

# THE IMPACT OF A DECADE OF INDIA'S TRADE REFORMS

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### *Abstract*

*For almost half a century, India maintained one of the restrictive trade regimes in the world. It imposed a system of high tariffs and stiff nontariff barriers such as licensing and quotas, which virtually closed the economy from the international trade arena. India implemented economic reform since the middle of 1991, and has made drastic changes in trade policy to reorient itself to integrate with the global economy. While reviewing the trade policy measures, an important empirical question that is investigated in this paper is: How open has India's trade been after a decade of economic reforms?*

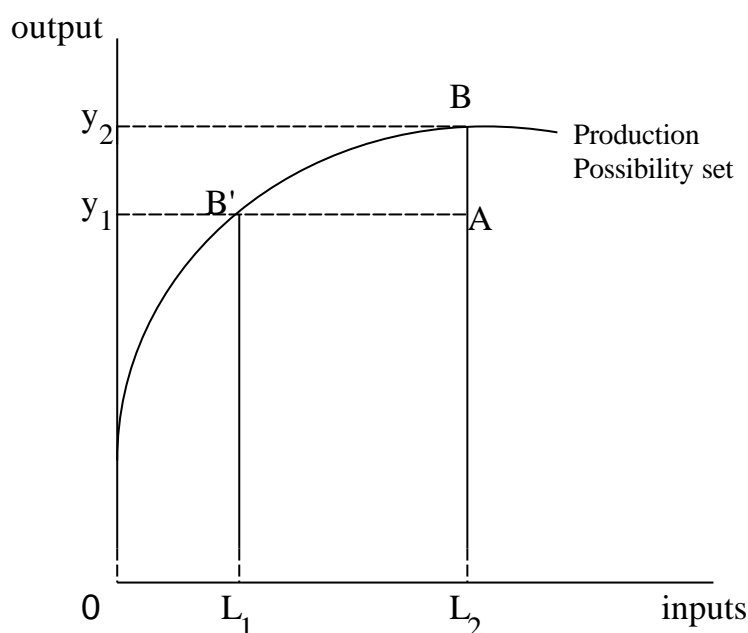
### INTRODUCTION

In pursuit of solving the acute economic problems accumulated until 1991, the Indian Government introduced reform measures in fiscal, monetary, industry, exchange rate and trade policies to stimulate the economy. As there are several publications, which discuss in details the various circumstances that lead to the accumulation of crisis over a period of time, they are not discussed here. The objective of this paper is to provide a review of the impact of a decade of trade policy reforms on the Indian economy. A simple model of economic reforms is presented in the next section. The impact of reforms on India's international trade and the economy is empirically examined in the following section. The next section discusses the specific policy reforms that were implemented from July 1991 to June 2001 to improve India's international trade and a final section brings out the overall conclusions of this paper.

### A SIMPLE MODEL OF ECONOMIC REFORMS

In Figure 1, points  $B$  and  $B'$  show the maximum possible or potential output that can be produced with given input levels and technology in a static sense. In other words, these levels of outputs could not have been obtained with fewer inputs with the existing technology. However, the economy is producing at point  $A$ , where the output is less than the country's potential output, given its frontier production possibility set. The country is producing at point  $A$  due to various non-price and organisational factors, which are the consequences of government policies, that exert influence on production. Now, there are two basic options for the government, which are not mutually exclusive. The government may choose to cut and to intensify the use of inputs to produce at  $B'$  to move on further to  $B$ . Alternatively, the government may choose to maintain the same input level and to effectively use the inputs to produce at  $B$ . However, policy emphasis needs to be different depending on which path the government would like to choose. Suppose, the government chooses the path from  $A$  to  $B'$ , then policy emphasis needs to be more on reducing the levels by encouraging substitution and intensive use of inputs. Relatively major emphasis then would be on fiscal policy reforms aimed at pruning government expenditure.

On the other hand, if the government chooses the path from  $A$  to  $B$ , then the emphasis needs to be on improving the competitive structure to achieve efficient use of inputs. Accordingly, those policies that exert influence on competitive structure, such as trade policy, exchange rate policy, and investment policy play a dominant role in the reform process<sup>1</sup>. Developing countries with serious supply bottlenecks and unemployment problems tend to go more for the choice of the path from  $A$  to  $B$  relative to the path from  $A$  to  $B'$  to  $B$ . As discussed earlier, data reveal that since mid 1970s and until recently, the government has not been able to reduce the fiscal deficit consistently. On the other hand, economic growth has risen on average to 6.5% per annum since reforms compared to the average annual growth rate of 3.5% of the pre-reform period. This indicates that India has been relying more on the reform path of moving from  $A$  to  $B$  by initiating trade policy, investment policy and exchange rate policy reforms aimed at improving the competitive structure of the economy.



**Figure 1. Production possibility and Potential and Actual production points**

In this paper analysis is restricted to examine the types of trade policy reforms that have been implemented in India since 1991 and their impact on export promotion and import liberalisation. The empirical evidence from a number of studies points to a strong and significant effect of openness to trade on growth performance (Srinivasan, 1998: 202-8). An important empirical question that is investigated in this paper is: How open has India's trade been after a decade of economic reforms?

## Reforms, India's GDP and Trade

Literature shows that dramatic policy changes in some countries have not always lead to significant improvements in actual performance. The end results in terms of the actual performance of the economy provide a measure not only to show how effectively the policy reforms were carried out, but also to gauge the appropriateness of such reform measures towards the stated objectives. Based on the above modelling of India's reform process, and with the assumption that India has been effectively implementing appropriate reform measures, it is rational to expect significant growth in GDP and trade consistently.

Figure 1 shows India's total exports, total imports and GDP at current market prices in US dollars. Consistently, the ratio of imports to GDP has been higher than the ratio of exports to GDP in the 1990s and the gap has been widening. Figure 2 shows India's merchandise exports, merchandise imports, and GDP at current market prices in US dollars. The ratio of merchandise exports to GDP steadily increased from 4% in 1970-71 to 11% in 2000-01, which indicates the rising importance of exports to the Indian economy. During 2000-01 exceeding the target of 18%, the merchandise exports at US\$44 billion have grown by 19.8% over 1999-00 (RBI, 2001).

India has been always enjoying trade surplus with respect to services trade even before reforms, though it used to be less than a billion US dollar until recently. After the reforms only in 1995-96, due to the world recession, India had negative balance in services trade. However from 1996-97, surplus in services trade has been surging steadily. Export of services touched the level of US\$15 billion during 1999-00 from US\$13 billion in 1998-99, which translates in to a growth rate of 15%. This success is mainly attributable to 'miscellaneous services' component, mainly software services, which touched US\$9 billion in 2000-01 from US\$6.5 billion in 1999-00 registering a growth rate of about 35% (RBI, 2001)<sup>2</sup>. Thus, services trade has been recently helping the economy to narrow the current account balance.

## **INDIA'S TRADE LIBERALISATION**

Within a broader perspective, the reforms implemented in India were not very different from the reforms undertaken by many developing countries. However, the difference lies in the speed with which these reforms were implemented. Just like the Chinese case, India's reforms were implemented in a gradual manner. Nevertheless, the reasons for the gradual approach to reforms are different between China and India. Being the largest democracy with a pluralist society in the world has made it necessary for India to obtain a reasonable consensus across different interest groups before policy changes could be implemented and this has been the major cause for the slow pace of reforms. The main thrust of trade policy reforms have been to open up India's trade and hence the policy

measures concern with export promotion and import liberalisation. How open is India's trade today after a decade of trade policy reforms?

### *Export Promotion Measures*

#### **EXIM Policy 1992-97**

When the Eighth Plan commenced, the three-year Import-Export policy (1990-93), valid until March 1993 was in operation. With a view to reinforcing the trade policy reforms and complementing the fiscal, industrial and investment measures, the new five-year Export-Import Policy (1992-97) was introduced with effect from April 1992. For the first time, the policy was given an export bias. Earlier this policy was known as Import-Export policy; the new policy was titled Export-Import policy (EXIM Policy). Several schemes were introduced or modified to eliminate regulatory measures and discretionary controls impinging on free trade. Major schemes and their impacts on India's exports and imports are discussed in the following pages.

Just before the launching of the EXIM Policy 1992-97, on March 1, 1992, the Liberalised Exchange Rate Management System (LERMS) was introduced. Under the LERMS, exporters were required to surrender 40 per cent of the foreign exchange earning at the official exchange rate. The Government would use the amount to import essential items such as petroleum, fertilisers and life saving drugs. The exporters were allowed to sell the remaining 60 per cent of the foreign exchange or use it to finance their own imports, which facility was not given to exporters in the pre-reform period. This system acted as a self-correcting mechanism to keep trade deficit under control. With effect from June 1992, the 15% Foreign Exchange Conservation (Travel) Tax was abolished. The travel tax had become redundant with the introduction of partial convertibility of rupee and Liberalised Exchange Rate Management System (LERMS) under which foreign exchange for travel had to be obtained at the market rate. Along with this change in the exchange rate regime, the import licensing system was abolished for capital goods, intermediates and components; these items could be imported on open general licence (OGL) subject to payment of tariffs (Ministry of Commerce).

To promote investment by Non-Resident Indians, a new deposit scheme was introduced in June 1992, under which accounts in Indian rupees could be opened with authorised dealers by remittance of funds in freely convertible foreign exchange from aboard or by transfer of funds from the existing on-resident (external)/FCNR accounts. No penalty was to be levied for premature withdrawal of existing non-resident deposits for the purpose of making investment in the proposed scheme. Full convertibility of rupee on trade account (current account) was introduced and dual or partial exchange rate was abolished. In March 1993, the exchange rate was unified and transactions on trade account were freed from exchange control (CMIE, 2000).

The Export promotion capital goods (EPCG) is a scheme to liberalise capital goods imports. This was introduced to boost exports. The EPCG scheme allows exporters to import machinery both new and second-hand duty free or at concessional duty if the importer agrees to achieve a fixed export target within a specified period of time. Under the scheme, the duty on import of capital goods was reduced from 25 per cent to 15 per cent subject to an export obligation of 3 times the c.i.f. value of imports and the period of achievement was increased from 4 years to 5 years. The scheme was very popular when customs duty on capital goods was high. Currently under the EPCG scheme, import of capital goods carry 10 per cent customs duty though duty free imports are also permitted, subject to a minimum import volume. Exemptions are available for certain sectors like agriculture and garments even if the minimum floor limit is not met. If a computer system is imported under this scheme, supporting manufacturers and service providers are also eligible to import capital goods. Industry uses this scheme for modernisation and upgradation purposes (CMIE, 2000).

As a consequence, Capital goods imports increased by 23% in 1993-94 over 1992-93. This facilitated exports to register a growth rate of 30% in 1993-94 over the previous year. Manufacturing exports increased by 29%, which is five-percentage point more than the previous years growth. Trade deficit drastically declined to US\$1billion in 1993-94 from US\$3 billion in 1992-93. These data clearly indicate that schemes such as the EPCG have really paid off. This situation is analogous to the Chinese reform process.

When the Chinese reform started in 1978 with the introduction of the Household responsibility system replacing the commune system, economic growth surged in the following years.

The other major schemes are as follows: Duty Exemption Scheme (DES), Scheme for Gems and Jewellery, and policies enlarging the scope of instruments of export promotion such as export oriented units (EOU)<sup>3</sup> and export processing zones (EPZ), joint ventures and different types of trading houses<sup>4</sup>.

**Duty Exemption Scheme:** Under this scheme, import of raw materials, intermediates, components, consumables, parts, accessories, packing materials and computer software required for direct use in the export product is permitted duty free for processing and export by the competent authority under the categories of advance licences, advanced intermediate licence, special imprest licence, licences under export production programme, advance customs clearance permit and advance release orders<sup>5</sup>.

**Scheme for Gems and Jewellery:** Exporters of gems and jewellery are allowed to import inputs by obtaining Replenishment Licences and Diamond/DTC Imprest Licences (DTCIL). The replenishment licences are transferable. Exports effected in fulfilment of export obligation against DTCILs do not qualify for this benefit. The latter licence can be issued in advance for import of rough diamonds and for export of cut and polished diamonds. Though DTCILs are not transferable, imported goods may be transferred but the responsibility to fulfil the export obligation vests in the licensee. These licences carry an export obligation fixed in the inverse ratio of 65% of replenishment. That is, if the licence is issued for a CIF value of \$65, the FOB value of export obligation will be \$100.

The export oriented unit (EOU) and export promotion zone (EPZ) schemes were liberalised. 100 per cent foreign equity participation in EOU/ EPZ units was allowed (Ministry of Commerce).

The EXIM Policy 1992-97 was modified in March 1993 giving a new thrust to exports of agricultural and allied sectors, and services in which the country has a comparative advantage. Ironically, minimum export price was introduced to discourage the export of



non-basmati and low-grade rice, which would affect the domestic market. This was a step backward from marching towards free trade and also not in the interest of the farmers because the border price for rice was lower than the international price during the early nineties. Also, export of high value durum wheat and of non-fair average quality of jowar were allowed only subject to ceiling. These measures, which were discouraging rather than encouraging exports of cereals, were introduced to build buffer stocks with grains for the use of the public distribution system.

The EXIM Policy was modified in 1995 to boost agricultural exports. The highlights were: (a) in the category of agricultural and food exports only beef and tallow were in the negative list during 1995-96; (b) horticulture and floriculture exports were encouraged by providing various supports to farmers such as airfreight subsidy; and (c) quantitative ceiling and minimum export price in respect of rice was abolished; exports of wheat up to 2.5 million tonnes in case of non-durum wheat and 0.5 million tonnes in case of durum wheat was permitted; and in the case of coffee, free sale quota was raised to 70 per cent for large producers and 100 per cent for small producers. As a consequence to these policy changes, fruits, vegetables and flowers emerged as export products. EOUs in floriculture facilitated export of the perishable products. Airfreight subsidy provided a boost to these export items.

### **EXIM Policy 1997-2002**

Some of the major policy changes include (a) the threshold limit for EPCG zero duty scheme was brought down to Rs. 10 million (for agricultural and allied sectors from Rs.50 million and for electricals, textiles, leather, gems and jewellery, sport goods and food processing from Rs.200 million) and to Rs. 1 million in case of the software sector; (b) DEPB scheme was modified to neutralise not only the basic customs duty but also the special customs duty which was introduced as a temporary measure in 1998; and (c) exports of oilseeds for consumption purpose and vegetables were made free without any quantitative and licensing requirements (Ministry of Commerce).

Several modifications to the earlier schemes were done mainly to boost services trade, particularly IT exports. For example, the export promotion capital goods (EPCG)

scheme for services sector has been introduced. Under this scheme, capital goods are allowed to be imported for rendering services for which payments are received in a freely convertible currency. The scheme is applicable to professionals and other providers of services such as architects, consultants, economists, chartered accountants, engineers and tour operators. Exemption was given to exports under all export promotion schemes from the applicability of the special additional duty of 4 per cent introduced in the 1998 - 99 budget. Promotional measures and procedural changes that were made in 1998 include facilities such as extension of holiday for EOU/EPZ to 10 years, sub-contracting facility for Domestic Tariff Area and permission to set up private software technology parks.

In order to promote trade among SAARC countries, India unilaterally removed all QRs on imports of 2300 items from SAARC countries with effect from August 1, 1998. On December 28, 1998, a free trade agreement was concluded between India and Sri Lanka which would result in zero import tariff for most commodities on both sides by 2007. Following the third round of negotiations held under SAARC Preferential Tariff Agreement (SAPT), the Revenue Department notified on August 11, 1999 concessional customs duties - ranging from 25 per cent to 60 per cent for least developed countries (Bangladesh, Maldives, Nepal and Bhutan) and 10 per cent to 50 per cent for the other three countries - covering items in 1800 tariff lines which account for 60 per cent of imports (Ministry of Finance).

On March 31 1999, the following new schemes to boost service exports were introduced. The setting up of Special Economic Zones (SEZs) was announced with a view to providing internationally competitive and hassle free environment for exports. Together with the Foreign Direct Investment policy initiatives for SEZs, it is expected that these zones will have the potential to act as "magnets" for investments for export production from home and abroad. As a first step, four existing Export Processing Zones (EPZs) -- at Kandla, Santa Cruz, Cochin and Surat -- were converted into SEZs with effect from 1 November, 2000. Setting up of new SEZs in the following areas has been progressing steadily: Positra (Gujarat), Nangunery (Tamil Nadu), Kakinada-Vizag

(Andhra Pradesh), Paradip (Orissa), Kulpi (West Bengal) and Bhadohi (Uttar Pradesh). It is too early to judge their success. However, their success will depend on how effectively domestic regulations and infrastructure bottlenecks are eliminated in these zones. In order to provide an impetus to infrastructure development, deemed export benefits have been extended to infrastructure projects with a minimum investment of Rs. 100 crore<sup>6</sup>.

With a view to making exports a national effort by involving all the State Governments, a Scheme has been evolved for granting assistance to the States on the basis of their export performance for development of export related infrastructure. To facilitate an equitable allocation of resources, this amount will be distributed on the basis of absolute export performance as well as on the basis of incremental one. To begin with, an allocation of Rs. 2.5 billion is proposed for 2001-02, which would be suitably increased in the subsequent years. There would be subsequent annual allocation for this Fund. The amount would be utilised by the States for complementary export related infrastructure, such as roads connecting the production centres with Ports, research and development of state specific ethnic products, development of cold chains for agro exports, development of minor ports, creation of new export promotion industrial parks, human resource development and for the purpose of developing marketing infrastructure. The units may be allowed to dispose of obsolete or unusable capital goods, spares and other goods in the domestic tariff area (DTA) on payment of applicable customs duty. Such disposal shall, however, be subject to the Import Policy in force.

Under the SEZ scheme, the goods cleared from the Zone will be treated as imported goods. Therefore, in case of DTA clearances, though the duty charged will be central excise duty, this duty will be equal to the aggregate of all duties of customs (WTO). In other words, the SEZ units will have to pay full customs duty (applied duty) on their DTA clearances. The only laws which will operate within the SEZs will be those related to labour and banking.

A SEZ unit shall maintain proper account financial year-wise, of all foreign exchange inflow by way of exports and other receipts, all foreign exchange outflows on account of

imports, payment of dividend, royalty, fees etc, consumption and utilisation of the materials and ale in the DTA. RBI will permit banks to open branches in the SEZ and permit transactions to be operated in dollars for all units.

Most of the units within SEZ may be employing less than 1000 workers. With the recent change in the labour laws announced in the Union Budget 2001-2002 that a firm employing less than 1000 employees is not required to get the approval from the Government to layoff any employee or to close down the unit, labour laws particularly may not be a constraint. Further, the new law allows outsourcing and employing contract labour, which facilitates reducing employer-employee frictions in work places (Ministry of Finance).

With the view that agriculture is the responsibility of state governments, the central government has insisted through the revised EXIM policy of 1997-2002 that the state governments should identify and develop product-specific agricultural export zones (AEZ). It is expected that the states will identify product-specific AEZ for end-to-end development from a geographically contiguous area. They will also have to evolve a comprehensive package of services provided by all state government agencies, agricultural universities, and some Central institutions and agencies for 'intensive delivery' in these zones. The AEZ would have access to the Centre's proposed market access initiative, which will provide market research, warehousing and retail marketing infrastructure in select countries, and direct market promotion activities. Two AEZ exist, one in Tamil Nadu and another in Gujarat.

### ***Imports Liberalisation***

India retained import of items under five categorisations — the prohibited list, the special import licence (SIL) list, the restricted list, the canalised list and the free list. The number of items included in these lists keeps on changing. Of these, the restricted list has been freed and SIL abandoned and freed. The canalised list is being retained, but under a new nomenclature (the special list) and a new set of products. Thus, at present, the number of import lists has come down to three — the prohibited list, the special list and the free list.

The prohibited list contains only a few products prohibited on grounds of religious and cultural sensitivity and the list includes tallow, fat and oils of animal origin, animal rennet and wild animals including their parts and products and ivory. Bulk agricultural commodities that include grains excluding feed grade maize, edible oils, oilseeds, sugar, and non-agricultural products such as urea, petroleum products are in the special list that was earlier called canalised list. Imports of these items should be done by state agencies.

Apart from the special list of consumer products, gold will continue to be imported through designated banks. Import of all primary products of plant and animal origin will also be subject to import permits to be issued by the ministry of agriculture after an import risk analysis based on sanitary and phyto-sanitary measures and provisions. In addition, conditions have been prescribed for the import of new and second hand cars for ensuring road safety. Import of foreign liquor, processed food products and tea wastes has to be made subject to already existing domestic regulations concerning health and hygiene. Rest of the commodities are in the free list. Imports of these freed items attract high tariffs with bound rates.

### **EXIM Policy 1992-97**

In 1990, prior to economic reforms, India's peak tariff<sup>7</sup> was at 300%. During 1992-93, the peak rate was reduced to 150% (WTO, 1998). The Government also introduced a system of value-based advanced licences to export houses, trading houses and star trading houses which permitted duty free imports of necessary raw materials as components up to a stipulated ratio of the value of anticipated exports. Special Import Licences (SIL), which could be traded in the market, were issued to certain categories of exports like exports to Asian clearing union countries, deemed export, trading houses and manufacturers who have acquired the ISO 9000 or other international certifying quality. Before the Uruguay Round Agreement (URA), only 5 per cent of India's tariff lines were bound. The Government indicated that after the URA came into force, about 68 per cent of India's tariff lines would be bound. As of December 1, 1995 more than 3000 tariff lines covering raw materials, intermediates and capital goods were freed from

import licensing requirements. Removing these goods from licence requirements is good news for traders. Also, India had to do in accordance with the WTO negotiations. However, replacing licences with high tariffs, India indicates that its promotion of free trade is not without restraint.

In 1995-96, on industrial raw materials, components and capital goods, India had bound tariffs at 40 per cent (where they were above 40 per cent in 1993-94) and at 25 per cent in other cases. Countervailing duties at the rate of 30% to 40% were imposed as additional tariff above 25% for goods other than raw materials, components and capital goods. Nevertheless, QRs were present as the rest of the goods were classified into either negative list or special licence list during that period. India indicated ceiling bindings of 100 per cent on primary products, 150 per cent on processed products and 300 per cent on edible oils. With an improvement in India's BOP, the country was under pressure to eliminate the QRs. India had entered into bilateral agreement with the EU, New Zealand and Australia, to remove QRs on 1,429 items from April 1, 2003. Such an understanding was not reached with the USA.

### **EXIM Policy 1997-02**

During 1997-98, the peak rate of import duty was reduced to 40 per cent advalorem except for passenger luggage, alcoholic beverages, dried grapes and a few other products. The peak rates for imports of raw materials and capital goods for projects were reduced to 30 per cent and 20 per cent respectively. However, the special additional customs duty was raised from 2 per cent to 5 per cent on all imported goods except petroleum products and certain project imports<sup>8</sup>. A surcharge of 10% on basic duty was introduced in 1998-99 mainly to control imports of consumer goods.

From 1 April 2001, removal of QRs became necessary in the face of India losing the case against the USA. By replacing QRs with high tariffs, India indicates that its promotion of free trade is not without restraint. In fact, high tariffs have been imposed on goods removed from QRs to protect the domestic industry from overseas competition. WTO permits tariff setting, so far as the applied rates do not surpass bound rates. India's applied rates are mostly lower than the bound tariffs. India is now imposing tariffs up to

the allowable maximum for imported agricultural and consumer goods to protect domestic production. The recently announced peak tariff rate is 35% plus a 3.5% surcharge on tariffs and a 4% special duty on items from which QRs have been removed. In addition, countervailing duties ranging from 16% to 32% are imposed on certain goods. Basic tariffs have been increased on vegetable oils from 25% to 45%, on tea, coffee, copra and coconut from 35% to 70%. Uniform rates of 75% and 85% are imposed on crude edible oils and refined oils respectively. Maximum tariffs on imports of rice are 80%. Without doubts, these tariffs substantially raise the import prices of several agricultural products. The duty on used cars has been put at 105 per cent, which translates into 180 per cent including countervailing and special additional duties.

The total numbers of customs duty rates during 2001-02 are 35 per cent, 25 per cent, 15 per cent and 5 per cent. The Special Additional Duty imposed in 1998-99 (for all products except for petroleum products) is still applicable. However, the surcharge of 10% on basic duty that was introduced in 1998-99 is now removed. At present, most consumer goods, which have been in the free list of imports effective 1 April 2000, are being placed at the peak rate 35 per cent plus the surcharge. A number of agricultural and horticultural products placed on the free list of import in earlier years are being brought to the peak rate to ensure adequate protection to Indian farmers (Table 1).

For sensitive agricultural products such as wheat, rice, sugar and edible oils in which the Indian experience with supply management has underlined the importance of occasional tariff adjustments, the Finance Minister would make suitable enabling provisions to fix the statutory tariff rates at approximately high levels.

What is this experience, and why does it result in upward tariff adjustments? The main approach of the Government Policy has been to regulate international trade in a manner to ensure adequate availability of essential food items to consumers at reasonable prices and to protect farmers from foreign competition. Concerning exports, the objective is to maximise agricultural exports in order to earn foreign exchange and provide remunerative prices to the farmers keeping in view the prime consideration of ensuring adequate availability of essential commodities to the domestic consumers at reasonable prices.

Concerning agricultural imports, the policy aims to regulate imports keeping in view the domestic demand and supply situation, the interests of the farmers and consideration of out-flow of foreign exchange.

Whenever supply appears to be meeting the demand, then import of that concerned commodity will be restricted through high tariffs or canalisation, even when the international price is lower than the domestic price. When supply exceeds demand, then export is encouraged only after building up buffer stock for the public distribution system. Imposing minimum export price and/or ceilings has regulated exports of rice and wheat.

In the case where there is excess demand, and particularly the international price is lower, the Government has encouraged imports by imposing lower tariffs. A recent example is edible oils imports. Some of the main reasons have been increase in edible oil consumption, stagnating oil seeds production and falling international prices. In addition to this the differential duty structure in favour of refined oil led to an upsurge in edible oil imports. When in 1992-93 the Golden revolution to achieve self-sufficiency in oil production was launched, many oil solvent extractors set up the extraction units as they saw huge potential in the market. But with oil seeds production not catching up with the demand plus lower per hectare yield of just 850 Kgs compared to the world average of 1600 Kgs of oil seeds, made the country resort to external sources.

At present, India has more than 15,000 oilseeds crushing units more than 600 solvent extractors, more than 400 vegetable oil refiners and more than 190 Vanaspati oil units. All these are working at below 40% capacity utilization. With such a low capacity utilization the solvent extraction industry is in doldrums, many of these units have already shut down. The Government is keen to protect the domestic oilseeds industry. Recently in Budget 2002, it increased the basic duty on RBD (Refined, Bleached and Deodorized) Palmolein to 85% from 65% and maintained the special additional duty at 4%. It even increased the basic duty on Crude Palm imports by 50% to 75% this decision is likely impact already sulking solvent extraction industry. For refined Soybean however the government maintained the status quo with 45% basic customs duty.



What are the implications of this Government agricultural tariff policy? The implication is that such a provision may lead to the misuse of bound rates. For the uninitiated, bound tariff rates are the highest tariff rates that a country agrees, under the WTO regime, to apply to a particular import or class of imports. The general peak tariff rate is 35 per cent, also too high in relation to almost any other country.

The need for applied rates to be close to, or the same as, bound ones is not good. Because, the very logic of bound rates is to keep them at the highest level possible, so that such duties may be applied in crisis times. It does not mean that they should in fact be applied all the time. However, the possibility of the producer lobby putting pressure on the Government to raise tariffs even for some minor temporary setbacks in production is very high. The question to ask is if India really wants to revert to its severely protectionist past or to further lower its still-high tariffs.

Has anything else happened that could generally be classed as import liberalisation?

In the Customs duty the Government withdrew the surcharge of 10 per cent and with this the peak tariff rate will decline to 35 per cent from 38.5 per cent. Basic Customs duty on specified textile machinery declined to 5 per cent from 15 per cent. Customs duty on silk waste, cotton waste and flax fibre reduced to 15 per cent from a range of 25 to 35 per cent. Customs duty on soda ash was reduced to 20 per cent. Customs duty on polyester chips and nylon chips for manufacture of fibre and yarns was reduced to 25 per cent, and on cut and polished coloured gem stones to 15 per cent from 35 per cent. Duty on rough diamond was reduced to 5 per cent. Customs duty on cement and clinkers was reduced to 25 per cent from 35 per cent. Duty on gold was reduced to Rs. 50 per 10 gm from Rs.400.

India joined the Information Technology Agreement on 25.3.1997, which aims to expand world trade information technology products. According to the agreement, customs tariff on IT items need to be brought down to zero (WTO). India has committed to bring down the tariff on 217-bound item. Out of which 95 lines were reduced to zero in 2000, and India has committed to reduce tariff to zero another 4 lines in 2003, 2 lines in 2004 and 116 lines in 2005.

According to the IT Agreement, customs duty on some components was reduced to zero in the budget 2000-01. And also customs duty on parts of capacitors, resistors and semi conductors falling under Tariff sub headings 8532.90, 8533.90, 8541.90 and 8542.90 was reduced to zero.

Import of agricultural products like wheat, rice, maize, other coarse cereals, copra and coconut oil has been placed in the category of State Trading though on commercial lines. This is a kind of non-tariff barrier to free trade.

Is it necessary? "License Raj", heavy government interventions, has been a major feature of the Indian economy in the pre-reform period and any market cannot be free from the government intervention. This has generated institutional complementarity in an Indian context in the pre-reform period and it appears that this characteristic of the Indian economy has not changed completely yet. This procedure of State Trading in the agricultural products in the post-reform period has the potential to slow down the process of liberalization. This State Trading restriction appears to be due mainly to political reasons. Though wheat, rice, maize, coarse cereals, copra, coconut oil and urea are no longer on the QRs list, the government has kept an eye on the rural vote bank by restricting their trade by putting them in the special list. Import of all these products continues to remain canalised through state trading enterprises.

This is despite the fact that the government has armed itself with weapons such as high bound rates under WTO for wheat, rice, and maize; sanitary and phyto-sanitary restrictions; safeguard measures to prevent dumping; a "war cell" to monitor imports of 300 sensitive items; besides a new enabling law to impose temporary QRs. Clearly, it is not confident that these will suffice to curb excessive imports of wheat, rice and maize, should the need arise.

What the government has overlooked here is that even if all these commodities were placed on the free list, no imports would actually take place until it was commercially viable to do so. For instance, no flour miller in north India imports wheat because it is cheaper to procure locally. On the other hand, the milling industry in Tamil Nadu has been importing wheat as the landed cost is lower than transporting domestically from

Punjab. Moreover, given the end-user conditions in most of these commodities, it is most unlikely that any speculative trading would take place to harm domestic farmers and bring down prices. Thus, there is no valid reason to have a special list at all which constraints free trade. Domestic supply conditions should be tackled by appropriate domestic policies aimed at improving productive efficiency.

## CONCLUSIONS

India's import substitution and inward-looking policy regime resulted in high tariffs on many products and creation of non-tariff barriers (NTBs). Hence, reduction and rationalization of tariffs and removal of NTBs has been an integral part of India's trade policy since 1991. India has taken major steps towards trade liberalisation since 1991, partly on its own initiative and partly from its commitments to WTO. During the WTO Second Trade Policy Review of India, the members complimented India for reduction in the tariffs (WTO, 1998). However, some members raised question about the complex structure of the tariff system, particularly high tariff rates on the import of consumer goods. The average tariff on consumer goods in 1997-98 was reduced to 25 percent as against 153 percent in 1990-91. The 2000-2001 budget reduced the peak rate to 38.5 percent. However, the additional special duty and countervailing duties add up and increase the tariff. Thus, simply comparing the peak rates will not give a real picture of trade restrictions. Though the peak rate is used as a guide for imposing tariff, applied tariff can be much higher but below the bound rates. India's applied rates on several items are still very high compared to the ASEAN countries. Though policymakers have mentioned on several occasions inside and outside the Parliament that India's tariff will be similar to ASEAN very soon, with the present tariff structure, it is very difficult to expect that it would happen that soon.

India has bound 68 percent of its tariff lines compared to 6 percent prior to the UR. All agricultural tariff lines and 62 percent of the tariff lines of industrial goods are bound. Though at present, the applied rates are below the bound levels, producer lobby may put pressure at any time on the Government to impose tariff very close to the bound rate. If that happens, this would be equivalent to the previous 'licence raj' system.

What would be the impact of removal of QRs on Indian industries? One reason for the continuation of QRs was that the Indian producers could not compete with the best in the world. The industries that have been reaping the benefits of QRs now want the government to provide a level playing field. There are also pressures to provide them protection through high tariff walls (Mehta, 2000). It is also contended that Indian exporters still face many obstacles which affect their export prospects, for example, reservation of items for the small scale sector, labour laws which restrict flexibility in hiring and firing, and complicated port procedures. It is time that the Government takes necessary steps in a time bound manner to remove the obstacles facing the exporters. Even when India borrows the Chinese model of SEZs, it still applies the existing labour laws to units in the SEZs. Similarly reservation for small scale sector in sectors such as toys constrain India's export prospects. The government must also look at trade policy issues from the interests of consumers and the economy as a whole.

India appears to be using the conventional 'domestic failure argument' against free trade. India's negotiations for upward revision of tariff bindings under Article XXVIII of GATT 1994 in respect of certain agricultural products which were bound during the previous rounds of GATT negotiations at zero or low levels of tariffs warrant attention (WTO, 1998). Upward revision on these tariff bindings for such agro products under Article XXVIII was done with a view to giving the necessary protection to domestic agriculture and agro-industry. **This will affect the Indian economy in various ways as long as institutional complementarity is re-established.** The existing productive inefficiency in agriculture, public sector industry and small-scale industries are the consequences of heavy protection so far given to the industrial sector. Such domestic failures should be corrected through a proper domestic policy measures such as the removal of all subsidies to farmers and industries; and effective removal of internal and international restrictions on agricultural products, particularly cereals. **This implies that India's trade liberalizing reforms are forced to slow down or could be counter-productive if highly regulated spheres of other markets remain untouched.** It has been acknowledged that India can lift and sustain the growth rate from the low 3.5 % per annum to 6.5% per annum through economic reforms. Based on the ratio of total trade to

GNP as a proxy of to what extent the economy is involved in world economy, **it can be safely asserted that India's trade has been open now compared to that of the pre-reform period, as the ratio increased from 14.1% in 1980 to 20% in 1999. However, when it comes to an international comparison, India still has to wide open her doors.** For example, the ratio of total trade to GNP in China increased from 12.6% in 1980 to 37% in 1999. This only indicates that the Indian economy can move forward with further reforms and not with restrictions.

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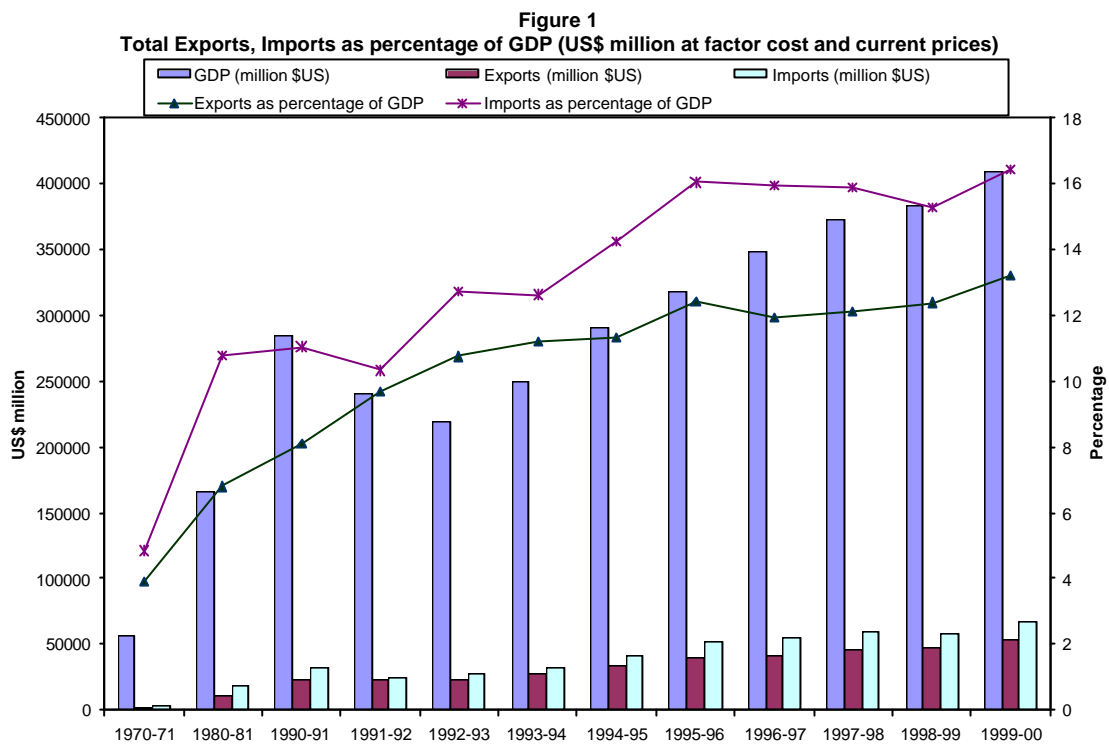
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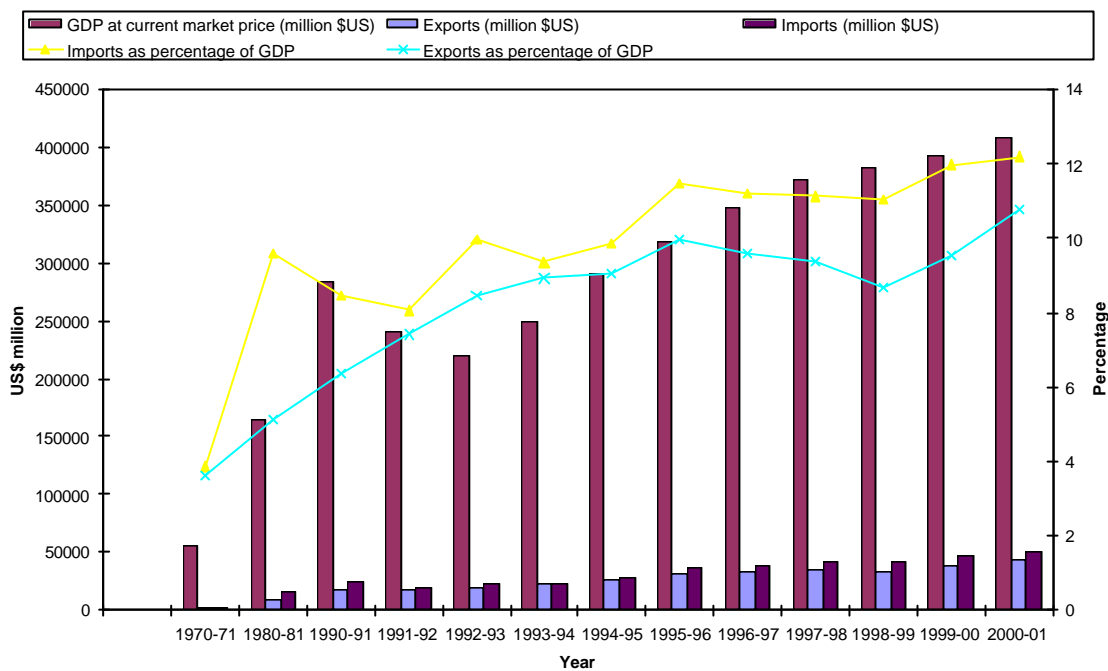
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Source: RBI (2001).

**Figure 2**  
**Merchandise Exports, Imports and GDP (in US\$ million)**



Source: RBI (2001)



Table 1.

**Items on which import duties have been raised in April  
2001**

<i>Items</i>	<i>Previous Tariff</i>	<i>Revised Tariff</i>
Skimmed Milk Powder	0%	60%
Wheat	0%	50%
Rice in the husk(paddy or rough)	0%	80%
Husked (brown) rice	0%	80%
Semi-milled or wholly milled rice,	0%	70%
Broken rice	0%	80%
Maize (corn) seeds	0%	50%
Grain sorghum	0%	50%
Millet (Jowar)	0%	50%
Arecanut	35%	100%
Apples	35%	50%
Tea	15%	35%
Coffee	15%	35%
Sugar	40%	60% (+a countervailing duty of Rs. 850 per tonne).

Source: Ministry of Commerce.

## APPENDIX I

### Trading Houses

The criterion for recognition as a trading house or a star trading house is either on the basis of the FOB (free on board) value or Net Foreign Exchange (NFE) earned on physical exports and export of services during the last three licensing years or preceding licensing year, whichever is opted by the exporter. However, for the purpose of grant of Super Star Trading House, exports at least in minimum three product groups are required to be essential. The FOB and the NFE criteria are as follows:

Category	Average FOB value of eligible exports made during the preceding 3 licensing years (in Rupees)	FOB value of eligible exports made during the preceding licensing year (in Rupees)
<b>FOB Criteria</b>		
Trading houses	500 million	750 million
Star trading houses	2.5 billion	3 billion
<b>NFE Criteria</b>		
Trading houses	300 million	600 million
Star trading houses	1.25 billion	1.5 billion

Source: EXIM Policy 1997-2002.

## Footnotes

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<sup>1</sup> The reform path is not as simple as it is discussed here. Generally, a combination of both paths A to B and A to B' will constitute a reform process. For example, "... until the 1960s in Japan and until the 1980s in Korea and Taiwan, export-promotion policies were superimposed on the import-substitution policies rather than replacing them." (Hayami, 1998, p.18). However, within a reform process, a particular path may be given higher priority from time to time. In most of the IMF structural adjustment programs, higher priority is given first to choose the reform path A to B', which may increase unemployment and reduce imports at least in the short run.

<sup>2</sup> Software exports in physical form are captured under the item "merchandise exports" in the data on India's Balance of Payment (BoP), while software exports through on-site and off-site routes are recorded under computer services in "miscellaneous receipts" which form part of "non-factor services" under invisibles.

<sup>3</sup> EOUs can be started anywhere in the country and mostly they are located in places where there are easy access to raw materials and other inputs such as power and transportation. It can be private, government owned or joint ventures. Government does not fund the EOUs, though they provide some concessions such as duty free imports (Ministry of Commerce).

<sup>4</sup> Details on different types of trading houses are given in Appendix I.

<sup>5</sup> Advance licences are issued under the Duty Exemption Scheme (DES) for duty free import of inputs and are subject to fulfilment of a time-bound export obligation as well as specified rate of value addition. These licences may be either value based or quantity based and are regulated in freely convertible currency, their FOB value or exports and CIF value of imports to be specified accordingly. It is allowed to dispose of raw materials imported against advance licences without prior permission of the concerned authorities (Ministry of Finance).

<sup>6</sup> Deemed Exports refer to those transactions in which the goods supplied do not leave the country. The following categories of supply of goods by the main/sub-contractors shall be regarded as Deemed Exports under the Export and Import Policy, provided the goods are manufactured in India:

- (a) Supply of goods against Advance Licence/ under the Duty Exemption/Remission Scheme (DERS);
- (b) Supply of goods to Export Oriented Units (EOUs) or units located in Export Processing Zones (EPZs) or Special Economic Zones (SEZs) or Software Technology Parks (STPs) or to Electronic Hardware Technology Parks (EHTPs);
- (c) Supply of capital goods to holders of licences under the Export Promotion Capital Goods (EPCG) scheme;
- (d) Supply of goods to projects financed by multilateral or bilateral agencies/funds as notified by the Department of Economic Affairs, Ministry of Finance under International Competitive Bidding in accordance with the procedures of those agencies/funds, where the legal agreements provide for tender evaluation without including the customs duty;
- (e) Supply of capital goods, including in unassembled / disassembled condition as well as plants, machinery, accessories, tools, dies and such goods which are used for installation purposes till the stage of commercial production and spares to the extent of 10% of the FOR value to fertiliser plants;
- (f) Supply of goods to any project or purpose in respect of which the Ministry of Finance, by a notification, permits the import of such goods at zero customs duty;
- (g) Supply of goods to the power and refineries not covered in (f) above;
- (h) Supply of marine freight containers by 100% EOU (Domestic freight containers–manufacturers) provided the said containers are exported out of India within 6 months or such further period as permitted by the Customs; and (i) Supply to projects funded by UN agencies.

<sup>7</sup> Peak tariff rate is the general guide for setting the tariff rates. Higher tariff rates are exceptions. However, higher tariffs should be equal to or lower than the WTO approved bound rates.

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<sup>8</sup> The argument for imposing the additional duty was to provide some relief to domestic producers from internal sales tax.