The Evolution of Indian Trade Policy: State Intervention and Political Economy of Interest Groups

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Paper 1

Historical development of Indian trade policy and the impact of institutional choices on present time

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Executive Summary

The history of economic evolution in the period following the Second World War is essentially a history of the institutional choices made by nation states on issues related to international trade and investment relations. Though one can argue that this has always been true, it holds truer in the period following the Second World War because of decolonization and the rise of new nation states that led to the dismantling of globally connected colonial empires, and falling costs of transport and communication that intensified competition of the local with the global. This work tries to provide an overview of the institutional choices India made in this period, and its implications then, now and going on to the future. The institutional choices are not made in vacuum; they have a political-economic context and a matrix of interest groups whose priorities shape them. This work attempts to describe the politico- economic setting which formed the basis of these choices. The iron triangle of policy choice representing the interest group behavior of executive, bureaucracy, and interest groups have strong implications for democratic societies like India, and integrating that narrative of competition and cooperation within the larger debate on trade and investment policy choices is crucial to the understanding of both past as well as future policy decisions.

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This work is divided into two independent but inter-connected papers. Paper 1 provides the historical context to the evolution of the current trade policy regime. Paper 2 describes the current situation in Indian trade policy and the multi-level institutional choices and developments that needs to take place in order for India to participate more completely with the inter-connected global value-chain that has come to define the system of international exchange of goods and services.

Paper 1

Paper 1 is divided into three chapters chronicling the evolution of Indian trade policy set firmly within the context of politics and domestic policy. Chapter 1.1 looks at the early development of the modern Indian economy and the rise of a domestic industrial and entrepreneurial class with their own independent interests. Independence and the needs of a late industrializing economy provided opportunities for both cooperation and conflict of the business community with the government. The incompatibility of an industrial policy that micro-managed production and investment decisions, with any form of free trade and investment regime led to a series of exceptions to such controls. The result of any exception based system is to encourage rent seeking based gains and not productive gains, and this naturally led to the stagnation of India's otherwise significant participation in international production networks. It is important to recognize that alternatives to import-substitution policies that were pursued was possible, but several decades of an license-quota-permit based control regime that allowed discretionary exceptions to a chosen few led to the establishment of an entrenched and powerful lobby that included actors from all three elements of the 'iron-triangle'of policy choice (i.e. executive, bureaucracy, and interest groups.

Chapter 1.2 looks at the period post 1980s when the first baby-steps to economic reforms were taken, and the 1990s when such reforms accelerated under the pressure of external events. The process of reforms was largely steered by a strong bureaucracy that was committed to reforms but had to contend with interest groups in both the private sector and, within government, and in the wider political arena. This led to a process of incomplete reforms and institutional choices that did not completely challenge the entrenched interest groups within India's private sector. Thus, this legacy of discretion based exceptions, though much reduced in scope, continued. It also resulted in incomplete integration of the Indian economy with global and regional production networks. The 1980s also witnessed the rise of conflicting priorities, especially for India's larger business houses. On the one hand they need to protect their dominant position in catering to India's large and growing consumer market, and protecting the privilege of serving this market sheltered as far as possible from foreign competition. But at the same time had to contend with an increasing need to look beyond India for technology, finance, and markets as the global geography of production shifted and changed.

Chapter 1.3 charts the inherent confusion that arose in India in this conflict with the short-term need to protect a few entrenched interests in a few specific sectors (and firms) with the longer-term need of other sectors (and firms) to integrate India with markets abroad. A cautious policy of trade negotiations (regional, bilateral, and multi-lateral) led to unclear institutional choices. Such a cautious approach resulted in trade agreements that were largely lacking in ambition, and mostly defined by India's defensive (protecting domestic interests) rather than offensive (promoting export and investment interests) needs. The design of these trade agreements were also largely lacking in the disciplines that address micro-level transactional issues that drive global trade and investment decisions related to issues that go far beyond mere tariff and market access negotiations. Caution and lack of ambition also led to an under investment in the institutional development of trade policy, trade facilitation, and competitiveness enhancing bodies. The landscape of how products are produced, traded, and consumed changed and business models for capturing value from such global transactions changed rapidly post the 1990s. Indian policy-makers was found wanting in terms of trade policy solutions that could address these changes. The specific challenges posed to Indian trade policy due to this changed landscape of global production and trade is picked up in Part II.

The overall thrust of Papers 1 and 2 in combination is to provide a political economy perspective of past, present and future challenges to Indian trade policy, and some of the more important challenges and solutions that confront India as it seeks greater integration with the global economy, not in the least to provide meaningful employment to the largest cohort of young workers available to an economy ever in the history of the human race.

1.1 Two Wars and a Depression: Pre-Independence Trade Policy

The Historical basis of Institutional Interests in Indian Trade Policy

The imperial interests of the British India established the basis of Indian trade policy. The policy choices made by the British Indian government would have longer-term impact had would have implications on the post-colonial policies that followed. This in turn left behind a legacy in political economic terms and through the formation of specific interest groups that continue to have impact on Indian trade policy today. In order to understand the continuum that runs through the important shifts in trade policy, and trajectory of interest group behavior, it is important to start with a brief understanding of the historical context within which trade policy and industry in India evolved. This chapter therefore presents an overview of the pre-independence and post-colonial phase of trade (and industrial policies that are the basis of such trade policy decisions). For the purpose of this work, we define post-colonial phase to extend up to the 1980s, at which point first attempts were made to liberalize the highly regulated and closed trade and investment regime in India.

Pre-World War I: The Beginnings of India's Withdrawal from Production Networks

British India inhabited a world, where except for the United States(where weighted average tariffs were between 40-50 per cent,) most of the other leading industrial powers like Germany, France, Belgium, Netherlands and Japan had tariff levels at or below 10 per cent, with Britain abolishing customs tariffs on trade altogether.[1,2] Initially, the British Indian administration had imposed some tariffs in India (usually less than 10%) but with the deep tariff preferences on British imports.[3] By 1882, even the marginal tariff duties in place were abolished and the Indian trade was conducted virtually on the basis of free trade. The system of preferences for British goods over goods from other industrial powers eroded the ability of Indian traders and entrepreneurs to establish genuine linkages globally. Instead, their international trade was inter-mediated entirely through the British system and subservient to British business interests.

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[1] Before 1911, Japan was obliged to keep low tariffs (up to 5 per cent) through a series of "unequal treaties" with the European countries and the United States.

[2] Chang, H.J., "Kicking Away the Ladder: The "Real" History of Free Trade", *Foreign Policy in Focus (FPIF) Special Report*, p. 2, December 2003.

[3] Kumar, D., and Raychaudhuri, T. ed., *The Cambridge Economic History of India: Volume 2 c. 1757 – c. 1970*, Cambridge University Press: Cambridge, 1983.

The commitment to free trade by most of the world's major powers came to an abrupt end in 1914, or the beginning of World War I. This disruption was to have a profound impact on the development of modern Indian industry, and the emergence of a domestic lobby of industrialists with their own specific interest vis-à-vis the international trading system.

Inter-war Period: Rise of Modern Indian Industry

In the new international environment that followed the First World War, many industries in Europe and the US were granted protection as pre-war linkages could not be re-established adequately. This background is important to put some context on India's formative structure of trade policy and the role of interests groups around it that were to shape the future trajectory of India's engagement with the world. As a commodity exporter, the Great Depression debilitated world prices, and Indian commodity export prices fell sharply and consequently India's total trade. According to UN estimates, Indian exports fell by over -71 per cent between 1928 and 1932 while imports declined by -65 per cent.[4] The net result of this was a further decline in India's importance in the international trading system (India's 4.1 per cent share of world exports in 1913 to reach 2.6 per cent by 1938).

India as an exporter of a narrow range of primary commodities and semi manufactures was particularly susceptible to external demand and technological changes. Two major commodity exports in the inter war period, Cotton goods (yarn and piece goods) and Jute (raw jute and jute manufactures) declined sharply affecting India's total exports due to competition from new products (jute) and more competitive producers (Japan in case of cotton). But the disruptions caused to international production networks had forced Britain and other allied powers to source wartime industrial material like steel and chemicals from India. The war had also increased the demand for textiles, leading to expansion of Indian owned operations in this sector. By the end of the First World War these changes in the structure of trade and industry led to the emergence of a domestic lobby of industrialists with their own vested interests separate from the imperial interests in London.

[4] UN, *International Trade Statistics 1900-1960*, [Draft], United Nations Statistics Division, 1962.

At times of peace, the Colonial Government had been largely indifferent, if not hostile, to Indian business interests. With the rise of a more diversified domestic industrial sector, the first demands for protection of Indian industry were articulated as early as during the War period. In 1917, the Government of India's Commerce and Industry Department, in a dispatch endorsed by the Viceroy's Executive Committee, emphasized that 'the necessity for the full exploitation of our own resources, not merely on economic but also on political grounds, will probably compel some measure of protection for the nascent industries specially suited to this country'.[5] A Tariff Board was set up in 1923 to implement the proposals and protection was given to several industries, particularly the protection offered to the iron and steel industry that helped save the Tata Iron and Steel Co. (TISCO) from bankruptcy. But the level and scope of protection remained well below the demands of Indian industry[6]. The Second World War provided Indian industry with another demand boost and expansion. It also made independence (and by implication, the possibility of sovereign trade policy) imminent.

Role of Bombay Plan in Shaping Post-Colonial Trade and Economic Policy: Mercantalist Demands vs. Socialist Outcomes

There were two attempts by the industrial class during the pre-independence period to be part of the 'developmental state'. The first was through the National Planning Commission (NPC) that was set up in 1939 by the Indian National Congress with Jawaharlal Nehru as the chairman. The second was through the publication called the *Memorandum Outlining a Plan of Economic Development for India* in two Volumes, during 1944 and 1945, popularly known as the 'Bombay Plan'. A common consensus emerged in the discussions between Congress

[5] Lockwood, D., *The Indian Bourgeoisie: A Political History of the Indian Capitalist Class in the early 20th Century*, p.97, I.B. Tauris& Co. Ltd.: London.

[6] The comment by WalchandHirachand at the Annual General Meeting of FICCI highlights this "I personally hold the conviction that no country at the present day can develop her industries without following a deliberate policy of discrimination, without excluding the non-national in the country, without giving substantial help…to those nascent industries that require careful bringing up…It is no use mincing matters on this most important question, and the longer the right of economic self-government is delayed, the more embittered will be the feelings of the nation towards those who withhold it" (quotes from Lockwood, D., *The Indian Bourgeoisie: A Political History of the Indian Capitalist Class in the early 20th Century,* p.97, I.B. Tauris& Co. Ltd.: London.

economists who were for the most part socialists, and India's entrepreneurs. The NPC consensus was that the private sector was to have a significant role as a must in the future economy and the NPC assured industry of largely mercantilist policies of cheaper credit, protection from foreign competition and support of the future state to a private sector led to the industrialization process.

However, there was an important point of divergence between the businessmen members and the Congress'expert on the role and the extent of state intervention. The Congress economists also wanted state ownership for the capital-intensive and heavy industries, such as steel, engineering and mining, meant for the development of the nation post-independence, leaving the consumer goods industries to the private sector. Predictably the business class objected to this proposal and the NPC became a failed attempt at generating consensus on the issue of state-led industrialization.[7] This pre-eminent role for the state in key sectors of heavy industries would also have ramifications for FDI and trade policies, whereby the Indian state for a long time would not allow an open investment or trade regime in many such industries, preferring to tweak imports and investment decisions case-by-case based on a regime of licenses, permits, and discretionary investment proposal approvals.

It is important to put the Bombay plan in the context of the trajectory taken by the post-colonial industrial state. Bombay Plan was an attempt by the Indian entrepreneur to articulate the needs of a late industrializing business community that expected government support of infrastructure, easier access to capital and protection from external competition that would allow them the pursuit of profit maximization[8]. It was a scheme that postulated the economic unity of India as an essential condition of economic planning and sent a powerful appeal for promoting private industry within the umbrella of state planning but not under a structural and disciplinarian planning system that gave the bureaucracy absolute primacy in both the choice of technology (productive efficiency) and allocative efficiency.[9]

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[7]Chibber, V (2006) "Locked in Place: State Building and Late Industrialization in India" Princeton University Press

[8] Banerjee, P (2007) "Constrained Optimization: The State and the Indian Entrepreneur", *Doctoral Working Paper Series, No. 0607 002,* School of Public Policy, George Mason University,

[9] Ibid

The Bombay Plan, seen as a roadmap, had all the elements of India's reintegration with the world economy on her own terms. It envisaged greater integration into global production networks inter-mediated by the Indian private sector with strong government support. India was unique in the developing world of that time to have a large private sector and a relatively sophisticated industrial base. India, immediately after its independence, started out as one of the more outward oriented economies. But the policies that followed led to extensive controls of trade, investment and industrial activity leading to India's gradual withdrawal from international production networks and rapid shrinking in its share of global trade. The trade policy implications of this economic trajectory were to make itself felt till the early 1990s.

Trade Policy under Nehru

The three five year plans during the Nehruvian period was based on the pre-independence vision of economic self-reliance and a growing admiration of the Soviet socialist planning. India's regulatory policy regime evolved to become increasingly more restrictive and inward oriented until the late 1970s. The two key state apparatus that emerged to guide and control the economic activities were the Planning Commission, and the Industries (Development and Control) Bill, later modified as the Industries (Development and Regulation) Act of 1951.

The IDRA epitomised Indian economic planning during that period. It was hoped that through the instruments of heavy regulation, the State would be able to;

1) direct investment into the most important branches;
2) correlate supply and demand in the domestic market;
3) eliminate competition
4) ensure the optimum utilization of social capital.[10]

The provisions that had the most debilitating effect on the industrial development were the 'restrictive provisions'to fulfill one of the stated objectives, i.e. the regulation of industrial

[10] Accessed from: http://dipp.nic.in/English/Policies/Industries_act1951.pdf

investment and production according to plan priorities and targets. For instance, under this act, prior approval was required to:

1) Establish a new manufacturing unit;
2) Expand output by more than 5 per cent in one year; and
3) Expand output by more than 25 per cent over a period of five years.

Thus, the role of the state was not just confined to giving support and direction to industrialization as was evinced in Japan, and later in South Korea and Taiwan, it was being extended to the micro-management of all operational decisions on technology, location and even the scale of operation.[11]

The twin apparatus of the Planning Commission and the IDRA were instrumental in achieving two goals. The first was to guide and gain state control of the economy through progressive expansion of public ownership of the means of production. The second goal was to get the private sector to conform to plan priorities through quantitative restrictions on private investment, capital issues and foreign collaborations, as well as imports of technology, capital goods, and intermediate inputs. This distorted the market price signals and the private sector became in effect a rentier class.[12] There was little competition because firms did not have to make an effort to sell their products, only distribute them. There was little incentive for firms to improve their international competitiveness and export industrial products[13].

In such a scenario, India's trade policy limited its participation in world trade. It sought to minimise imports by supporting indigenous production. Import tariffs, based on the recommendation of the Tariff Commission, were initially used to provide infant industry protection to selected industries. However, the ambitious investments in heavy industries at the start of the 2nd Five Year Plan (1956-61) led to a greater than anticipated flow of imports

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[11] Banerjee, P (2007) "Constrained Optimization: The State and the Indian Entrepreneur", *Doctoral Working Paper Series, No. 0607 002,* School of Public Policy, George Mason University

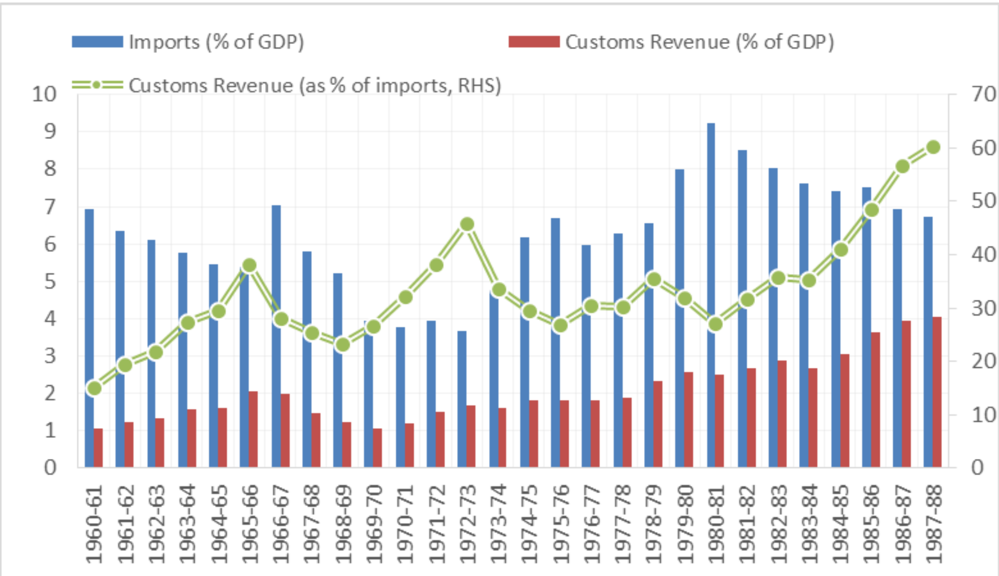
[12] Srinivasan, T.N. and Tendulkar, S.D (2003) "Reintegrating India with the World Economy", Peterson Institute of International Economics,

[13] Banerjee, P (2007) "Constrained Optimization: The State and the Indian Entrepreneur, *Doctoral Working Paper Series, No. 0607 002,* School of Public Policy, George Mason University

for a total trade balance of USD -4 billion or over 50 per cent of the value of exports during the plan period.

This led to the first balance of payment crisis in 1957, and India invoked the balance of payments exception under the GATT Article XVIII (B) to impose quantitative restrictions on a number of imports to meet the crisis – something India continued until 2001 in varying degrees.[14] Graded import tariffs (highest on "least essential" consumer goods, lower on industrial intermediate inputs, and lowest on capital goods deemed "essential" for development) were also introduced in the 1960s in an effort to contain balance of payment deficits. This high trajectory of high tariffs, especially on consumer goods (and associated interest group politics) have left a lasting legacy the impact of which is being felt to this day as India continues to have one of the highest average tariff protection in the world.

Figure 1: Imports and Customs Revenue as a share of GDP: 1960-1988



Sources:

i. Foreign Trade Statistics Vol I &Vol II, Ministry of Commerce, Govt. of India

ii. Statistical Abstract of India (Annual), CSO, Govt. of India

iii. Indian Economic Statistics (Public Finance), Govt. of India

[14] Srinivasan, T.N. and Tendulkar, S.D (2003) "Reintegrating India with the World Economy", Peterson Institute of International Economics

India's Trade Policy in context of developing world priorities: 1950-1980

All emerging countries (including long-independent developing countries) viewed trade policy principally through the domestic lens with a focus on outcomes such as domestic employment, industrialization, and making available crucial foreign exchange to import resources and technology required by a developmental state. Hence, trade policy as an instrument of development strategy was largely left to the binary approach of either import substitution (IS) or export promotion (EP).

Anecdotal and observed experience of countries like Korea, Taiwan, Malaysia, and Thailand supported by "fairly robust" results indicate that "export oriented policies have been more favorable in some cases, or could have been in others, than import substitution policies in expanding employment in developing countries."[15] Table 1 below provides a ready-reckoner of the toolkit of policies that have largely been used in India and elsewhere for IS and EP related initiatives.

Table 1 IS or EP Trade Policy Instruments that countries typically use

		Aim or Effect of the Measure	
		Discourage Imports or Exports	**Encourage Imports or Exports**
Where the Measure is Deployed	**At the Border**	Tariffs Quotas Rules of origin Trade-remedy laws Bans on counterfeit goods Export restrictions	Preferential tariff treatment Preferential quota treatment Trade facilitation Duty drawbacks Export-processing zones Export subsidies
	Behind or Beyond the Border	Taxes Sanitary and phytosanitary measures* Technical barriers to trade* Price controls Anti-competition policy Trade-related investment measures Restrictions on distribution Government procurement restrictions Buy-national laws or programs	Tax concessions Investments in infrastructure Production subsidies Stockpiling Competition

[15] Krueger, Anne O., Hal B. Lary, Terry Monson, and NarongchaiAkrasanee, eds. *Trade and Employment in Developing Countries: Individual Studies.* Chicago: The University of Chicago Press, 1981, p. 25.

Measures that are "beyond" the border include those imposed on goods prior to their shipment to the importing country (e.g., pre-shipment inspection).

** Denotes a measure that may not (and according to WTO agreements should not) be employed principally with the aim of affecting trade, but may nonetheless affect imports and exports indirectly.*

No country followed a complete IS or EP set of policies and used a mix. The differentiation lies in whether EP or IS instruments were used for the most part. It is also important to distinguish a chronological trajectory, i.e. did IS measures give way to increasingly more EP measures as industry matured and critical investments in industrial capacity had been made. It is in the intensity of the use of EP vs. IS measures, and the persistence of IS measures over a longer period of time that India differs from many emerging economies in Asia and Latin America (including Brazil, that is closest to India in terms of intensive use of IS measures). This stress on the need to retain undiluted sovereignty to impose IS measures largely informed India's GATT positions. Box 1 below summarizes India's pre-Uruguay round GATT priorities.

Box 1 India's role in the GATT

An Independent India became an active participant in the development of new institutions of global economic governance as represented by the Bretton Woods process, including as one of the 23 founding Contracting Parties to the General Agreement on Trade and Tariffs (GATT) in October 1947. As one of the largest developing countries in the world, India championed the developing-country concerns in the discussions that led to the formation of the GATT, and it continued to do so in the subsequent multilateral trade negotiations (MTNs) under the GATT.

India wanted to retain the sovereign right to shape tariff policies and trade instruments and was unwilling to compromise on the concept of total sovereignty. In context of India's recently terminated experience of colonialism where such sovereignty lay effectively with the British government in Whitehall, such a position was completely in step with the general narrative of post-colonial nationalism that was emergent at that time. To share or brook any compromise of that sovereign right was seen not just as a political-economic challenge to the formation of a state for newly independent nations, but a recipe for continued domination by western capital by developing economies.

The insistence of newly independent developing countries in these negotiations, led in large part by India, did result in some real concessions to their point of view, during the negotiations as well as in later rounds, such as less than full reciprocity (LTFR), conditional use of quantitative and import restrictions, and concessions under the trade preference schemes, among others. After such concessions were granted to its stated views, India participated in all the tariff negotiations conducted under the GATT. India also committed to a progressive reduction of quantitative restrictions, to their non-discriminatory application and to a process of consultation with GATT on the continued application of import restrictions.

Since not all of India's imports were covered under the GATT commitments, India was free to raise duties, whether the purpose was progressive replacement of import quotas by tariffs, or widening the scope for more revenue for the twin object of securing resources for financing the Five-Year Plans or checking inflationary pressures arising through imports. However, both the government and industry felt that GATT commitments stood in the way of imposing quotas and extending the scope of government revenue.

An early example of the Indian business interests seeking protection from proposed liberalization due to trade agreements is of FICCI urging India to withdraw from the GATT altogether. Alternatively, it had published a long list of imports on which concessions granted by India should be withdrawn.

In the Indian context, its less costly import substitution had been completed and investment in infrastructure had matured by that time. The external environment was also favourable, with rising global trade, growth with full employment in the developed countries generating labour scarcity, and the absence of any competitors in the labour-intensive manufacturing sector except for Japan and newly industrializing East Asian economies. However, in contrast to the successful export-oriented strategies embarked up on by South Korea and later Taiwan, India got mired in the grip of economic nationalism under the leadership of Indira Gandhi and certain exogenous events, such as the war with Pakistan, two successive droughts and the perceived failure of the 1966 devaluation of the currency.[16] With time, as economic power with its related privileges and rent seeking opportunities increased, the bureaucracy and the rentier class developed a vested interest in keeping alive this system of 'planned'economy popularly known as the 'license-quota'raj.

License-Quota Raj and its impact on India's Foreign Trade

The start of the Second Five Year Plan in 1956 coincided with a severe foreign exchange crisis, and the following period up to 1966 was characterised by comprehensive and tight administration of the import licensing system . These foreign trade policies were an extension of more general economic policies under which the "commanding heights" of the industrial economy were dominated by state enterprises, and the private sector was subject to extensive controls.[17]

In the pre-devaluation period of 1966, all imports were either subject to discretionary import licensing or were "canalized" by monopoly government trading organizations, with some flexibility provided by changing Open General License (OGL) lists (which naturally become subject to rent-seeking).

In this system, tariffs lost most of their relevance for regulating the quantity of imports and for protecting local industries; their main function was to raise revenue and to transfer quota rents from or to the recipients of import licenses. After 1956, import licensing was regularly tightened in response to steadily worsening foreign exchange situation, and tariffs were increased to prohibitive levels by early 1966. As result, large and highly variable gaps opened up between domestic and international prices of manufactured products.

In order to offset the anti-export bias resulting from an increasingly over valued exchange rate, subsidies were provided to manufactured exports by allowing exporter to import duty free otherwise restricted raw materials, components and machines that they could sell in the domestic market for premiums, reflecting the scarcity values. As a result of these subsidies and other export incentives for manufacturing, a fair range of manufactured products begun

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[16] Srinivasan, T.N. and Tendulkar, S.D (2003) "Reintegrating India with the World Economy", Peterson Institute of International Economics

[17] Bhagwati,J. and Desai, P (1970) India: Planning for Industrialization, Oxford University Press, London, 1970.

to be exported for the first time. The average implicit protection was very high and increased during the pre-devaluation period.[18]

The First Steps towards Liberalization: Prelude to Reforms

While 1991 is often designated as the 'official'date for the inception of economic reforms that dismantled the license-quota planning regime in India, the move towards reforms started earlier during the Prime Ministership of Rajiv Gandhi, or as some economists contend, at least the faint signs of a shift in growth could be seen starting in the late 1970s.[19] There were two events that led to the initiation of the first steps towards liberalization:

1. In the 1970s, the accumulated reserves of public stocks of food grains and foreign exchange put the government in a comfortable position. Therefore, when the second oil price hike hit globally during 1979-80, the government did not adopt contractionary policies, but instead it looked to relax counterproductive regulations on domestic and international transactions during the 1980s.
2. The lobbying by the industrialists to liberalize the imports of raw material and machinery was the first major push. The industrialists found the existing regime counterproductive and pressed the government towards deregulation.

In a recent article on the role of Chambers, the agitation by the industrialists against anti-industry policies was highlighted. During its rule in the post-Emergency era, the Janata Party came out with a policy that capped foreign investment in companies at 40 per cent, forcing Coca-Cola and IBM to leave India. G D Birla, leader of the Indian industry, urged the industrialists to break the law by producing more than what their respective licences allowed (rules then allowed a company to produce only 25 per cent more than its licensed capacity). These were the first strong public utterances of Indian industry seeking freedom from the controls of a closed economy.[20] Although FICCI was against restrictive and opaque policies of the government the business leaders were also wary of direct and sudden competition from

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[18]Bhat, T.P (2011)., "Structural Changes in India's Foreign Trade", Indian Council of Social Science Research: Delhi,

[19]Panagariya, A (2003), "India in the 1980s and 1990s: A Triumph of Reforms", Seminar Paper, 6 November, New Delhi. Accessed from: https://www.imf.org/external/np/apd/seminars/2003/newdelhi/pana.pdf

[20] Das Gupta, S (2014).,'40 Years Ago... And now: Chambers - Sometimes with government policy, often against it', *Business Standard*, 12 November,

abroad. This attitude was clearly reflective of the fact that Indian industry strongly felt the need for dismantling the controls in the economy as a pre-condition to gradual openness.

Thus, when Rajiv Gandhi made his first overseas visit to Russia in 1985, he preferred being accompanied by a Confederation of Indian Industry (CII) delegation that consisted of young industrialists like Rahul Bajaj and J N Godrej to the old guard of FICCI. At the industry's behest, the Rajiv Gandhi government also took the first steps towards economic reform by reducing some of the restrictions in the license regime, making it easier to import capital and consumer goods, reducing import quotas and allocating more funds in science and technology.[21] Rajiv Gandhi's vision of incorporating rapid technological changes laid the foundation for the Information Technology (IT) boom that became India's entrepreneurial hallmark by the late 1990s.[22]

Five steps that were initiated post mid-1980s towards a more liberal trade policy.

1. The Open General License (OGL) list, reintroduced in 1976 with 79 items, was steadily expanded to cover 1,339 items by 1990[23].
2. There was a decline in the share of canalized imports, which refers to monopoly rights of the government for the imports of certain items[24].
3. Several export incentives were introduced or expanded, especially after 1985, which helped expand imports directly when imports were tied to exports and indirectly by relaxing the foreign exchange constraint.
4. There was a significant relaxation of industrial controls beginning in 1985[25].

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[21] Ibid.

[22] Tripathi, D., *The Oxford History of Indian Business,* Oxford University Press, 2004, p.318.

[23] During 1987-88, 30 per cent of all imports entered under the OGL.

[24] Between 1980-81 and 1986-87, the share of these imports in total imports declined from 67 to 27 percent. Over the same period, canalized non-POL (petroleum, oil and lubricants) imports declined from 44 to 11 percent of the total non-POL imports. This change significantly expanded the room for imports of machinery and raw materials by the industry.

[25] In March 1985, 25 product groups were freed from licensing. In December 1985, another 22 products were removed from the list provided plants were located in the designated backward areas. In January 1986, 28 industry groups were broad-banded meaning that they were defined more broadly so as to allow the firms in them to expand into related products without permission from the licensing authority. Finally, in 1986, firms that reached 80 percent capacity utilization were assured authorization to expand capacity up to 133 percent of the maximum capacity utilization reached in any of the previous years.

5. Another crucial source of liberalization was a realistic exchange rate. From 1985 onwards exchange rate policy became more active though the ‘fiction’ of a fixed basket-peg was still maintained.

The limited reforms during the 1980s did help usher in new entrants, domestic and some foreign, to the Indian market. The automobile industry in India began its nascent growth during the 1980s[26] (the Indian automotive industry today, is one of the largest value-added export sectors in India)[27]. India’s IT sector also had its roots in the 1980s. Wipro first ventured into IT in 1980, and Infosys was founded in 1981. Once the policy environment turned permissive, these firms were able to reap handsome benefits from India’s prior public investment in higher education (the Indian Institutes of Technology in particular). Reforms in the 1980s, therefore, unleashed the entrepreneurial and preexisting strengths of the Indian economy by bringing in business-friendly reforms. These initial reforms had a substantial impact on foreign trade. In fact in relative terms, the impact was more substantive than the reforms of the early 1990s would have in the period 1991-1995. However since such liberalization was largely limited to producer and capital goods, the visible impact for the common man was less than the 1990s liberalization.

A major impact of the policy changes was the rapid growth in external borrowings and rising government expenditures at home. The external borrowings helped bridge the considerable gap between exports and imports, while high current expenditures proved unsustainable. Combined fiscal deficits at the central and state levels, which averaged 8 percent in the first half of the 1980s went up to 10.1 percent in the second half. Continued large deficits of this magnitude led to a buildup of very substantial public debt with interest payments accounting for a large proportion of the government revenues. They also inevitably fed into the current account deficits, which kept rising steadily until they reached 3.5 percent of the GDP and

[26] The decade 1985 to 1995 saw the entry of MarutiUdyog in the passenger car segment, through a joint venture with Suzuki of Japan and joint ventures with Japanese manufacturers in the two-wheeler and commercial vehicle segments.

[27] Nag, B (2011).,“Trade liberalization and international production networks: Experience of the Indian automotive sector”, in Mikic, M., and Pasha, M., ed., *Fighting Irrelevance: The Role of Regional Trade Agreements in International Production Networks in Asia*, UNESCAP.

43.8 percent of exports in 1990-91. The eventual outcome of these developments was the June 1991 crisis.[28]

Rodrik and Subramanian make a distinction that the reforms during the 1980s were more *pro-business* than *pro-market*. A pro-business orientation focuses on raising the profitability of the established industrial and commercial establishments. In contrast, pro-market reforms focuses on removing impediments to markets and aims to achieve this through economic liberalization and market-oriented policy reforms, or what was seen during the 1991. Easing restrictions on capacity expansion for incumbents, removing price controls, and reducing corporate taxes (all of which took place during the 1980s) are examples of pro-business policies.[29]

They observe that the reforms of the 1990s were of course triggered by the BOP crisis of 1991, however, the internal reforms that were already happening in the 1980s could have prepared India to bounce back quickly from the crisis as well as realize the potential of the reforms quite unlike the shock and awe responses noticed in Latin America or in sub-Saharan Africa. In effect, the pro-business rather than pro-market/pro-competition orientation of the reforms of 1980s manifested itself in the greater focus on internal rather than external reforms. [30] Chapters 1.2 that follows traces the trajectory of these largely domestic reforms in 1980s and later in the 1990s, and chapter 1.3 discusses the implications for trade policy in the bilateral, regional, and multi-lateral setting for India.

1.2. Economic Liberalization and India's Trade Policy[31]

The 1980s presented a rapidly evolving global economic landscape. The planned economies of the Communist bloc were starting to show the limits of their growth. At the same time rapid economic growth and poverty elimination through the creation of manufacturing sector jobs were taking place in several developing economies. Indian businesses and policy-makers were seeing the positive impact of entrepreneurship driven economies that were not impaired by centralized controls that they had established across East and Southeast Asia. Large

[28]Panagariya, A (2003), "India in the 1980s and 1990s: A Triumph of Reforms", Seminar Paper, 6 November, New Delhi. Accessed from: https://www.imf.org/external/np/apd/seminars/2003/newdelhi/pana.pdf

[29]Rodrik, D., and Subramanian, A (2005) "From "Hindu Growth" to Productivity Surge: The Mystery of the Indian Growth Transition", *IMF Staff Papers*, Vol. 52, No.2, International Monetary Fund,.

[30]Ibid., p.225.

[31] Roy, Jayanta (1991) "Trade Reform in the Nineties: Freeing the Economy" Seminar, April

developing countries such as China, Indonesia, and Turkey among others were also implementing significant economic reforms. The absolute size of the capital base and the risk appetite of the Indian private sector had also increased, especially for a few large firms that were already fairly globalized in their operations. Thus Indian big businesses as represented by these few large outward oriented firms, and influential policy-makers were increasing becoming convinced that 'business-as-usual' was not a sustainable solution in such a rapidly evolving landscape. An environment supportive of cautious and gradual reforms was slowly emerging.

A critical role in initiating such limited but significant reforms were provided by a group of technocrats from World Bank, IMF and other international institutions that had been brought into the administration by Prime Minister Rajiv Gandhi. This small but influential group had a far more liberal perspective then the entrenched bureaucracy and played a key role in pushing forward the incremental reforms of the 1980s that serve an important prelude to what followed in the 1990s.

An important point needs to be made here to correct the popular impression that the reforms in early 1990s in India were a sudden break from the past. The incremental reforms that preceded in the 1980s- such as pursuing a realistic exchange rate policy and some removal of anti-export bias by making inputs available for exporters at world prices--are a pointer to the fact that the general direction towards economic reforms and liberalization of the economy from over-arching government controls was not an isolated phenomenon imposed upon a very unwilling Indian establishment in the face of crisis in the 1990s, but a movement that was well underway by the time the crisis of 1991 took place. In fact the trade reforms that need to follow were fully articulated in papers written by economic advisers in the government. The World Bank and IMF conditionalities were mostly based on the internal recommendations of these white papers. The GOI owned the reform program.

However the real catalyst for major reforms would come due to external shocks that would in turn allow the domestic reforms lobby (represented largely by reform minded technocrats and a very small number of influential business houses) to push through deregulation and liberalization related policies. These external shocks came in the form of the collapse of the Soviet Union and Communist bloc (thereby ending the luxury of Rupee-Ruble trade) and rising oil prices due to the crisis in the middle-east that culminated in the first Gulf War. These created additional pressure on India's already fragile Balance of Payments situation.

Current account balance had been in the red since 1978-79, reaching -3.2 per cent of GDP in 1990-91. Foreign exchange reserve, the biggest worry for policy makers, was down to finance just half a month's inflating import bill. Foreign investments were hardly forthcoming and India was left to rely massively on external assistance and commercial borrowings. To put things in perspective, current account deficit in 2013-14 was at a manageable -1.7 per cent of GDP, and even with a burgeoning trade deficit and India's foreign exchange reserves stood at USD 304 billion that could comfortably finance 8 months of India's imports.

Table 2: India's Balance of Payment, Select Indicators: 1975-1993 (in USD million)

	1977-78	*1978-79*	*1979-80*	*1980-81*	*1981-82*	*1982-83*	*1983-84*	*1984-85*	*1985-86*	*1986-87*	*1987-88*	*1988-89*	*1989-90*	*1990-91*	*1991-92*	*1992-93*
Exports	6354	6817	7817	8445	8697	9490	9861	10061	9461	10413	12644	14257	16955	18477	18266	18869
Imports	7051	9512	12076	16314	15970	16468	16575	15715	17294	17729	19812	23618	24411	27914	21064	24316
Trade balance (X-M)	-698	-2696	-4259	-7869	-7273	-6978	-6714	-5654	-7833	-7316	-7168	-9361	-7456	-9437	-2798	-5447
Invisibles, net	2011	2406	3574	5065	4094	3572	3499	3238	2967	2756	2316	1364	615	-242	1620	1921
Current account, Balance	1313	-290	-685	-2804	-3179	-3407	-3216	-2417	-4867	-4560	-4852	-7997	-6841	-9680	-1178	-3526
Foreign Investment	-12	30	86	.	.	.	.	.	.	195	434	357	410	103	133	557
External assistance, net	1030	555	813	1409	835	1168	1148	1184	1370	1414	2271	2216	1856	2210	3039	1859
Commercial borrowings, net	39	200	55	252	164	761	761	934	954	1966	976	1894	1777	2248	1456	-358
Capital account, Balance	828	1597	1090	1665	657	2087	2655	3147	4506	4512	5047	8064	6977	7188	3777	2936

Box 2 : India's Uruguay Round Commitment and Other Associated Impacts Goods

Tariffs

As a result of Uruguay Round, India had bound about 67 per cent of its tariff lines, including all agricultural lines and some 62 per cent of lines for imports of industrial goods. Lines remaining unbound included those on consumer products and some industrial items.

Quantitative Restrictions

India, under the exceptional provision of Article XVIII:B of GATT, used QRs on 2714 tariff lines for balance of payment purposes. The US brought a case against India in 1997 to the Dispute Settlement Body to examine whether India's continued maintenance of QRs were WTO-compliantt. India subsequently lost the case and had to phase out all QRs by 2001, except for 600 tariff lines that it continued to impose on some consumer goods.

Services

With respect to the General Agreement on Trade in Services (GATS), India made commitments in 33 sectors. Opening the services sector under the GATS was expected to make these sectors more competitive, through foreign capital inflows, technology and innovation. It needs to be noted here these commitments largely reflected the extent of unilateral liberalization, i.e. Commitments were made in those sectors that were already open for foreign businesses in terms of both market access and national treatment. It also needs to be noted that qualifications as to extent of market access and national treatment for foreign operators in the context of investments (i.e. Mode 3) remained in place.

TRIPS

India's obligations under the trade-related intellectual property rights (TRIPS) agreements required India to increase the term of patent protection from 14 years to 20 years on both product and process patents. India has since met its WTO commitments by enacting amendments (in 1999, 2002, 2005, and 2006) to the Indian Patents Act of 1970, allowing product patents in pharmaceuticals and chemicals.

TRIMS and Other Measures

On trade-related investment measures (TRIMS), India eliminated all such measures that it had maintained by 1January, 2001, such as dividend-balancing requirements and mixing requirements in respect of newsprint among others. Similarly, India had to amend the legislation on Customs Valuation Rules, 1988, to bring it into conformity with provisions of the Customs Valuation Agreement.

Overall balance (Current + Capital)	2141	1308	405	-1140	-2523	-1319	-561	730	-361	-47	195	68	136	-2492	2599	-590

1991 era Reforms: The Key Elements[32]

While the 1991 reforms in India are much discussed and written about, a reiteration of some the key elements serves to put things in context in what follows in the following chapters. The important elements of the reforms initiated in 1991 were the dismantling of controls on industrial production, removal of licensing for imports, a massive reduction of tariffs, and maintenance of a realistic exchange rate which were closely followed by unilateral liberalization, first, and later due to commitments made at the Uruguay Round in the WTO (see Box 2 above for details of Uruguay round related policy changes). Comment: the BOP case related changes were not UR commitments. They were a result of the dispute settlement case. They should not be in the Box, unless you change the title by adding words like "and subsequent impact of the new disciplines". The reason I suggest the addition is that to some extent, the BOP provisions were tightened. However, that did not have an impact on the result of the dispute. So either an expanded title, or dropping the part of the text is suggested. Or else, you could say that the revised BOP disciplines were in place when US brought the case very soon after the Uruguay Round.

De-licensing and Easing of FDI restrictions

The first step in the liberalization of industrial regime was in the form of 'Statement of Industrial Policy' released on July 24, 1991, and the Monopolies Restrictive Trade Practices (MRTP) Act. These led to elimination of the public sector monopolies and raising the cap for foreign direct investment (FDI) in several sectors up to 51 per cent (from the pre-existing 40 per cent cap under the pre-1991 regime[33]). Most sectors were brought under the 'automatic route'for FDI. This eliminated the need for approval for FDI on a case-by-case basis that made investment subject to political approval and influence. The requirement of prior government approval was removed for all private investments except those in 18 industries[34] and allowed large industrial houses to expand, diversify, and merge without prior approval from the government.

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[32] Roy, Jayanta (1996) "Trade Liberalization: The Road Ahead" in Kelkar, V and Rao, Bhanoji (ed) India Development Policy Imperatives, Tata-McGraw Hill

[33] With respect to foreign investment, automatic approval was introduced which empowered the Reserve Bank of India (RBI) to approve 34 industries (mentioned in annex 3 of the New Industrial Policy) to have equity investment of up to 51 per cent. This automatic approval was extended to include all manufacturing activities (except those subject to public sector monopoly or licensing) in the Special Economic Zones (SEZ).

In essence the most draconian measures of the Industries (Development and Regulation) Act (see chapter 1) that shackled entrepreneurship and competition, prevented efficient allocation of resources led by market forces and led to a 'rent seeking' led culture were finally dismantled leading to a more transparent and market oriented business environment. Removal of such a system, popularly known as the 'licence-permit raj', was an essential pre-condition to the development of a robust industrial sector that could compete globally.

Gradual Removal of Import Licensing

The post-1991 policy regime also dismantled the import-substitution policies and exposed Indian industry to greater competition in a phased manner. Although licensing restrictions were greatly reduced, they were not entirely eliminated. This would come about through the WTO route only in early 2000s. The exchange rate adjustments in 1991, through the devaluation of the rupee, introduction of a dual exchange system with one rate effectively floated in the market and liberal import policy began the transition from a regime of quantitative restrictions to a price based mechanism.[35]

Table 3: India's Tariff Structure: 1990-91 to 1997-98

	1990-91	*1993-94*	*1995-96*	*1996-97*	*1997-98*
Avg. Unweighted					
Agriculture	113	43	27	26	26
Mining	100	70	30	26	25
Manufacturing	126	73	42	40	36
Whole Economy	125	71	41	39	35

[35] The dual exchange system refers to The Liberalised Exchange Rate Management System (LERMS) that was put in place in March 1992 involving the dual exchange rate system in the interim period. It was replaced by a unified exchange rate system in March 1993. According to the RBI, the experience with a market determined exchange rate system in India since 1993 is generally described as 'satisfactory' as orderliness prevailed in the Indian market during most of the period. RBI, *Exchange Rate Policy and Modelling in India*, Available at: http://www.rbi.org.in/scripts/PublicationsView.aspx?id=12252

Avg. Weighted	87	47	25	22	20
- *Consumer goods*	153	86	36	33	25
- *Intermediates*	77	42	22	19	18
- *Capital goods*	97	50	29	29	24

Note: The import-weighted average of the tariffs, by product, are from World Bank estimates. World Bank, 2003

Source: WTO, 1998

Reduction of the Absolute Scale of Tariff Protection

India went on to reduce tariffs significantly. But this needs to be seen in the context that India's average tariffs in 1990-91 was 125 per cent, with tariff peaks on consumer goods reaching up to 355 per cent, which were far above the levels prevailing in other developing countries. Import-weighted tariff averages were highest in consumer goods at 153 per cent, as consumer goods were still considered non-essential for the development of the economy. The corresponding figures were lower for intermediates and capital goods, but were still at much higher levels compared to other developing economies. As will be discussed later, India's applied MFN tariffs continue to remain one of the highest in the world, even when compared with other large developing countries.

The Chelliah Committee, set up in 1991 to review and recommend tax reforms, had recommended for bold reduction in the average-weighted tariffs in a phased manner from 87 per cent in 1989-90 to 45 per cent in 1995-96 and further to 25 per cent by 1998-99. The actual reduction in import-weighted average had been from 87 per cent in 1990-91 to 25 per cent in 1995-96 and 20 per cent in 1997-98, going beyond the recommendations of the Chelliah Committee.

However, what needs to be stressed here is that the tariff structure remained complex, with a large number of bands. India also continued to provide very significant protection to agriculture sector through very high tariffs as well as quantitative restrictions (QRs).

Very Limited Services Liberalization

Market access in the services sector was kept fairly restricted, a notable exception being telecommunication services where private investors in joint ventures were allowed to provide intra-voice telephone services in various States and metro areas. Many value added services, the most important of them being cellular mobile telephone, were opened up to 49 per cent foreign equity participation, together with the establishment of an independent regulator. This led to the much discussed mobile telephony revolution, and India over time evolved to become one of the most competitive mobile telephony markets with domestic brands that are now becoming serious players in the global mobile telephony market.

But other critical services sectors such as financial services (banking and insurance), retail, shipping, and professional services were not opened up to foreign participation. India continues to impose significant entry barriers in these sectors (see Table 3 in chapter 2.2). The political-economy of the service sector liberalization is as, if not more, complicated than manufacturing. Powerful lobbies in the professional services sectors such as legal and accounting and politically significant small traders and retailers have been and will continue to stymie reforms and liberalization of their respective sectors.

Politically well networked and influential employee unions in Public Sector financial services companies (i.e. insurance and banks) have managed to hold-back more aggressive liberalization of banking and insurance[36]. There is also a whole set of regulatory reforms applicable to several services sectors that need to be addressed. Important services sectors such as engineering and technical services, education, construction, surface transport (road, rail and inland water), warehousing, distribution, health and postal for instance are largely un-regulated in a modern context (i.e. laws and regulations that apply date back at least three or more decades). Other key sectors like civil aviation, shipping, and professional services are poorly regulated. The development of services sector competitiveness would have to address these incomplete reforms in terms of stronger regulatory and institutional basis for these services (this is discussed in more detail in chapter 2.2).

[36] Roy, J and Banerjee, P (2013), “Why Isn’t India a Major Global Player? The Political Economy of India’s Trade Liberalization”, *Robert Schuman Centre for Advanced Studies Working Paper No.2013/84,* European Universities Institute

Analyzing the 1990s era Reform: The Failure of Sequential Liberalization due to incomplete reforms

Indian policy-makers were essentially trying to follow the late-industrializer model followed successfully by countries like Japan and Germany a century earlier. This would essentially mean creating a competitive domestic industrial environment while providing effective protection from external competition for a while to allow domestic industries to develop scale and capacity. Thus domestic de-licensing and liberalization of FDI were the first items on the agenda, while tariff protection (and restrictions on market access in services) continued to remain in place. Unfortunately, given its rather delayed reforms on the domestic front (initiated in the 1980s as opposed to 1970s by most other comparable economies), this meant squeezing in the transition period, and that Indian industries would have to adjust, develop skills, and acquire technology before Uruguay round commitments and geo-strategic need to engage in bilateral agreements would force tariff and market access liberalization (starting early 2000s).

The other most important part of this story is that the de-licensing, removal of domestic restrictions on industrial activity and liberalization of FDI regimes (specifically in manufacturing) were not accompanied by aggressive reforms on trade and business facilitation. Procedural and infrastructural transaction costs remained significantly high as a legacy of a highly controlled economic regime. Micro-level reforms (addressing specific departmental procedures and infrastructure issues) that would have addressed these transaction costs were not taken up.

This meant that despite the more liberal policy environment in terms of permits and licenses (and effective external protection), Indian manufacturing was not able to pick-up pace and expand in a manner that was hoped for. Technological osmosis and international linkages that should have been enabled through inward investment in manufacturing by global players under a more liberal FDI regime was also restricted as investors were scared away by a poor business environment and high transaction costs. This very critical theme of incomplete reforms and its consequences is taken up in greater detail in Chapters 1.3 and 2.2.

Look East and Nascent Regionalism

Until the 1990s, India's attempts at creating forums with some trade or economic policy goals had been entirely based on geo-political necessities that had little to do with economic considerations. The South Asian Association for Regional Cooperation (SAARC) is a classic example, where political goals took complete dominance over any agenda on regionalism or economic integration. In other words, till the mid-1990s India had never undertaken serious dialogue on trade policy outside of the multilateral system represented by GATT/WTO.

By the mid-1990s, there was growing consensus that demographics and the pace of technology and skills transfer would ensure the re-emergence of Asia as the center of gravity of the global economy. India's trade however looked mostly westward, to Europe, North America, and Middle-East, and not eastwards where much of the future of global economic growth was (and is) expected to come from. The inward looking, import substitution oriented policies described in chapter 1.1 resulted in developing trade relations with the more developed industrial markets in Europe and North America, and to a limited extend with Japan and the former Soviet Union. The linkages with the emerging Asian production network were largely missing. The impact of this orientation of trade as a legacy of policies followed post-independence up to the 1990s is being felt even to this day as the government seeks to increase India's regional linkages in Asia that remain far below potential given India's relative size and competitive advantage.

It was in this context that conscious efforts were taken up in the 1990s to strengthen India's ties with East and Southeast Asia. This refocusing on Asia was also easily aligned with the strategic and political objective of reviving historic cultural and economic ties with an eye to balancing some of the rapidly increasing dominance of China in India's extended neighbourhood (i.e South Asia and SE Asia). There was strong consensus in India political and technocratic establishment for the 'Look East'policy launched by Prime Minister P.V. Narasimha Rao. However, the outline and the plan of engagement of this 'Look East'policy remained unclear. While the ultimate objective was to reconnect India economically with SE Asia, the concrete steps required to achieve this was not clearly enunciated. The discussion on strategic regionalism on chapter 2.2 brings out this un-coordinated policy of Look East that led to diminishing returns and very limited levels of ambition in terms of actual regional integration. While India's share of trade and investment (both outward and inward) increased significantly with SE Asia, regional integration in South Asia remains well below par. Even in the context of SE Asia, India's linkages are less to do with production network related and led exports and imports, and more to do with natural resources and basic goods.

Within South Asia, India attempted at a limited scope preferential trading arrangement in 1993, in the form of the South Asian Preferential Trading Arrangement (SAPTA). Its main stated aims were gradual liberalization among the SAARC members leading to economic integration in the longer run. However, India showed very limited ambition despite its overwhelming economic size and influence in the region. India agreed to offer preferences on only 437 items or product categories at the HS six-digit level to all member countries. The least developed countries like Bangladesh, Bhutan, Maldives and Nepal were offered additional concessions on 571 items at the HS six-digit level.[37]

Much of this modest liberalization was due to region-specific lobbies that wanted certain sectors to be protected from competition in other South Asian countries. Good examples include the textiles and ready-made-garments lobby based out of Tamil Nadu and Punjab, cement, and certain chemical industries. By 1993, India was firmly entrenched in coalition politics where no single party enjoyed a complete majority Parliament. This made the central government sensitive to such regional business interests. In addition, the general resistance to opening up to Pakistan, while Pakistan continued to deny India even WTO mandated MFN benefits on spurious grounds remained a significant deterrent to progress of SAPTA and its emergence as a genuine regional integration arrangement.

India later negotiated bilateral arrangements with Nepal, Bhutan, Afghanistan and Sri Lanka (although the India-Sri Lanka FTA was the only true FTA with reciprocal and substantial tariff reduction). The SAPTA itself gave way to SAFTA in 2005 and increased its scope considerably to include services as well. However, the same political-economic considerations and interests groups that held back SAFTA have been relevant for SAPTA as well, resulting in very slow progress and inability to evolve into a platform for genuine economic integration. The lack of physical connectivity and poor regional trade facilitation discussed in greater detail in chapter 2.2 were also important impediments to the ground progress on regional integration. India's early efforts at regionalism did not have any meaningful effect in terms of increased trade or economic integration. What it did show was

[37]Jha, S. (2011) "Utility of Regional Trade Agreements: Experience from India's Regionalism." *Asia- Pacific Research and Training Network on Trade, Working Paper No. 99.*

a political and strategic intent towards regional integration within South Asia and with Southeast Asia[38]. India's engagement both bilaterally with the countries in the two regions as well as regionally indicated India's desire to play a greater role within the pan-Asia context.

However, this political and strategic intent was not grounded on a sound industrial strategy or the backing of India's business sector stakeholders, nor did the government consider undertaking comprehensive public-private initiatives to increase investment and trade linkages as a precursor to seeking greater integration. This led to an obvious disconnect between Indian business priorities and efforts at regional integration in the early stages of such regional deal making. Chapter 1.3 that follows investigates the inter-play of forces starting the late 1990s that has been shaping India's FTA and regionalism policy, and continues to do so at present.

1.3. First Steps to Proactive Engagement: Strategy of 'Cautious and Gradual Bilateralism'

The domestic dynamics in the mid to the early 2000s in India with reference to trade was one of cautious optimism. The domestic reforms encompassing removal of licensing and control over all industries, except for a small specified list, and the strong economic growth of 5.7 per cent experienced during the 1991-92 to 1996-97 period generated greater political support for further liberalization, reforms and trade engagement. The implementation of the conditionalities of the IMF and the World Bank mandated reforms, as well as Uruguay Round obligations had also not resulted in the dire scenarios that had been predicted by the most vociferous opponents of such reforms and liberalization, thereby muting the criticism of future rounds of policy changes in this direction.

The right-of-centre Bharatiya Janata Party (BJP) led National Democratic Alliance (NDA) coalition that came to power following elections in 1998 had always been a votary of a more

[38] An early result of India's long-standing intent to develop some regional linkages is the Bangkok Agreement, which was signed as early as 1975 (making it India's first PTA), and included China, South Korea, Bangladesh, Lao PDR and Sri Lanka, besides India. However, like all of India's early efforts, the tariff preferences received and granted under this agreement were very limited in number, and not of much significance.

market oriented and open economy given its strong support base among the middle-class and traditional trading and small business communities. The BJP led NDA was therefore keen to keep the momentum of reforms going forward[39]. However, the general consensus in the business, political and bureaucratic establishments in India was that more 'gradual'reforms and liberalization were needed, as was some discretion as to the specific agenda of such liberalization[40]. Symbolic of such thinking was the quip by a leading politician from the BJP that India needed 'computer chips and not potato chips' essentially underlying that liberalization of trade and investment should only happen in those sectors where it served 'national interest', and the state should have the final sovereign right to decide.

Thus, by the early 2000s, India was ready to join the bandwagon of bilateral agreements sweeping across the world. Such bilateralism or FTAs suited India's political economic consensus of cautious and gradual engagement since they allowed India to safeguard or exclude sectors and disciplines selectively areas in which it was not ready to liberalize or enter into bilateral arrangements. The 'second wave of regionalism'that hit the 1990s, saw the cumulative FTAs in force increase from six in 1990 to over 200 by the start of the Doha Round in 2001. In that period, India had only one true FTA in force, the one with Sri Lanka. However, starting early 2000, especially after the failure of Doha round of negotiations, India initiated several FTAs focusing mainly on SE Asia and East Asian economic regions which it saw as the fulcrum of its future economic interests.

Mattoo and Subramanian argue that the US 'abandonment of the multilateral-only route combined with the uncertain prospects of the Doha Round, and a slowdown in India's growth and reform process meant that a strategic shift in India's outward orientation was on the anvil.[41] Jayanta Roy[42] provides a more comprehensive understanding of factors that led to the

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[39]Roy, J and Banerjee, P (2013), "Why Isn't India a Major Global Player? The Political Economy of India's Trade Liberalization", *Robert Schuman Centre for Advanced Studies Working Paper No.2013/84*, European Universities Institute

[40] Ibid

[41]Mattoo, A., and Subramanian, A (2002) "JagdishBhagwati and India's Trade Policy Today", *Economic and Political Weekly*, Vol. 37, Issue No. 50, 14 December,

development of ever-closer trade and investment relations between regional partners in the period starting late 1990s. Manufacturing supply chains increasingly sought to leverage regional specialisations to take advantage of the economies of scale and market size offered by the larger region in which they operate. This led to the creation of new political-economic vested interests in regionalism. In several cases it was strategic considerations that initiated the process of regional integration and paved the way by creating institutions and incentives that led the way to regional economic integration.

Thus, India's shift to bilateralism was not just a reaction to failure of multilateralism and slowdown in growth. As noted earlier, the choice to go for FTAs was rooted on a more gradual approach preferred by India policy-makers, the geo-strategic prerogatives of the India state as articulated by its 'Look East'policy (indeed India's first FTA with Sri Lanka is a perfect example where strategic imperatives was the leading factor for entering into an FTA), and clear understanding the multilateral architecture driven as it is by common minimum consensus would never be the driving force of future economic engagement, but provide the contours of a globally agreed upon 'rules of the game'[43]. As noted by Kamal Nath, India's Minister of Commerce (2004-2009), India did not see the use of RTAs as subverting the international economic order, but a means to strengthening it.[44]

Table 4: India's expanding universe of Trade Agreements since 2000

Signed and in effect	Negotiations launched/FA signed	Proposed/under consultation and study
Sri Lanka: FTA (2000)	Thailand: CECA (2003)	Eurasian Customs Union (earlier proposed with Russia): JSG (2006)

[42] Roy, J (2013) "India's trade needs strategic regionalism" Business Standard, July 6th

[43] Roy, J and Banerjee, P (2013), "Why Isn't India a Major Global Player? The Political Economy of India's Trade Liberalization", *Robert Schuman Centre for Advanced Studies Working Paper No.2013/84*, European Universities Institute

[44] Nath, K (2004).,"FTA: Is this an Engine of Growth?",*Indo-American Chamber of Commerce*, Keynote Address,.

Thailand: EHS; Goods (2003)	Mauritius: CECPA (2005)	Turkey: proposed (2009)
Afghanistan: PTA (2003)	Sri Lanka: CEPA (2005)	COMESA: JSG (2012)
Singapore: CECA; Goods, Services, Investments (2005)	GCC: FTA (2006)	Taipei, China: proposed (2014)
South Asia: FTA; Goods (2005), Services (2010)	EU: BTIA (2007)	Peru: proposed (2014)
Asia-Pacific: APTA; Goods (2005)	SACU: PTA (2007)	
Bhutan: PTA; Goods and transit (2006)	EFTA: BTIA (2008)	
Chile: PTA; Goods (2007)	MERCOSUR: FTA (2009)	
Nepal: PTA revised; Goods and transit (2009)	Canada: CEPA (2010)	
MERCOSUR: PTA; Goods (2009)	Chile: FTA (2010)	
South Korea: CEPA; Goods, Services, Investment, IPRs, Competition (2009)	New Zealand: CECA (2010)	
ASEAN: FTA; Goods (2010), Services and Investment (2014)	Israel: FTA (2010)	
Japan: CEPA; Goods, Services, Investment, IPRs, Competition, Government Procurement (2011)	Australia: CECA (2011)	
Malaysia: CECA; Goods, Services, Investment (2011)	BIMSTEC: FTA (2011)	
	Indonesia: CECA (2011)	
	ASEAN+6: RCEP (2013)	

Source: Authors'compilation based on Ministry of Commerce information.

Even Gradualism Challenged: Vested Interests of Locally Powerful Industries

India's initial trade agreements were sensitive to adhering to gradual approach that allowed for selective liberalization, paying only lip service to the agenda for deeper economic integration in areas of institutional engagement such as effective liberalization of services markets, trade facilitation, IPR, and technical standards [45]. It negotiated a spate of partial trade agreements with neighbours, Nepal, Afghanistan, Bhutan and regionally, the South Asian Preferential Trade Agreement (SAPTA). The India – Sri Lanka FTA (ISLFTA) had the added imperative of ensuring geo-strategic objectives as well as showcasing an example of a successful India led economic integration in South Asia. Thus, India abandoned the much less ambitious and defensive product-by-product approach of SAPTA and other such preferential agreements like the Asia-Pacific Trade Agreement (APTA), and adopted a negative-list approach to trade liberalization under the ISLFTA, whereby all items would be liberalized except a 'sensitive'or negative list of items. India, in order to highlight its regional leadership role (underlining the geo-strategic imperative that was the lead factor in this FTA) was willing to also adopt a less-than-full-reciprocity approach, liberalizing a much greater number of sectors (i.e. tariff lines) vis-à-vis its much smaller negotiating partner.

However, Indian policy-makers were quick to find out that concentrated economic vested interests in India could even upset this broader consensus towards gradual liberalization through FTAs. Specific locally powerful industries in India such as pepper and copper that were impacted by ISLFTA lobbied hard against provisions of the agreement. As Roy and Banerjee [46] point out, given the sensitivities of coalition politics and fracture mandates, a

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[45] Banerjee, P (2013) "Trade in Professional Services and Technical Barriers to Trade in India's Preferential Trade Agreements", Dissertation, School of Public Policy, George Mason University, available at http://digilib.gmu.edu:8080/xmlui/handle/1920/8276

[46] Roy, J and Banerjee, P (2013), "Why Isn't India a Major Global Player? The Political Economy of India's Trade Liberalization", Robert Schuman Centre for Advanced Studies Working Paper No.2013/84, European

government in Delhi could not be completely isolated from strong regional concentrated pressure groups. As the discussion in Box 3 showcases, this had significant political economic impact on trade negotiations.

As India trudged along with a FTA strategy, there was often vocal criticism of such FTAs by specific sectoral or regional interests. An interesting example that helps to illustrate this point is the 'Early Harvest Scheme or EHS'within the wider India-Thailand Comprehensive Economic Cooperation Agreement (CECA). Indian negotiators were criticized for not anticipating the problem of 'inverted duty structure'that surfaced in various sectors like auto components, glass part, chemicals and electrical components in the EHS with Thailand. Various industry sectors, especially the auto and auto parts and components industry feared that this would lead manufacturers shifting base to Thailand by taking advantage of the tariff arbitrage to export to India and to third countries (much like the case of vanaspati discussed in Box 3).

Box 3

The state of Kerala accounts for 92% of Indian pepper exports. The ISLFTA contributed to the depreciation of pepper prices in the Kerala market that led to discontent among the local producers in state. In 2006, the Indian Pepper Spices Trade Association pressurized the central government to impose quota restrictions on Sri Lankan pepper imports, as there were allegations that third-country pepper was coming to India via Sri Lanka through the FTA. Accordingly, the central government imposed an annual import cap of 2,500 tons on Sri Lankan pepper imports and designated one port, Kochi, for such imports in order to monitor quantity and quality of such imports.

Copper exports from Sri Lanka were also subject to much scrutiny from India, based on their low domestic value addition, arguing that copper exports from Sri Lanka were under-invoiced and violated the ROO criteria. This led to a change in invoicing measures, and led to a drastic reduction in copper imports.

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The ISLFTA also exposed Indian policy-makers to the intrinsic link between transaction costs, production networks and business decisions on investment and location. Indian manufacturers of vanaspati (a local edible oil formulation) used the tariff arbitrage provided for in the agreement by relocating in Sri Lanka. India maintained high tariffs on imports of crude palm oil from countries such as Malaysia, while Sri Lanka maintained relatively low tariffs on imports of these products. Thus Indian manufacturers set up vanaspati manufacturing plants in Sri Lanka, imported crude palm oil, processed it in Sri Lanka to produce vanaspati and exported it to India free of duty under the FTA.

While it was understood that the choice available in the future negotiations would always be an aggressive pursuit of production network linkages and development of value-chains, or defensive stance that protects as much as possible of domestic industry and investment, as shall be discussed later, the political-economy of trade negotiations remained fuzzy and somewhat indecisive given the need to navigate a multiple vested interests, some of which could be small but locally concentrated players important to the political economy of a specific state (i.e. province), though marginal in the overall national picture.

This did not happen. Instead the economies of scale afforded by India's large market and greater depth of technical and engineering talent combined to actually witness rapid growth in India's auto components sector which could now also leverage linkages with the well-established Thai auto industry. This augmentation of Indian industry due to trade agreement when local conditions provided locational advantage can easily be understood in the context of production network-centric trade relationships. As would be argued in greater detail in chapter 2.2, value-chain led trade integration as a strategic objective has largely been missing from the trade policy narrative emanating from both government and industry.

But such vocal criticism, especially by some critical sectors like auto and auto parts, led the Ministry of Commerce to reappraise the negotiated and proposed FTAs amidst growing apprehension that India may concede greater market access to partner countries without commensurate actual gains (given competitive and connectivity constraints, again subjects of more detailed discussion in chapter 2.2) in the partner countries. Going forward, India took a far too cautious approach during the negotiations with ASEAN, SAFTA, Thailand, Singapore and MERCOSUR[47] with very conservative Rules of Origin and sensitive lists (the Thailand CECA is still under negotiation while India has only signed a preferential trade deal with MERCOSUR). The fact that even India's gradual and relatively shallow integration approach (focusing mostly on tariff reduction of non-agricultural merchandise and some selected services sectors) was under vocal opposition from well-organized vested interests greatly reduced the confidence and ambition of Indian negotiators.

FTAs were largely perceived as 'necessary evils'. They were necessary to ensure geo-strategic goals such as 'Look East'and ensuring that 'influence erosion'in geo-strategic terms did not take place, especially in light of aggressive FTA strategies undertaken by geo-political rivals such as China. Such FTAs were also necessary to minimize 'market access erosion'as not having an FTA would mean Indian exports subject to MFN rates would have to unequally compete with lower preferential rates applicable to countries who have FTAs with India's major economic partners. Thus, even when India stepped up to sign more comprehensive agreements with key Asian partners like Singapore, Korea, Japan, and Malaysia, negotiators were hobbled by a reluctant domestic industry that put a premium on defensive priorities sectorally rather than take a production network oriented aggressive position on market access.

Advanced Regionalism: Agreements with Singapore, Korea, Japan and ASEAN Economies

The mid 2000s saw rapid expansion of Indian exports. This was a result of three independent forces that converged together. The first was the generally rapid global economic growth in this period that Indian industry was a beneficiary[48]. The second was the dividends of the increasing linkages with global production networks in some key industries such as automotive, pharmaceuticals, textiles, and chemicals (and IT and ITES exports in services) that resulted from liberalization and open-ness to foreign investment following the reforms in the 1990s. Last but not the least was that domestic reforms that saw the dismantling of

[47] A Spanish acronym for 'Common Market of the South' – involving Brazil, Argentina, Uruguay and Paraguay
[48] Roy, J (2013) "No quick fixes for high growth" *Business Standard*, February 26

controls on production and location decisions and allowed easier imports of inputs, unleashed the entrepreneurial forces in India leading to product innovation and search for newer markets.

Policy-makers wanted to encourage this trend where India was diversifying both in terms of basket of goods as well as markets (i.e. reducing the dependence on EU and North American markets and looking towards ASEAN, Japan, China, Korea and emerging economies in Africa and Latin America). It was felt that comprehensive economic agreement would help intensify economic relationships in the wider Asian region. However, the Indian definition of comprehensive simply meant that BOTH goods and services would be negotiated and tariff reduction and market access commitments would be somewhat more ambitious than what had been previously made in earlier FTAs. The 'comprehensiveness'of these agreements in negotiating both goods and services market access needs to be put in perspective.

Manufacturing

India's comprehensive agreements with more advanced economies, i.e. Singapore, Korea, and Japan are all on a 'less-than-reciprocal'basis with India holding back a significant number of sectors from liberalization[49]. Besides agriculture products, India has kept a number of tariff lines in chemicals, plastics, rubber, machinery and mechanical appliances in the negative list with all the FTA partners. Textiles and clothing that continues to be one of the most important sectors, receives protection either under the negative list or the 'sensitive'track, on a country-by-country basis.

The sensitivities of strong domestic lobbies in India are even greater in the case of FTAs with developing and emerging countries given that the range and state of development of sectors where Indian businesses find itself either as a competitor in international markets or face

[49] Singapore agreed to bind all their tariff lines at zero customs duty on India's exports while 93 per cent of India's imports from Singapore will be under zero duty or phased tariff reduction. India-Korea CEPA (2010) would liberalize 85 per cent of India's tariff lines over an eight year period and 93 per cent of Korea's tariff lines, and in the India-Japan CECA, 87 per cent of India's tariff lines and 92 per cent of Japanese tariff lines, again over an eight year period.

strong competition from low cost imports in the Indian market. In the India-ASEAN FTA, some 1080 items at the HS 6-digit level on agriculture, cash crops, auto and auto components, chemicals and textiles were either excluded or kept in the sensitive list. The India – Malaysia CECA is defined as ASEAN-plus simply because further tariff concessions are granted on just 76 items to Malaysia (giving access to products such as fruits, cocoa and synthetic textiles). Malaysia has provided concessions on 140 items of export interest, particularly in the auto sector where India got non-reciprocal market access on motorcycles and trucks for the first time under any FTA.[50] This concession from Malaysia has been flagged as a major success, and if seen purely from the narrow 'give and take'nitty-gritty of negotiations, it definitely is. However, such marginal 'successes' accentuate the lack of a grand strategy for regionalism or ambition for developing genuine cross-border production networks with SE Asian economies that could have underpinned India's competitiveness in manufacturing in the long-run.

Services

If analyzed purely on the basis of sectoral coverage, India's services chapters in the agreements with Japan, South Korea and Singapore can said to be comprehensive. The agreement with Malaysia on the other hand is somewhat less ambitious. But such coverage essentially compares the extent of sectoral commitment vis-à-vis multilateral commitments, but not with effective market access that is the key in services trade. Effective market access can be defined as the existing level of market access available sectorally (i.e. it is the actual extent of market access allowed to ALL partner countries on an MFN basis) and the existing institutional architecture in terms of domestic regulation[51]. If preferential commitments are at a level below what is already available, it does not create any incremental advantage to businesses of the trading partner and does not succeed in even locking in the existing level of market access already available in actual terms (as opposed to declared levels of market

[50]Ministry of Commerce and Industries, India website. Available at: http://commerce.nic.in/trade/FAQ_on_FTA_9April2014.pdf?id=9&trade=i

[51]Banerjee, P (2013) "Trade in Professional Services and Technical Barriers to Trade in India's Preferential Trade Agreements", Dissertation, School of Public Policy, George Mason University, available at http://digilib.gmu.edu:8080/xmlui/handle/1920/8276

access in an trade agreement) in the partner country. In such a case gains from the bilateral agreement are purely notional, i.e. a safeguard against extreme future actions of protectionism where the partner decides to restrict market access very substantially.

In several sectors, India's comprehensive agreements fail to deliver commitments that lock-in effective market access available in India and in partner countries, i.e. the level of ambition is low on both sides. True depth in services markets that could only be achieved through some mechanism for dealing with behind the border regulatory barriers (for e.g. mutual recognition of professional certification, or ownership and investment restrictions related to domestic regulatory or licensing needs) are also not addressed[52]. Commitments on movement of professionals or Mode 4 (an area of critical concern and priority for Indian policy-makers) are also notional as these agreements create no special visa category (as was done in the case of NAFTA) or a preferential visa granting system (as in the case of US-Korea FTA), they are simply a re-iteration of existing levels of access available on an MFN basis to professionals of all countries and India receives nor gives preferential access to professional and skilled labor markets[53].

India's comprehensive agreements fare poorly on another point in terms of the level of depth that they achieve. They completely fail to address or pay only lip service to issues of great importance to the management of modern trade as defined by production networks. The agreements have no detailed road-map for effectively dealing with technical standards in a manner that reduces transaction costs for exporters on both sides. They also provide no disciplines on trade facilitation that makes substantial and concrete commitments.[54] As would be argued in chapter 2.1 later, these issues represent far more important trade policy objectives in terms of the real depth of agreements in the context of the modern landscape of global exchange of goods and services in a networked system rather than simple tariff reduction (where progressive reduction of such barriers are assumed as a given over the longer-term) and mere re-iteration of a commitment to keep markets open in services (often assumed as a fait accompli).

[52] Ibid
[53] Ibid
[54] Ibid

This much reduced scope of India's most ambitious bilateral trade agreements is also a result of the political economy in India. Since Japan, Korea, and Singapore all have committed to more ambitious agreements with other trading partners (for e.g. US and EU), it can safely be assumed that the reduced level of ambition was a result of India's lack of interest in pursuing greater scope and depth. Domestic lobbies in India in important sectors such as steel, automotive, chemicals, machine tools, textiles, and agro-processing industries were the ones that were most concerned with the Korea, Japan, and Malaysia agreements. In addition, the agreement with Malaysia saw active lobbying on the part of rubber-based industries that saw Malaysian competition as a threat.

Given the relative lack of sophistication of services industries in these countries (with the exception of Singapore), India could have taken a more proactively liberal stance in services and leveraged it to drive deeper bargains. However, lack of confidence among domestic stakeholders, especially in crucial sectors (such as legal, accounting services, financial, and retail services) and the incomplete agenda of domestic reforms (also applicable in the professional, retail, and financial services)[55] are some of the reasons for the lack of scope and ambition on the services part of these agreements. Another factor that has held India back in formulating a wider agenda for services liberalization and engagement in its trade agreements is over focus on the IT and IT enabled industries[56]. Even in the context of IT services, getting some commitment on Mode 4 visa regime that allows Indian IT professionals and firms ease of movement became the definitive objective. Such a limited agenda could only lead to limited results. Indian trade policy in services was thereby a function of lack of private sector aggressive interest (i.e.as demanders of market access) in wide range of sectors and the lack of substantial domestic reforms in some key services sectors that would have created conditions for more sustained engagement and bargaining. These deficits ensured the pursuit a several FTA initiatives (pushed as mentioned earlier by geo-strategic objectives), but without an aggressive long-term strategy on the part of India's business and other stakeholders to add to the depth of negotiating mandate.

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[55]Roy, J and Banerjee, P (2013), "Why Isn't India a Major Global Player? The Political Economy of India's Trade Liberalization", *Robert Schuman Centre for Advanced Studies Working Paper No.2013/84*, European Universities Institute

[56] Ibid

India's Curry Bowl: FTAs as Substitute for Real Trade Policy

Mattoo and Subramanian argue that the regional integration option should be considered seriously as a complementary effort in securing economic liberalization efforts at home and abroad.[57] They go on to make a strong case for an India – US FTA as an economically better strategic choice than the Ministry of External Affairs (MEA) backed geo-political choice of the ASEAN region. The US is still the single largest 'natural'trading partner for India, as it has been over the past two decades. It needs to be noted that Indian traders apply for more Certificate of Origin (COO) for the US Generalized Scheme of Preferences (GSP) than the aggregate sum of COO for all other FTAs and preference schemes, indicating that the usage of US preferential market access to Indian exporters are far more valuable in absolute terms than the preferential access on offer from India's multiple FTAs, including those in East and SE Asia.[58]

Roy and Banerjee (2004)[59] have argued that strategic pursuit of trade agreements, such as a pure services oriented FTA between US and India, where both US and India have greater convergence of interests should be explored more aggressively to find specific solutions to India's market access needs. As in manufacturing, India's key markets for services exports are in the US, followed by EU and Japan. SE Asia, with the notable exception of Singapore, remain relatively insignificant in India's services trade basket (in fact, much more so than manufacturing). However, the relative importance of SE Asia in both manufacturing and services have potential to grow rapidly, and trade agreements are negotiated for longer term strategic convergence of trade and investment interests and not just immediate short-term gains.

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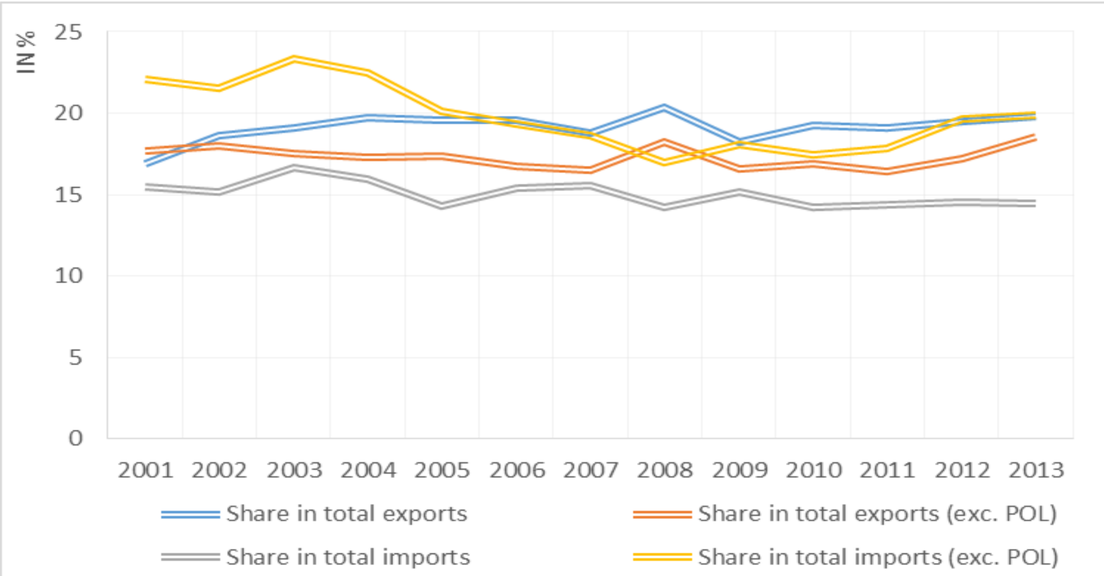
[57]Mattoo, A., and Subramanian, A (2002), "JagdishBhagwati and India's Trade Policy Today", *Economic and Political Weekly*, Vol. 37, Issue No. 50, 14 December,

[58]Jha, S (2013)"*Preferential Trade and Rules of Origin: A Study of India's Preferential Trading Arrangements*", Doctoral thesis, Indian Institute of Foreign Trade,

[59] Roy, J and Banerjee, P. (2004) "India-US Free Trade Agreement in Services: An Analysis of Issues for Discussion", *Confederation of Indian Industry WorkingPaper*, July

The mandate for a more comprehensive approach to FTAs is complicated by the fact that there has been very little reorientation in India's direction of trade despite the growing number of FTAs that have come into force recently. The share of India's exports going to the FTA partners has only marginally improved from 17 per cent in 2001 to about 20 per cent in 2013. Surprisingly, amidst all the fears of cheaper imports flooding in from FTA partners, the share of imports supplied by the FTA partners has in fact declined from 15.5 per cent to 14.5 per cent during the same period.

Figure 2: Share of FTA partners'in India's Trade: 2001-2013



Note: None of the partial trade agreements have been included, including with Chile and MERCOSUR. Notably, China is not included as an FTA partner (although India and China have a partial trade agreement under APTA).

Source: Authors calculations based on ITC Trade Map data.

Admittedly, most of the comprehensive FTAs have come into operation only very recently and therefore the trends may not be very revealing. It takes some years for production network and investment linkages that leverage preferential access to develop. Also, it takes some time for businesses to develop new relationships based on trust If businesses have been oriented towards a few specific markets for years, it also requires very strong incentive in terms of opportunities available in the new markets (or loss of opportunities in existing ones) to push them to develop such new linkages. All of these factors have influenced the relatively slow up-take in trade between India and FTA partner countries.

However, the trends help us pose certain questions about the received wisdom that FTAs have been beneficial to India's trade or, to put it differently, whether the 'curry bowl'of India's FTAs have helped Indian industry in gaining market access or connect to global value chains at all. One of the stated objectives of the Look East policy , after all, has been to integrate India into the production networks prevailing in 'Factory Asia', a coinage to reflect the extant complex cross-border supply chains in East and Southeast Asia.[60]

Roy and Banerjee[61] have stressed that India's FTA negotiating efforts were largely un-coordinated and FTAs were put into motion even with relatively insignificant markets like New Zealand and Chile. Largely platforms such as BRICS (Brazil, Russia, India, China and South Africa), IBSA (India, Brazil and South Africa), and RIC (Russia, India and China) evolved to forge partnership with emerging countries like Brazil, China, Russia, and South Africa. While providing India with a space to cement its presence at the global table strategically (example being the formation of the BRICS Bank), such platforms will not serve the specific purpose of advancing India's trade priorities in actual terms.

While the strategic goal of integrating with the ASEAN region makes sense in terms of the dynamic trends in the international geography of trade, both in terms of garnering new middle class consumers and developing sustainable and globally competitive value-chains, that there is a glut of no less than nine FTAs either being completed or negotiated bilaterally, regionally and mega-regionally. A great illustrative example of such multiple layers of preferences being created is India-Sri Lanka trade. India-Sri Lanka trade can happen through any of the four preferential routes, namely, India-Sri Lanka FTA, SAFTA, APTA and Generalised System of Trade Preference (GSTP), which is a preferential scheme between developing countries.

While on the face of it such a glut of FTA can seem to be a happy problem for a textile exporter in Madurai (she can choose the right FTA for her exports). But it might actually

[60] "Make 21st Century truly an Asian century: PM", Prime Minister Manmohan Singh's Keynote address at special leaders dialogue of ASEAN Business Advisory Council, 12 December 2005. Available at: http://pib.nic.in/newsite/erelease.aspx?relid=14102 (Accessed on 29 November 2014)

[61] Roy, J and Banerjee, P (2013), "Why Isn't India a Major Global Player? The Political Economy of India's Trade Liberalization", *Robert Schuman Centre for Advanced Studies Working Paper No.2013/84*, European Universities Institute

pose a huge challenge in actual transactional terms. The extent of complication in documentation procedures for preference utilization and resultant high compliance costs might actually make the exporter decide to go the MFN route. There is very large anecdotal evidence of such transaction costs imposed by a 'curry bowl'of FTAs[62]. Actual data on the very low utilization rates (i.e. preference utilization) of 5 to 25 per cent of India's FTAs also highlight the impact of such compliance costs.[63]In the case of multiple FTAs available for exporting to a particular country, exporters prefer the route where compliance and rules of origin requirements are less cumbersome, even if the duty benefits are fewer or unavailable.

Another major hurdle in the policy formulation process for FTAs goes deeper than the procedural issues. As indicated earlier, a lot of India's FTAs were led more by geo-strategic objectives as envisaged by the Ministry of External Affairs (MEA) rather than the pure commercial interests as understood by the Ministry of Commerce and Industry (MOCI). There have been several indications on the lack of a robust collaboration between the MEA and the MOCI in formulating FTA strategies. As Sanjaya Baru noted, "[Opposition to regional integration efforts] found open expression in the meetings of the Trade and Economic Relations Committee, an institutional innovation of Prime Minister Singh that enabled the ministry of external affairs to voice its views on such matters, in opposition to the views of sectoral ministries and experts".[64]

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[62] Several trade committee meetings in FICCI, ASSOCHAM, and CII that the authors have been part of had discussion on such issues highlighting the actual levels of complications presented by such procedures needed for preference utilization, and related transaction costs

[63] Internal study done by the Ministry of Commerce suggests that utilization rates for exports are well below 20 per cent. The 5 per cent to 25 per cent range has been quoted by the Asian Development Bank: 'Consolidate FTAs for better realisation: Asian Development Bank', *Economic Times*, 4 May 2013. Available at: http://articles.economictimes.indiatimes.com/2013-05-04/news/39027066_1_ftas-free-trade-agreements-consolidation, Accessed on 29 November, 2014.

[64]Baru, S. (2009), "Look East policy comes of age", *Business Standard*, 21 October

Failure to Launch: Impediments to Concluding India-EU Bilateral as a Case Study for Future Challenges

India's agreement with EU[65] is a great case study of the lack of appetite for major trade policy initiatives and bold FTAs emanating largely from the lack of a broad longer-term perspective on the part of Indian domestic stakeholders. Thus, the discussion on India-EU that follows is a great illustrative example of the systemic challenges in India's trade policy environment. None of these challenges are either unique or new and are common to most large emerging economies. For example, the short-term focus on keeping domestic markets protected is not unique to India, but the historical trajectory of India's political economy discussed in chapters 1.1 and 1.2 come into play to aggravate the problem. Some important points need to be considered with this context in mind.

First, given the above average applied tariffs in India in key sectors, and relatively lower tariffs in partner countries, India would always stand to lose more in terms of 'effective tariff protection'in a FTA. This problem is exacerbated in dealings with more advanced economies where applied tariffs for non-agricultural goods are very low, even close to zero in many instances (with exceptions of high tariffs in some sectors, and tariff peaks). This means India stands to gain very little in actual incremental terms of market access (i.e. reduction of an applied tariff of say 0.5% to 0 offers minimal preferential advantage to the Indian exporter). However, the partner country exporter gains a lot (reduction of an applied tariff of 5% to zero in India) in terms of such incremental market access. This lack of marginal gains from the perspective of Indian business (and in relative terms loss of a much greater degree of protection) greatly reduces the enthusiasm for FTAs.

Second, the lack of deep institutional reforms in India on key areas such as regulations on services and technical standards ensures that India is held back from negotiating deep and meaningful disciplines in these areas. Given that the most significant barriers in terms of transaction costs of exporting (especially in the case of the more advanced markets like Japan and EU) are essentially related to such regulatory issues and technical barriers (in both goods

[65] Officially called the India-EU Broad-based Trade and Investment Agreement (BTIA), it aims to liberalize trade in goods, services and investment and have chapters on economic cooperation, government procurement, intellectual property rights and sustainable development, among others.

and services), ability to negotiate meaningfully in these areas would have been of much greater interest to Indian business stakeholders. It also needs to be noted that given their largely defensive posture, Indian business has never quite taken the initiative to push for such engagement, thereby reducing the incentive and interest of Indian negotiators to take up such matters more proactively.

A good example of such an institutional factors impacting market access is the issue of data privacy law in the EU impacting India's IT and ITES offshore export industry. Given the push from industry, Indian negotiators have made it a critical element of the India-EU negotiations. But given the lack of development in India's own domestic regulatory systems on data privacy and data protection concluding a bilateral agreement on this issue has proved to be difficult between two largely unequal regulatory systems and institutions. The European Commission has been stressing that the issue of data protection adequacy should remain separate from the FTA and that India must meet the EU requirements for adequacy under the process set out in the 1995 Data Protection Directive. Negotiations have highlighted gaps, which can then be addressed, allowing India to obtain adequacy or 'safe harbour'status in a clearer time frame[66].

Third, powerful vested interests in certain large and well organized industries such as automobiles and alcoholic beverages that are used to far higher rates of effective protection[67] (and thereby have greater entrenched interests in continued protection) have lobbied hard against dilution of such protection vis-à-vis EU based manufacturers. Some authors argue that there are vested interests in government as well. The alcoholic beverages sector is a big revenue earner for the central and state governments and the push to retain high duties is not mainly from Indian producers but rather from the government itself[68]. This has greatly reduced the flexibility of Indian negotiators in trade deals.

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[66] Available at: http://www.nasscom.in/euindia-fta-discussions-gather-steam?fg=235321. Accessed on: 30 November, 2014

[67] Average Applied Tariffs in automobiles (fully built and CKD), and alcoholic beverages

[68] Mukherjee, A., Goyal T., Goswami, R (2013).,"India as a Trading Partner: Issues in India-EU BTIA and Way Forward", European Union: Brussels.

Fourth, gains in some critical areas of concern to India such as a more liberalized visa regime for skilled workers is hard to come by in a trade deal given their intrinsic linkage to immigration and security issues. As has been stressed earlier, even India's successfully concluded comprehensive agreements with Japan and Korea simply reiterate the existing visa regime as a commitment. In cases where substantive change would have to made to such a visa regime, for e.g. in the case of EU, where India demands a replacement of the country-by-country approach for work visas with a more Schengen (non-business visas for visitors given for multiple EU member states) like system, partners are more likely to not be able to deliver on such demands. Indian negotiators would be under pressure since not being able to deliver on Mode 4 would be seen as a major 'defeat', making deal conclusion that much more difficult.

Fifth, systemic lack of domestic reforms on trade facilitation and effective export oriented incentive policies (discussed in chapter 1.2) increases the transaction cost of exports and reduces the scope and depth of the competitive edge Indian exporters have. This in itself is a limiting factor, reducing the risk appetite of the Indian entrepreneur in terms of exploring foreign markets. A large domestic economy with a growing middle-class (precisely the factors that makes foreign entrepreneurs desire a trade deal with India) provides a ready market, thereby reducing the incentive for Indian entrepreneurs for actively seeking consumers elsewhere.

Sixth, the same level of strategic push towards greater regional economic integration with ASEAN-plus is missing from the India-EU BTIA. This has allowed the space and capacity for interest groups and lobbyists to derail entire negotiations rather than work constructively in finding negotiated solutions.

Finally, mass demonstrations on sensitive issues like the impact of the IPR provisions on India's public health and access to medicine have further stoked public opinion against a possible deal.[69] Being a vocal and diverse democracy, many civil society organizations (some with legitimate demands) are principally opposed to an open trade and investment regime, where they fear that the government will shrug their socio-economic responsibilities. Thus,

[69] Available at: http://firstbiz.firstpost.com/economy/why-indias-fta-with-eu-is-very-bad-for-its-people-38082.html. Accessed on: 30 November, 2014

discussions on trade liberalization in India make strange bedfellows of protectionist lobbies and social activists.

The prospects of an India-EU FTA began with great expectations, or perhaps an “unbridgeable expectation gap”. It would have been India’s first agreement with a developed economy as well as India’s largest trading regional partner, and EU’s first with a large emerging market had it been concluded by the expected deadline of 2009. A combination of the factors discussed above have all combined to create a ‘less than urgent’environment for concluding trade deals, of which India-EU is a great case to the point.

This leads us to question the dynamics of India’s trade policy in the face of change we are witnessing since 2012 onwards, which is the topic of discussion in Paper 2. The critical challenge that discussions in Paper 2 take-up are the need for a longer term perspective in the context of a global economy that is increasingly becoming connected through a web of task-oriented production networks dispersed globally, and while dealing with the challenges of short-term political economic interests that are the product of India’s economic evolution discussed here in chapters 1

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