inclusion of Investment and Competition Policy in the agenda in order to have multilateral set of rules on these issues. At Singapore the developing countries, with India in the lead, managed to limit the work on Investment and Competition Policy to the establishment of Working Groups on Trade and Investment and a Working Group on Trade and Competition Policy. These two issues, along with Trade Facilitation and Transparency in government procurement have come to be known as Singapore issues.

4.122 The Organisation for Economic Cooperation and Development introduced the Multilateral Agreement on Investment to provide better opportunities for investment by TNCs, although there was no consensus on the issues. The OECD initiative covers all direct investment transactions, whether by non-resident enterprises or by domestic enterprises under foreign control. Three fundamental principles form the basis of the OECD instruments, viz. right of entry and establishment, national treatment, and freedom of repatriation, both on capital and current accounts, with the ultimate objective of progressive liberalisation of policies to be carried out by member countries in respect of foreign investment. It was propounded that it will provide the requisite transparency, predictability and legal security to foreign investment.

4.123 The Doha Ministerial Conference decided to start negotiations on the MAI and other Singapore issues once a consensus (on the issue of negotiations) is reached in the fifth session of the Ministerial Conference. On the basis of the decision, by explicit consensus on the modalities, actual negotiations will begin. However, a number of issues are of concern for developing countries like India, which need to be addressed prior to actual negotiations. Some of these are discussed here.

Issues of Concern

4.124 This agreement has important implications for the developmental objectives that the host country may want to address while inviting foreign investment and negotiating the multilateral agreement. The developing countries feel the need for selective and judicious intervention of the government to support domestic industry and technology creation so as to ensure a level playing field for domestic enterprises. These developing countries also employ an appropriate mix of incentives and performance requirements for foreign investment to achieve specific developmental objectives. The responsibilities of the MNCs need to be addressed and also prevent imposition of trade restrictive clauses on their subsidiaries. It is in this background that the important features of MAI need to be looked into in greater detail and view the proposed agreement of bringing the world under a legally secure, non-discriminatory and stable regime for foreign investment. In any case, it is essential to recognise that the multilateral framework cannot guarantee an increase in FDI inflows, although it could impact the quality of the inflows.

4.125 The treaty seeks to adopt a comprehensive asset-based definition of investment as opposed to the enterprises-based one, i.e., it covers all forms of assets, which are recognised and also the evolving forms of investment. Specifically, investment has been defined as 'every kind of asset owned or controlled, directly or indirectly, by an investor', while the investor is the natural or legal person of a contracting party. Thus, investment would cover, not just equity capital, but also portfolio investment, debt capital, monetary and financial transactions, and every form of tangible and intangible assets including intellectual property rights, licences and authorisations. It is this wide definition of 'investment' that has been contested. The other major issue of concern under the MAI is regarding performance requirements and investment incentives. The proposed treaty aims to go far beyond the restrictions on performance requirements under the TRIMs agreement of the WTO. The treaty prohibits a wide range of performance requirements totally even if they apply equally to domestic and foreign investors.

4.126 As far as the issue of privatisation of firms in host countries is concerned, the agreement aims to apply national treatment and the most favoured nation principle at all stages of the privatisation process. The agreement does not prohibit government-designated monopolies provided the rules of non-discrimination in their sales and purchases prevail. The problem is regarding handling dispute settlements, particularly that relating to investor to State disputes, State to State disputes, etc. The investor could have an option to file the dispute in the national courts or international arbitration. This would have implications on the rules chosen for arbitration, which could be rules operational in the host or parent country or even other international bodies. At the same time, the State (of the host country) would have no option but to go by the national legal remedies. These are also contentious issues that require negotiations.

4.127 Further, in case of the new MAI framework, it is likely that the flexibility available to us, under bilateral investment protection agreements, is taken away. In the next two years, we need to think in terms of (a) the possible impact of an MAI on different sectors; (b) status of the Indian economy in regard to the relation between trade and investment and trade and technology transfer; (c) existence or devising of new policy instruments or legislation to protect certain high priority areas; (d) to ensure a level playing field for domestic industry and (e) to provide enabling legislations to rein in the multinationals when their conduct is contrary to national objectives. This is possible in view of the emphasis in the Declaration that account should be taken, as appropriate, of the existing bilateral and regional arrangements in investment. In India such agreements are based on a model code, devised and approved after careful considerations.

4.128 Similarly, the issues relating to Trade and Competition have wide ranging implications. The Working Group has been concentrating on principles of transparency, non-discrimination and procedural fairness and provisions for hardcore cartels. Negotiations on multilateral competition agreement could commence after a consensus is reached after the 2003 Ministerial. There has been considerable exploitation due to monopoly power of major TNCs and the price fixation mechanism. The issue of anti-competitive pricing by TNCs and that of mobility and tradability of factors of production like labour, needs to be taken up as it relates to clarification of core principles, including transparency, non-discrimination and procedural fairness, and provisions on cartels. Strengthening of the international competition law needs to be preceded by strengthening of domestic competition law and regulatory framework. India and many other developing countries are required to introduce such a system domestically. At the same time, legal reforms in governance of factor market, particularly labour market is essential.

4.129 As far as the proposed changes in the issue of 'government procurement' is concerned, greater transparency in assessment of alternative investments in a fair manner would greatly enhance efficiency and help development in the developing countries. Fundamental changes are expected in the Indian and world economies within the period of the Tenth Plan where competition, productivity and efficiency will determine the place of a country in the comity of nations. In recent times, while analyzing the productivity of investment, leakages or corruption has been identified as a retarding factor in the development process. The Doha Declaration, focusing on transparency in government procurement seems to be backed by this consideration. Already there is a plurilateral agreement and a Working Group is working on this issue. During its working, the group has identified and analysed a number of principles of transparency and due process in procurement. These include definition and scope of government procurement, transparencies of decisions on qualification and contract awards, etc. Of these elements significant differences have remained on several key elements, including, in particular, scope and coverage of a transparency agreement and application of WTO Dispute Settlement Procedures to such a possible agreement. As the discussions in the Working Group on this subject have sought to tread on many market access related issues, developing countries are concerned that the real intention appears to be to extend the market access in future. However, according national treatment to all tendering parties may not be acceptable to developing countries like India, as preference would have to be given to domestic suppliers.

4.130 In India, government procurement procedures are in accordance with technical specifications and no details are revealed on the system of selection of tenders. Although there is a felt need for following standardised and transparent procedures, there is no unanimity on the exact implementation and review method. In fact, it is felt that developed countries should be prevented from using transparency principle as a means of securing market access on grounds of social and development needs. At the same time, an improved and transparent government procurement system is required for our economy.

4.131 Trade facilitation came on the work programme to undertake exploratory and analytical work, drawing on the work of other relevant international organisations, on the simplification of trade procedures in order to assess the scope for WTO rules in this area. Most of the trade facilitation proposals related to customs procedures while some were also related to transport, payment, insurance and other financial requirements. The process of negotiation on trade facilitation is also likely to commence after the Mexico ministerial in 2003. The agreement is expected to modernise and standardise customs procedures and facilitate movement and clearance of goods. The Doha Declaration on trade facilitation carries the objective of Article 8 of GATT regarding the desirability of reducing formalities in trade transactions by reducing customs and other procedures and enhancing movement, release and clearance of goods. As the transaction cost in Indian exports are quite significant, it is essential to implement reforms in these areas on an urgent basis. This would help our export promotion efforts once improved procedures are established.

4.132 Emphasis needs to be given to measures that ensure economic growth and development with trade. Inclusion of these issues, taking developmental concerns of LDCs, should be given due cognisance which would help to streamline the flow of multilateral investments into these LDCs. On the one hand, it would give access to foreign investors in a transparent framework and get legal protection, while, on the other, it would give greater confidence to the host country players to take maximum benefit in terms of financial support and technological development from TNCs. The Trade Related Committee on Investments of the WTO has been monitoring the notifications for relaxation by member countries. At the same time, negotiations on the labour market front are essential and could ensure that LDCs get improved working conditions for their skilled/unskilled workers abroad.

Trade and Environment and Related Issues

4.133 In line with increased international concern for issues relating to preservation of global environment, the multilateral environment agreements (MEA) are being brought in as part of the agreements on international trade. A harmonised code of conduct is being introduced to achieve universal conservation of the environment, as per global standards. In this case an important distinction has been suggested between environmental problems that are basically domestic, as against those that are inherently international in nature. The latter involves physical spillovers across national borders. It is these intrinsically international environmental problems that are related to trade issues, although domestic environmental problems are also related to trade through the operations of transnational production activities. Due to these issues, need has been felt for neutralising environmental externalities through use of appropriate taxes, subsidies and transfers. As part of the Doha Declaration, it has been mandated to have negotiations on limited aspects of trade and environment, viz., relating to WTO rules and trade obligations, procedures for exchange of information between MEA and WTO, and reduction/elimination of tariff and non-tariff barriers to environmental goods and services.

4.134 The multilateral Agreement on Environment addresses protection of human, animal and plant life. Here, all governmental and non-governmental bodies that set standards are required to abide by the ‘Code of Good Practice for the Preparation, Adoption and Application of Standards’, which states that national standards must be based on international norms. An exception is made where the international standards are ‘ineffective’ or ‘inappropriate’, or where the national standards are used to pursue ‘protection of human health or safety, animal or plant life or health, or the environment’. However, it is suggested that exceptions to international standards must be least trade-restrictive and must be supported by available scientific and technical information.

4.135 Additionally, the agreement aims to establish universal risk assessment criteria in setting pesticide residue levels and other health standards found in environmental laws. The proposed criteria require that the standards for risks to human health be offset by balancing the economic benefits of the harmful activity. The agreement has implications for maintaining appropriate labour standards, including child labour in developing countries. The set of minimum standards proposed include freedom of association, collective bargaining, prohibition of forced labour, elimination of exploitative child labour and non-discrimination. Here the terms ‘unfair’, ‘exploitation’ and ‘forced’ are not precisely defined but reflect basic human rights and standards to stimulate economic development in the interest of all workers and countries.

4.136 The agreement on Technical Barriers to Trade accords protection to developing countries against prescriptions on technical regulations for products which could sometimes work as unreasonable barriers to trade. The basic principles prescribe that the regulations should not be more trade restrictive than necessary to fulfill legitimate objectives of the government based on security, health or environment. The regulations are prescribed in terms of performance of the product rather than design or descriptive characteristics and are to be non-discriminatory among members. The agreement encourages adoption of international standards. It also requires a high degree of transparency in preparation and administration of technical regulations and standards in the industrialised countries.

Issues of Concern

4.137 It has been felt that trade is basically aimed at exploiting markets whereas preservation of environment is traditionally outside its purview. Need was felt for an objective harmonisation and search for compatibility between the interests of the trading system and environmental protection. Although, steps were taken to harmonise cross-country intra-industry environmental standards, these are being questioned. A particular country's preferred environmental choices and solutions, (say by setting up appropriate pollution standards and taxes) could be very different from that of another country. There are differences in endowments and technology across countries, and different costs of pollution abatement relative to income and consumption levels. Forcing the poor country to spend as much on abatement to improve its trade prospects could reduce its welfare substantially. There is continued need to encourage and promote improved standards rather than have drastic sanctions.

4.138 It has been felt that no universal agreement on minimum labour standards can be outlined from the fact that prevailing labour standards in a particular society are lower than those of another, thereby implying that the former is engaging in 'unfair' practices or is exploiting its labour. There is difference in values which leads to differences in labour standards. Also, consumers indicate their preferences through the market and thus change the prevailing labour standards in their country. Using labour conditions in developing countries to impose trade restrictions, is considered unfair and somewhat harsh. It is felt that this does not call for imposing protectionist measures/trade sanctions by the developed countries.

4.139 The work programme adopted at Doha clearly indicates that negotiations on environment will begin soon, notwithstanding the opposition from developing countries including India. The negotiations on trade and environment will concentrate on the relationship between existing WTO rules and trade obligations contained in multilateral environment agreements (MEAs) and reduction or elimination of tariffs and non-tariff barriers to environmental goods and services. The work programme of the Committee on Trade and Environment will evaluate the effect of environmental measures on market access, the relevant provisions of TRIPs and labeling requirements for environmental purposes. These, along with the application of the sanitary and phyto-sanitary measures, will create a strict and environment friendly regime having far reaching impact on trade of developing countries like India. As exports of these countries are already affected by the application of precautionary principles and other environmental measures including eco-labeling requirements, necessary steps would be required in upgrading quality control, consistent with the emerging environment regime.

4.140 The transparency requirement on grounds of market access accords the right to the developed countries to be able to intervene in various operations and regulations in developing countries. In case a new technical regulation is introduced by a member country, public notice is required to be issued and cognisance taken of comments offered by other members. A code of good practice for preparation, adoption and application of standards has been suggested to member countries and the measures are drafted in a way to protect their trade interests.

4.141 On the domestic front, it is important to establish set procedures for international and domestic trade, taking into consideration improved health and environment standards. The quality control mechanism could be strengthened as per requirements of our major export markets in the US, EU and other countries. Industry could also be given incentives for enhancing R&D expenditure to develop environmentally sound technologies and practices.

General Agreement on Trade in Services

4.142 GATS is the first set of multilateral legally enforceable rules covering international trade in services. It covers trade in services in terms of cross border supply of services like international telephony; tourism and education abroad; banking, legal advice and communication; and movement of natural persons. The GATS covers all services based on a positive list, and the aim is to progressively liberalise trade in services, within the existing architecture of GATS. The member countries are required to schedule specific commitments under the agreements. The objective of the GATS negotiations is to achieve progressively higher levels of liberalisation so as to promote economic growth amongst trading partners and development of developing countries. The overall balance of rights and obligations has been emphasised through market access to promote interest of all participants. The participation of developing countries in trade and services has been given special priority. Focus has been on sectors and modes of supply of export interest to the developing countries.

4.143 The Council for Trade in Services (CTS) carries out an assessment of trade in services in overall terms and on sectoral basis with reference to the objectives of GATS. The services negotiations are conducted in special sessions of the CTS, which in turn is required to report to the General Council on a regular basis. Specific schedules of commitments by individual member countries have been drawn out which form the basis for the negotiations. Appropriate flexibility has been provided for developing country members for opening fewer sectors, liberalise fewer types of transactions, progressively extending market access in line with their development situation. It was decided that the process of progressive liberalisation should be advanced in each sub-round through bilateral, plurilateral or multilateral negotiations directed towards increasing the general level of specific commitments undertaken by the members.

4.144 The sectors inscribed in the individual schedules are required to be accorded treatment that is no less favourable than accorded to its own like services and service suppliers, i.e., the schedules are subjected to ‘national treatment’. The members are allowed to modify and withdraw any commitment in its schedule at any time after three years have elapsed from the date on which the commitment came into force, after suitably notifying to the CTS. India has indicated a schedule of specific commitments whereby the limitations on market access and national treatment is outlined. These relate to professional services, computer and related services, R&D services, communication services, audio-visual services, construction and related engineering services, financial services, and other business services.

4.145 The Doha Declaration took cognisance of the proposals on various sectors, including movement of natural persons. Negotiations have been carried out between member countries on commitments for services and environment, movement of natural persons, financial services, maritime transport services, basic telecommunications and professional services. The Committees are to decide on the scope for further liberalisation of these services. The Committee on Professional Services is in the process of examining measures to ensure that the qualification requirement and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade.

Issues of Concern

4.146 It is the implementation of some of these issues, which are of concern to developing countries like India. Movement of natural persons has been restricted by many of the developed countries. India has the advantage in movement of professional and computer services, as it has a large reservoir of highly skilled and experienced professionals like lawyers, chartered accountants, cost accountants, company secretaries, computer and electronics based scientists/technicians, information technology/communications, scientists/technicians, engineers, doctors, etc. The barriers to high level of movement have constrained expansion of trade in technical and non-technical services from India. The requirement of the CTS to undertake constant consultation and cooperation with the UN and its specialised agencies has been limited. Further, GATS is silent on the issue of down-market unskilled workers like construction workers, labour, etc. There is need to negotiate trade of these services for such workers going abroad. There is scope also for promoting greater upmarket skills for higher earnings. Further, standardisation and harmonisation of requisite qualifications and experience of workers moving to the developed countries is called for. Requirements of local competency or local certification (e.g. medical boards) should not be used as non-tariff barriers.

4.147 It is important to note that, for India, the sectors where market access, particularly for professionals is relevant, include health, software, construction and engineering, accountancy, audio-visual, tourism and architecture. India has also to identify the sectors where it may assume commitments on market access in the negotiations. At the same time, there is need to spur active thinking on widening our negotiating initiatives in other modes (besides the mode 4 relating to movement of natural persons) of delivery of services. Commercial presence and cross-border supply are now gradually gaining importance in terms of India's capability.

4.148 On the domestic front, there is need for a regulatory mechanism, based on objective and transparent criteria, so that competence and ability to supply services is given due cognisance. The use of international standards needs to be further encouraged. There is need to improve the level of our professional institutions so as to raise it to the international standards. In addition, it may be mentioned that a demographic shift has been observed in developed countries where the ratio of working population has witnessed a decline; therefore, supply of skilled manpower/services from developing countries to developed countries may be negotiated suitably.

4.149 Another step needed is supplying more information to service providers in foreign markets with a view to exploiting emerging opportunities. Data and information on services is very important for both WTO negotiations and tapping the export potential for services. In this context, the Committee on International Trade in Services set up by the Department of Commerce has given concrete suggestions to improve the data collection process, which require to be implemented.

4.150 It is quite evident that a defensive position in WTO negotiations is no longer appropriate. India will have to take a more proactive and aggressive position on a number of emerging issues by proposing its own drafts. A few areas in which such positions can be taken are readily identifiable: Multilateral Agreement on Investment, trade in environmental goods, General Agreement on Trade in Services, and even on labour standards.

REGIONAL TRADING ARRANGEMENTS

4.151 With increased globalisation, there has been a proliferation of a number of regional trading blocks for economic cooperation within regions and across regions. There are around 15 regional blocks and an estimated 42 per cent of world trade is carried out through the preferential trade operations. The tariff rates within these blocks are usually significantly lower to the most favoured nation (MFN) rates required to be offered to all members of the WTO. There is thus an apprehension that India may be at a serious disadvantage in exporting to the dominant markets within these blocks. It needs to be noted, however, that the extent of disadvantage depends upon the differential between the MFN tariff rates and the preferential rate for any given product. In the case of most developed country markets, these differentials are fairly small except in the case of a few products in which there are tariff peaks, such as agricultural goods, textiles and clothing. Even in these cases, the effect may not be particularly substantial at present because of supply-side limitations on our part for most agricultural products and the operation of the Multi-Fibre Agreement (MFA) for textiles and clothing. In the future, however, as our agro-export potential improves and the MFA gets phased out, the negative effects may become considerable.

4.152 It would, therefore, appear desirable that a comprehensive strategy to mitigate the effects of regional trading arrangements be evolved. In doing so, however, it needs to be borne in mind that under the WTO, preferential tariff areas are expected to have a common set of tariffs such that the tariff rate on any product is equal to or less than the lowest rate prevailing in any member country prior to the formation of the block. This continues to remain relevant in the context of India joining one or more of the existing trade blocks, even though the Indian tariff rates are gradually being brought down to East Asian levels.

4.153 India is a member of the South Asian Association for Regional Cooperation (SAARC), which has very low level of intra-regional trade. The exports from India to the SAARC region constitute around 4.5 per cent of the total, while imports are a little over 1 per cent. It is important to emphasise development of regional initiatives in trade and investment since it is crucial for building on the potential synergies that are available in the South Asian region. It has been suggested that the possible gains from liberalisation of trade within the SAARC region are substantial and with very little risk. The main export items from India to the SAARC countries include cotton fabrics, sugar, rice, wheat, machinery, transport equipment, drugs and pharmaceuticals, rubber products, chemicals, steel, plastic products, etc. There is even greater potential for non-traded products such as power, transport and water resources. The potential of these items need to be explored during the Tenth Five Year Plan with greater vigour.

4.154 During the past few years, there has been efforts to upgrade India’s ties with the countries of the Association of South East Asian Nations (ASEAN). India has substantial trade with this region, constituting 7.9 per cent of our exports and 8.5 per cent of our imports. The main items of export in this trade include oil meals, groundnut, sugar, vegetables, wheat, rice, meat and its preparations, drugs and pharmaceuticals, plastic products, steel, machinery items, electronics, gems and jewellery, etc. The main import items are vegetable oils, wood and wood products, yarn and fabrics, electronic goods, machinery, chemicals, etc. There is scope to integrate software exports from India to the South East Asian countries, with the expertise in the computer hardware, apart from support in the form of communications, roads, ports and power. Intra-regional trade arrangements with these countries would facilitate industrial development and trade with the rest of the world. India should also actively participate in the regional grouping of the Bangladesh, India, Mayanmar, Sri Lanka, Thailand Economic Cooperation (BIMSTEC) to promote regional cooperation in trade and investment in the region. However, the process should be initiated cautiously in view of the fact that average tariff rates in the ASEAN region are around 10-15 per cent, while tariffs are only expected to be brought down in India to around 18 per cent by the end of the Tenth Plan.

Annexure 4.1

Export Projections for Tenth Plan

(US $ million)

S.No.	Sector	2001-02	2006-07	Total
1	Paddy & Rice	618.93	1085.09	4389.01
2	Wheat	289.01	383.76	1718.56
3	Other Cereals	74.37	98.75	442.22
4	Pulses	78.35	90.00	426.04
5	Jute	1.75	2.01	9.51
6	Cotton	6.16	7.08	33.52
7	Tea and Coffee	568.23	868.66	3691.60
8	Rubber	15.26	20.27	90.77
9	Other Crops	461.71	613.09	2745.55
10	Animal Husbandry	344.43	631.54	2514.31
11	Forestry and Logging	265.61	290.44	1401.67
12	Fishing	1357.18	2074.74	8817.12
13	Coal & Lignite	42.18	56.01	250.82
14	Iron Ore	327.60	376.32	1781.46
15	Other Metallic Minerals	137.65	200.86	868.35
16	Non Metallic Minor Minerals	369.95	491.25	2199.90
17	Sugar	515.23	863.32	3548.90
18	Edible Oils	179.52	206.21	976.20
19	Other Food & Beverages	1585.42	2656.53	10920.29
20	Cotton Textiles	2183.74	4004.04	15940.96
21	Woolen Textiles	50.04	71.34	311.08
22	Silk Textiles	267.86	381.82	1665.04
23	Art. Silk & Synthetic Fibres	406.78	579.85	2528.63
24	Jute Hemp Mesta Textiles	92.12	154.36	634.52
25	Readymade Garments	5253.59	10070.60	39474.29
26	Other Textiles	2798.52	3989.18	17396.10
27	Wood & Wood Products	33.51	56.16	230.84
28	Paper & Paper Products	255.81	339.69	1521.18
29	Leather & Leather Products	1549.53	2261.14	9775.19
30	Rubber Products	1074.88	1532.20	6681.66
31	Plastic Products	384.45	644.18	2648.07

Annexure 4.1 Contd.

32	Petroleum Products	1757.80	4550.74	16121.44
33	Fertilisers	6.23	7.15	33.86
34	Pesticides	255.13	293.06	1387.34
35	Synthetic Fibre & Resins	430.03	824.32	3231.12
36	Paints, Drugs & Cosmetics	1951.10	4082.97	15527.30
37	Other Chemicals	2134.62	4467.00	16987.75
38	Cement	77.22	110.07	479.99
39	Other Non-Metallic Minerals	6042.49	12644.80	48087.43
40	Iron & Steel	2041.90	3914.12	15342.38
41	Non-ferrous Metals	1662.82	2661.85	11123.89
42	Tractor & other Agricultural Machinery	44.39	63.27	275.93
43	Other Non-Electrical Machinery	1199.74	2299.78	9014.56
44	Electrical Machinery	961.40	2011.88	7651.05
45	Comm. & Electronic Equipment	791.30	1729.18	6479.94
46	Rail Equipment	50.41	71.86	313.38
47	Motor Vehicles	512.56	730.63	3186.16
48	Motorcycles,Scooters & Bicycles	112.63	160.55	700.15
49	Other Transport Equipment	294.39	419.64	1829.96
50	Other Manufacturing	2999.48	4275.64	18645.33
	Total	**44915.00**	**80419.00**	**322863.13**

Annexure 4.2A

Import Projections for Tenth Plan

Scenario - 1 (GDP 8.0% ; Tariff : 33.7%, 27%, 22%, 18% & 15%)

(US $ million)

S.No.	Sector	2001-02	2006-07	Total
1	Paddy	0.02	0.03	0.12
2	Wheat	0.26	0.40	1.70
3	Other cereals	6.70	10.15	43.26
4	Pulses	641.29	1240.19	4846.33
5	Sugarcane	0.00	0.00	0.02
6	Jute	22.47	43.45	169.78
7	Cotton	486.62	1010.26	3852.42
8	Tea and Coffee	14.71	35.90	129.66
9	Rubber	172.13	260.82	1112.03
10	Other crops	49.34	74.76	318.74
11	Animal Husbandry	20.38	39.41	154.01
12	Forestry and Logging	29.88	57.79	225.83
13	Fishing	8.96	17.33	67.72
14	Coal & Lignite	1123.31	2500.97	9313.29
15	Petroleum Crude	12664.60	20046.80	86400.03
16	Iron ore	21.44	41.46	162.00
17	Other Metallic Minerals	5804.82	14165.89	51163.97
18	Non Metallic Minor Minerals	4567.58	13920.89	46815.64
19	Sugar	21.32	44.26	168.77
20	Khandsari	0.00	0.00	0.00
21	Edible oils	1586.49	4835.25	16260.84
22	Other Food & Beverages	471.75	1151.25	4158.04
23	Cotton Textiles	45.67	94.81	361.56
24	Woolen Textiles	147.59	306.41	1168.42
25	Silk Textiles	146.75	304.65	1161.73
26	Art. Silk & Synthetic Fibres	300.72	624.32	2380.71
27	Jute Hemp Mesta Textiles	9.27	19.25	73.40
28	Readymade Garments	43.96	91.27	348.03
29	Other Textiles	402.30	835.21	3184.89
30	Wood & Wood Products	593.66	1657.39	5730.43

Annexure 4.2A Contd.

31	Paper & Paper Products	978.77	2179.18	8114.95
32	Leather & Leather Products	235.47	574.63	2075.44
33	Rubber Products	129.87	251.15	981.44
34	Plastic Products	264.13	548.35	2091.01
35	Petroleum Products	1407.02	2240.77	9381.72
36	Fertilisers	524.95	1115.66	4220.49
37	Pesticides	84.55	179.68	679.72
38	Synthetic Fibre & Resins	485.60	1185.05	4280.12
39	Paints, Drugs & Cosmetics	601.32	1338.79	4985.49
40	Other Chemicals	3649.87	9746.74	34183.70
41	Cement	2.51	5.58	20.79
42	Other Non-Metallic Minerals	356.96	832.22	3051.62
43	Iron & Steel	1396.73	2899.70	11057.43
44	Non-ferrous Metals	925.30	1789.46	6992.70
45	Tractor & other Agricultural Machinery	11.55	28.20	101.84
46	Other Non-Electrical Machinery	3495.70	8530.78	30811.26
47	Electrical Machinery	2025.83	5409.85	18973.37
48	Comm. & Electronic Equipment	3033.90	11439.28	36054.12
49	Rail Equipment	13.27	27.54	105.03
50	Motor Vehicles	915.67	1900.98	7248.99
51	Motorcycles,Scooters & Bicycles	0.32	0.66	2.53
52	Other Transport Equipment	4549.01	9444.01	36012.85
53	Other Manufacturing	3125.71	6959.19	25915.10
	Total	**57618.00**	**132058.00**	**487003.33**

Annexure 4.2B

Import Projections for Tenth Plan

Scenario - 2 (GDP 8.0% ; Tariff : 33.7%, 28%, 24%, 20% & 18%)

(US $ million)

S.No.	Sector	2001-02	2006-07	Total
1	Paddy	0.02	0.03	0.12
2	Wheat	0.26	0.37	1.61
3	Other cereals	6.70	9.31	40.99
4	Pulses	641.29	1138.20	4583.78
5	Sugarcane	0.00	0.00	0.02
6	Jute	22.47	39.87	160.58
7	Cotton	486.62	927.17	3641.97
8	Tea and Coffee	14.71	32.95	122.45
9	Rubber	172.13	239.37	1053.52
10	Other crops	49.34	68.61	301.97
11	Animal Husbandry	20.38	36.17	145.66
12	Forestry and Logging	29.88	53.04	213.59
13	Fishing	8.96	15.91	64.05
14	Coal & Lignite	1123.31	2295.29	8800.43
15	Petroleum Crude	12664.60	20046.80	86400.03
16	Iron ore	21.44	38.05	153.23
17	Other Metallic Minerals	5804.82	13000.86	48317.03
18	Non Metallic Minor Minerals	4567.58	12776.01	44146.37
19	Sugar	21.32	40.62	159.55
20	Khandsari	0.00	0.00	0.00
21	Edible oils	1586.49	4437.59	15333.70
22	Other Food & Beverages	471.75	1056.57	3926.67
23	Cotton Textiles	45.67	87.02	341.81
24	Woolen Textiles	147.59	281.21	1104.59
25	Silk Textiles	146.75	279.60	1098.27
26	Art. Silk & Synthetic Fibres	300.72	572.97	2250.66
27	Jute Hemp Mesta Textiles	9.27	17.67	69.39
28	Readymade Garments	43.96	83.76	329.02
29	Other Textiles	402.30	766.52	3010.91
30	Wood & Wood Products	593.66	1521.08	5406.78

Annexure 4.2B Contd.

31	Paper & Paper Products	978.77	1999.96	7668.08
32	Leather & Leather Products	235.47	527.37	1959.96
33	Rubber Products	129.87	230.50	928.27
34	Plastic Products	264.13	503.25	1976.79
35	Petroleum Products	1407.02	2056.48	8885.13
36	Fertilisers	524.95	1023.91	3989.32
37	Pesticides	84.55	164.90	642.49
38	Synthetic Fibre & Resins	485.60	1087.59	4041.96
39	Paints, Drugs & Cosmetics	601.32	1228.69	4710.95
40	Other Chemicals	3649.87	8945.15	32262.45
41	Cement	2.51	5.12	19.64
42	Other non-metallic Minerals	356.96	763.78	2882.69
43	Iron & Steel	1396.73	2661.22	10453.40
44	Non-ferrous Metals	925.30	1642.29	6613.87
45	Tractor & other Agricultural Machinery	11.55	25.88	96.17
46	Other Non-Electrical Machinery	3495.70	7829.20	29096.81
47	Electrical Machinery	2025.83	4964.93	17906.99
48	Comm. & Electronic Equipment	3033.90	10498.49	33952.20
49	Rail Equipment	13.27	25.28	99.29
50	Motor Vehicles	915.67	1744.64	6853.00
51	Motorcycles,Scooters & Bicycles	0.32	0.61	2.39
52	Other Transport Equipment	4549.01	8667.32	34045.60
53	Other Manufacturing	3125.71	6386.86	24488.00
	Total	**57618.00**	**122846.00**	**464214.06**