

# KNOWLEDGE PARTNERSHIP PROGRAMME TRADE AND INVESTMENT



## Developmental Dimensions of India's National Foreign Trade Policy

### Background

Developing countries like India strive to achieve inclusive and sustainable economic growth to address problems of poverty, unemployment and under development. It has been recognised in trade literature that trade expansion positively impacts economic growth, productivity improvement, and reduction in poverty. According to OECD (2009), trade expansion does lead to higher economic growth. This finding justifies using trade as a tool for development.

In order to achieve higher export growth, India has been following the National Foreign Trade Policy (NFTP) approach since 1991-92. The NFTP seeks to streamline India's domestic policies to meet supply-side constraints faced by export-oriented sectors to create advantages for such products in destination markets. The NFTP and its annual supplements contain several specifically targeted schemes tailor-made to use trade expansion as an instrument for employment generation.

These objectives were envisaged to be achieved through the use of fiscal incentives, providing full refund of indirect taxes and levies, institutional measures, change in procedures and improving exports infrastructure to reduce transaction costs.

However, one of the major criticisms of the NFTP has been its lack of inclusiveness as well as coherence with India's other domestic macroeconomic policies and trade negotiations. With the new NFTP set to be announced later in 2014, there is much anticipation regarding how the newly elected government is likely to address concerns raised on the content as well as implementation of the previous policy. To increase the relevance of NFTP, Consumer Unity & Trust Society (CUTS) International conducted a study for IPE Global under the Knowledge Partnership Programme (KPP) to provide various suggestions for enhancing the effectiveness of NFTP as an instrument for 'inclusive growth' in India. This policy brief presents the results of a study that was undertaken across various clusters throughout India to garner local perspectives on how to enhance the use of this policy as an instrument for inclusive growth.

Policy Brief Structure: Section II deals with previous empirical findings; section III presents methodology of the study; section IV presents the findings of the study; section V provides policy recommendations and finally, conclusions are presented in section VI.

# KNOWLEDGE PARTNERSHIP PROGRAMME TRADE AND INVESTMENT

## II. Previous Empirical Evidence

The relationship between trade openness and growth is a highly debated topic in growth and development literature. Yet, this issue is far from being resolved. However, most empirical studies generally support the idea that openness is positively related to economic growth (Edwards, 1998; Frankel and Romer, 1999). However, Rodriguez and Rodrik (1999) posit that open trade policies (defined as lower tariff and non-tariff barriers to trade) are not always associated with economic growth.

The UNCTAD (2012) studied the connection between trade and poverty and listed experiences in constructing policies that take into consideration inclusive and sustainable development. It noted that the benefits of trade were not always easily transmitted to all countries owing to a number of factors like limited productive capacity, lack of diversification, less-than-optimal generation of employment and the institutional structures that exist.

Harrison and McMillan (2006) focus on two measures of globalisation: trade and international capital flows. The evidence discussed in the paper suggests that globalisation produces both winners and losers among the poor.

The impact of trade development on employment generation is depends on many things. Experience from four countries suggest that while export has a positive impact on employment generation in Bangladesh and Vietnam while Kenya and South Africa have been handicapped by a lack of active export promotion and the capital intensity of their exports.

Coe et, al. (1997), find that increased trade with industrialised countries boosts productivity growth of developing countries via R & D spillover. Alcalá and Ciccone (2004) find positive impact of international trade on average labor productivity at the country level mainly working through labour efficiency.

Based on the above discussion, it is clear that trade liberalisation impact on economic development is not direct and depends on many crucial factors.

## III. Methodology

The methodology that was used in the project survey entailed the use of both primary and secondary data analysis. The field surveys covered the north-west, south, north east, north and central India.

The project surveyed a wide range of clusters particularly those that are labour intensive, technology intensive, industrial, vertical, horizontal, traditional and research-intensive; therefore, the following clusters were selected: Bamboo; Gems And Jewellery; Textiles and Garments; Handicrafts; Carpets; Coir Sector; Food Cars and the Auto-components Industry .

## IV. Survey Findings

- The survey report confirms that trade policy has positive impact on employment generation but also highlighted a number of gaps that if addressed in the new trade policy, can aid in enhancing the development dimension.
- One of the areas of improvement as indicated by the survey was a need for improved coordination between various local stakeholders.
- The report highlights the need to determine trade agendas with input from various stakeholders as the use of schemes in specific states can be counterproductive unless coordination between civil society, states and central government is improved. More importantly, for export promotion, trade fairs are an extremely potent mode of connecting credible buyers and sellers across countries.
- There is a need for increased coordination between relevant government ministries, such as the Department of Agriculture and Co-operations and the Directorate General of Foreign Trade to ensure an improved coordination among them.

# KNOWLEDGE PARTNERSHIP PROGRAMME TRADE AND INVESTMENT

- There is also a need to add more value to products and services. The current measures in place to encourage the import of goods that play a key role in export promotion could be useful particularly in sectors such as food processing.
- Multiple key-informants noted that reverse buyer seller meets and trade delegations are the most credible channels through which buyers can be reached and therefore more focus needs to be paid on increasing such activities. It was also noted that there were insufficient benefit sharing mechanisms as the fruits of increased export generation through mechanisms put in place by the trade policy, tended to be captured at the top of production chains.
- A major criticism of the previous NFTP that was highlighted during the survey was its lack of convergence with other major domestic macroeconomic policies such as that on investment.

## V. Recommendations for the New Policy

The recommendations for the new foreign trade policy are followings:

- Institute a sound monitoring and evaluation system which juxtaposes increase in exports against increase in employment opportunities.
- Engage national and sub-national organisations and actors in the formulation and implementation of the trade policy to ensure policy coherence.
- Make use of effective branding to influence price realisation.
- Strengthen value chains by fostering effective regional and global partnerships. Moving up the value chain requires more than technological upgradation.
- Make benefit-sharing mechanisms sustainable through the use of trade policy instruments although the linkage between trade and its direct benefits to local communities is not explicit. The new trade policy will need to have measures to ensure that everyone benefits from export increase.
- Synergies between trade and FDI policies: Synchronisation of India's trade policy with its FDI policy can definitely boost FDI led exports.

- Special Economic Zone (SEZ) policies, and increased investments in export-related infrastructure, are expected to attract more export-oriented FDI. This would not only help foreign firms to set up their export base in the country, but also help domestic firms in reducing their export costs and become more competitive.

## VI. Conclusions

Based on primary survey, this study suggests that trade policy should be 'contextualised' in respect to specific development dimensions such as employment generation, skill development and productivity growth besides export promotion. The recommendation of this study highly applicable to LICs and they can increase economic growth, reduce poverty and make their trade policy aligned coherence with other domestic macroeconomic policies by implementing the recommendation of this study.

*KPP is a South-South cooperation programme promoting knowledge sharing in the areas of Food Security, Resource Scarcity and Climate Change; Health and Disease Control; Trade and Investment; and Women and Girls. KPP is funded by the Government of UK's Department for International Development (DFID) and managed by a consortium led by IPE Global Private Limited under its Knowledge Initiative. The main objective of KPP is 'Gathering and uptake of evidence on issues central to India's national development that have potential for replication in LICs and impact on global poverty'.*

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