UNIT 20 TRADE POLICY

Structure

20.0 OBJECTIVES

After going through this unit, you will be able to:

- discuss the characteristics of trade policy prior to 1991 economic reforms;
- state major features of trade policy after 1991 economic reforms;
- identify the emerging foreign trade related issues in the changing nature of world trade;
- explain the role of trade policy in India's success in IT related activities;
- evaluate the export-import policy 2009-14.

20.1 INTRODUCTION

In Unit 6 and 7, we have learnt that India is moving fastly towards globalisation. Inter-dependence of the economies of the world has increased multi-fold. Trade in goods and services has gained prime importance. The share of exports of goods and services in GDP has increased from 14.0 per cent to 22.0 per cent in 2010-11 and India is now viewed as an important destination for FDI. The changes taking place in the world economy with a shift in economic strength towards emerging markets and especially in Asia are inherently favourable for India. In such a situation, trade policy plays a crucial role. Hence, in this unit, we shall discuss the trade policy, its features in pre-economic reforms and post-economic reforms period. We shall highlight the trade related important issues like trade in services, trade and intellectual property rights, agriculture and livelihoods, and regional trade. The features of trade policy 2009-13 and its evaluation will also be discussed. To begin with let us discuss the concept of trade policy.

20.2 TRADE POLICY: CONCEPT

Trade policy is the policy followed with respect to international trade, both exports and imports. The details of the trade policy depend upon the broad trade strategy adopted in the country. The trade strategy in turn depends upon the broad strategy of development adopted by the planners. Broadly two types of development strategies have been followed in India: Inward Orientation, and Outward Orientation

Control on trade has been the important feature of India's trade policy prior to 1991. Controls on trade are divided into two sets of measures — tariff and non-tariff measures. Tariff measures relate to duties or taxes imposed on imports and exports. Non-tariff measures are those that relate to quotas or other quantitative restrictions on trade. The setting up of standards, for instance, in the import of foods is also a form of non-tariff barrier to trade. The need to secure a license to import a good is also a form of non-tariff barrier to trade.

India's trade policy can be divided into two major periods with 1991 as the dividing mark:

- Trade policy prior to 1991.
- Trade policy 1991 onwards

Prior to 1991, there were very substantial controls on international trade, particularly on imports. After the major liberalisation measures in 1991, many of the controls have been removed. India, like most countries of the world, is a member of the World Trade Organisation (WTO), hence its trade policy needs to conform to WTO rules and regulations. WTO aims to end quantitative restrictions on trade, except under certain special circumstances, and to reduce tariffs.

Under WTO rules, quantitative restrictions on imports are only to be undertaken in special circumstances, such as when exporting countries are suspected to be 'dumping' their products. Dumping is supposed to occur when products are sold below cost price. But there is a major problem in determining cost prices, and thus in identifying dumping. Cost prices may be lower in the export. Further, in a situation of over-capacity, firms may well sell below cost in order to utilise excess capacity. Consequently, it is in fact difficult to determine if dumping takes place. The usual practice is not to rely on cost estimates but on trade figures — there is a sharp and sudden increase, what is called a 'surge' in imports from a particular country, then it is suspected that dumping is involved. Overall, however, there has been a shift away from quantitative restrictions on trade.

20.3 TRADE POLICY PRIOR TO 1991

From the time of Independence till the mid-1980s, and more so 1991, India's trade policy was derived from the policy of self-reliance. The aim of planned development was taken to be the setting up of an industrial complex, capable of producing not only final products, such as textiles, but also machinery and equipment. the aim was to set up not only consumer goods industries, but also industries producing capital goods.

Trade policy was geared towards achieving the end of developing a self-reliant production structure. There were high tariffs on imports. The intention of high tariffs was to promote domestic production, by making imported goods more expensive than those produced at home. This is what is called import substitution. There were not just import duties but various permissions required before importing something. Importing a computer, for instance, required many licenses and permissions. The central government would decide on imports, depending on its assessment of its importance for the national economy.

Import substitution had its other side — that of discouraging exports. There was no active policy of discouraging exports. But import tariffs meant that the profits from investing in import substituting production were higher from investing in production for export. Assuming that costs of production were not substantially higher in India, the profits would also be greater. In exports, on the other hand, Indian producers would have to compete with producers from other countries and there would be no excess profits for them. Thus, the policy of high import tariffs served to discourage investment in exports. As it said, high import tariffs distorted market price signals away from exports towards import substitution.

Economic policies are not just manufactured out of thin air. They are inevitably based on some theory of how the economy functions. What was the theory behind such a control on imports? The theory goes back right to the beginnings of plan development in India and was part of the formulation of the Second Five Year Plan (1961-65). The theory goes by the name of 'export pessimism'.

Export Pessimism

In the post-colonial situation of the 1950s, it was held that the export earnings of underdeveloped countries were subject to severe constraints. World manufacturing was concentrated in the industrialised or developed countries, while the under-developed countries were largely agrarian in nature. The structure of world trade reflected this division of the world economy. Under-developed countries exported raw materials and primary goods, such as coffee, tea, raw cotton or minerals. Developed countries exported manufactured products. World trade was an exchange of the manufactures of industrialised countries with the agricultural commodities and primary goods of agrarian and primary producing countries.

Manufactured goods are produced by companies, often large companies. With monopolistic market positions, these companies could determine the prices of their outputs, i.e. they were price makers. Agricultural commodities are produced by large numbers of small producers. These small producers do not have market power and cannot set prices for their products, i.e. they are price takers. On the other hand, the buyers of agricultural commodities from the developed countries are few in number. This is called a monopsony position, where there are just one or a few buyers for a product. The buyer or buyers can then be price makers for that primary commodity. The price of, say, coffee could be kept low and thus the returns to the millions of primary commodity producers would also be low.

We need to add a third dimension to the structure of world trade to complete this picture. That is the control of key mineral resources by the Multi-national

Corporations (or MNCs), sometimes also called Trans-national Corporations (TNCs) of the industrialised economies. The MNCs had operations in more than one country and they controlled much of the mineral and raw material resources of the developing countries. The classic example of this control was that of crude oil, mainly produced in West Asia, but controlled by the Anglo-American oil majors. The result of this control of crude oil was that the oil majors could keep the price of crude oil low, and give a small royalty to the governments of the supplying countries.

The role of under-developed countries in world trade was then to export agricultural commodities or minerals, non-manufactured goods of various kinds. In a competitive market, with a relatively fixed demand for agricultural commodities, an increase in production is likely to result in a fall in the price. Thus, even with an increase in production of the agricultural commodity, there may not be an increase in export earnings, since prices may fall.

Suppose there was a productivity increase by the farmers of coffee adopting more productive methods. Would the benefits of increased productivity not accrue to the producers? This would happen only if a few producers (progressive farmers) alone adopted the improved technology while the bulk of the farmers did not. Then, the progressive farmers would get the benefit of higher productivity. Their costs of production would go down. With a constant price, the higher productivity of the progressive farmers would give them higher export earnings.

But productivity improvements by farmers can easily spread beyond a group or even country. If all the producers of coffee adopt the improved practice, then the monopsony buyer could use competition among sellers to bring the price down. The premium for increased productivity would then go to the buyers from the developed countries, who may or may not pass on the benefits to consumers in their own countries. On the other hand, the MNC producers of industrialised countries did not have to pass on the benefits of increased productivity. Their monopoly positions allowed them to set prices of manufactures.

The implication of the above two propositions is that the terms of trade (i.e. ratio of prices of what a country sells to the prices of what it buys, or of primary goods' prices to manufactured goods' prices) for under-developed countries' would deteriorate. This, in brief, was the powerful analysis on what is known as the Prebish-Singer hypothesis. This was the understanding of export pessimism — that there was a strict limit to what an under-developed country could earn in the export market.

The other side of export pessimism was import rationing. Since India needed to develop its own industries, it needed scarce foreign exchange to be used mainly for importing equipment and machinery for industries. In times of food scarcity, food may also need to be imported. In this situation the limited foreign exchange earnings needed to be rationed, with the government and not players on the market deciding on what to import and what not to import on the basis of relative prices. Among all commodities that it was economically profitable to import, government would decide on the most important uses of the limited foreign exchange.

Export pessimism and import controls thus characterised Indian trade policy in the early decades after Independence. It began to change in the mid-1980s and was abandoned with the 1991 liberalisation.

20.4 TRADE POLICY 1991 ONWARDS: FEATURES AND ISSUES

The 1991 trade policy reforms were precipitated by the external debt crisis the government faced. At that time, the Indian government did not have sufficient foreign exchange to cover the external debt payments that were due. In order to avoid defaulting on its international debt obligations, the government was forced to approach the International Monetary Fund (IMF) for a loan.

The IMF usually and notoriously gives loans with conditionalities attached. These conditionalities relate to reforms that the borrowing government is required to undertake. The major reform required of the Government of India related to liberalising trade policy, basically removing import controls and letting producers and consumers decide on what to import and what to export. While changing trade policy was a condition for the IMF loan, the important question to answer is whether this change was required or beneficial for India's own development. This is a question we will return to later. But at this point, we take up the issue of why India's trade policy changed? Was there something in international experience that went against the 'export pessimism' approach to trade policy?

In the early 1960s, South Korea and Taiwan were not very different from other under-developed countries. They were largely agrarian economies and their exports were of agricultural commodities, such as rice or cassava. But in the late 1960s and 1970s, they along with Hong Kong and Singapore, which were together called the 'New Industrialising Economies' or NIEs, and later on South-east Asian countries (particularly Thailand and Malaysia) began to change the composition of their exports. From largely exporting agricultural goods they grew rapidly as exporters of light manufactures, such as garments, footwear, soft toys and plastic goods. These light manufactures were labour intensive. Since wages in these NIEs were lower than in Europe, North America or Japan, these countries were able to establish themselves as manufacturers and exporters of labour-intensive commodities.

After China's reform process in the late 1970s and early 1980s, the Chinese economy too joined in the process of establishing a strong presence in labour-intensive manufactures. In fact, China's advance in this area was helped by the fact that wages in the NIEs started going up, pushing the suppliers there to shift the labour-intensive portions of production to China.

We will return later to consider the nature of the global production and trade system that was being created. At this point, it is important to note that the NIEs, the South-east Asian economies and, most of all, China began to run up huge trade surpluses with their main trading partners, Europe and North America. This was an important and decisive refutation of the 'export pessimism' approach, which had held that there were strict limits to exports by the under-developed economies. What changed, of course, is that these economies shifted from being exporters of agricultural and other primary goods to being exporters of labour-intensive, light manufactures.

Why could India not do the same as the NIEs, SE Asia and China, a process that had made Asia the manufacturing hub of the world? In any case, the experience of these countries put an end to export pessimism and called for a new international trade policy. It called for a trade policy that paid attention to the comparative advantage of the former under-developed economies, now called developing economies, in the manufacture of labour-intensive manufactures. The earlier, export pessimism approach was based on the traditional comparative advantage of land-abundant countries in the production of agricultural commodities. The new approach called for a trade policy based on the comparative advantage of developing countries in not just land-intensive agriculture but also labour-intensive manufacturing.

Before continuing it will be useful to look at the conditions that brought about such a momentous shift in world manufacturing trade. First, there was the development of manufacturing and management capabilities in many developing countries. In the course of attempting their own development, whether in the import-substitution method or not, the Asian countries developed substantial skills, both among workers and managers. High levels of basic education were necessary for this expansion of light manufacturing for the world market.

One major issue in India's trade policy is the 'flip-flop' nature of some of restrictions. For instance, raw cotton exports may be allowed in one season and not in the next. Or, rice exports may be allowed when there is a bumper crop and there are problems of storing grain. In the current year (2012) India has emerged as the largest exporter of rice. But there is no guarantee that it will continue to be able to export rice the next year too. Various domestic pressures work in bringing about such a 'flip-flop' type of trade policy. But it is not conducive to building a sustainable trade pattern.

Check Your Progress 1

1) What do you mean by export pessimism?

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2) State the implications of export pessimism and import control prior to 1991 period.

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3) Explain the nature of global production and trade system prevailed in NIEs in 1980s and 1990s.

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20.4.1 India and the Changing Nature of World Trade

But there is the question: how did the developing economy firms manage to get entry into developed economy markets? Did they not have to overcome local competition? The manner in which external trade in items like garments and shoes developed was not through sale on the market, as in the case of say, rice or sugar. Rather, the developing country firms entered into contracts with buyers from the developed countries. Firms, like Gap, Nike or Adidas, sub-contracted the manufacturing work to developing country firms; therefore, the developing country firms did not have to independently search for markets. The developed country firms kept to themselves the so-called core competencies of design, branding and marketing and sub-contracted manufacturing to firms in East and South-east Asia.

This has meant a substantial change in the nature of trade. From trade in whole commodities (e.g. agricultural goods vs. manufactures) trade has now also become one in particular tasks involved in making a product. In the case of garments, for instance, the labour-intensive and relatively low-skilled tasks of making a garment or what is called Cut-Make-Trim (or CMT), possibly with inputs imported from numerous countries, is carried out in developing economy firms, while the design, branding and marketing are kept by developed economy firms. In this process intermediate products and their values enter into external trade more than once — as intermediates imported by the assembling country and then again as part of the price of the final product exported by the same country.

A very good example of trade based on such a splintering of tasks is that of diamonds and gems in India. India exports a high volume of diamonds and gems. But the export volume is mis-leading, since the raw materials or roughs, are all imported by India. These roughs are then cut and polished in India, using Indian labour for these tasks which are very labour-intensive. The full value of the cut diamonds enters into India's trade data, but all that India gets is basically the wage of cutting and polishing and the profit on that operation. There is high benefit in terms of the lakhs of workers employed in that industry. India accounts for more than 90 per cent of diamonds cut in the world. But we must note that the whole sector is not based in India. Not only raw materials are imported, but most of the diamond jewelry is designed and even set in other countries, though Indian firms are now entering into the design and manufacture of the low and middle ranges of diamond jewelry for the international market.

However, why has the opening of trade not led to India making the same advances in garments or leather products? This goes beyond trade policy, but it can be briefly noted that the historical policy of reservation for small-scale units, which continued till the early 2000s, poor infrastructure and supposedly inflexible labour regulations are all argued to have played a part in this failure of the change in trade policy to provide substantial employment in labour-intensive industries.

20.4.2 Trade in Services

Trade traditionally meant trade in goods. But the same splintering of tasks seen in manufacture has also played its role in developing international trade in services. Some services, of course, can only be provided on the spot to the consumer. Cleaning or cooking, or cutting hair can only be performed on the spot, that is, they are non-traded services. But a number of services can be provided at a distance, by foreign workers or by foreign investment.

The WTO under the General Agreement on Trade in Services (GATS) recognises three modes of trade in services. Mode 1 is by foreign companies investing in the country where the services are to be provided. Mode 2 is by off-shoring of the service to a foreign location. A good example of this are the call centers that have come up in many cities of India providing services such as answering consumer inquiries, taking orders, etc. Mode 3 is the movement of what in legal terminology is called ‘natural persons’, another term for migration.

Indian firms have established a strong presence in the world trade in services. Indian firms carry out a multitude of off-shoring tasks — from simple consumer service centres, to accounting services and the various business tasks called Business Process Outsourcing (BPO). These are also called IT Enabled Services (ITES), since they depend crucially on IT and communication technology.

In fact, the major Indian IT companies such as TCS and INFOSYS pioneered the off-shoring model of global delivery of IT services. They combined on-shore staff in the developed economies with off-shore staff in India (and now also in other developing countries). They split up an IT service into components that could be carried out in these different locations and then integrated into the service to be delivered to the client. In this way, they could use the advantage of well-skilled and cheaper professionals in India to gain a cost advantage. As Indian firms began to gain market share in IT services, the major international companies, such as IBM and Accenture, countered by setting up their own units in India to nullify the Indian firms’ cost advantage.

Indian firms, as mentioned above, account for a substantial share of world trade in IT and BPO services. Its contribution to Indian exports and GDP has been growing rapidly. Direct employment in these export services is of the highly qualified professionals and, at the least, of English-knowing graduates. The overall volume of employment is also quite limited, not more than 5 million altogether. But it is the success of Indian firms in the supply of IT services that has put India on the world map as a rising power.

How much did trade policy contribute to India’s success in trade in IT services? Initially, in the 1980s India’s trade policy actually hindered this development — since the import of the essential computers was both cumbersome and costly. But the removal of these import restrictions in 1991 made a lot of difference and enabled the export of services to really take-off.

India’s trade in services is not confined to that in IT and ITES services. There is a substantial contribution through migration. Migration is of two streams. One is that of professionals to the developed countries, and the other that of skilled or relatively low-skilled workers, chiefly to West Asia. The former is often publicised but the latter is also important in terms of the remittances the workers provide. In fact, India is one of the largest beneficiaries in the world from remittances. Remittances of around $10 billion a year (check figure) have helped cover India’s negative balance on trade, meaning that India’s commodity exports are less than commodity imports.

Tourism is an old form of service export, where the foreign tourist spends her money in India. This has been growing very rapidly in the last decade or so, with a brief slow-down with the developed countries’ financial crisis. New forms of on-site service provision are also taking place, in response to the very different prices at which similar services are delivered in India and the developed countries. With high-quality hospitals and well-qualified doctors at the top-end, India has become a new destination for what is called medical tourism.

20.4.3 Trade and Intellectual Property

In the WTO regime, trade issues have been somewhat broadened to include matters of Intellectual Property Rights (TRIPS- or Trade Related Intellectual Property Rights). Under TRIPS all member countries are required to have a similar IP protection law. Patent rights must be allowed for products and not only processes. Before the WTO requirement, Indian IT law protected only processes and not products. As a result, Indian pharmaceutical companies could develop different processes to 'reverse engineer' products initially made in the industrialised countries. Knowing that a product, such as a statin (developed and sold by Pfizer as Lipitor) has the property of reducing cholesterol, the Indian firm reverse engineered production of statin, using a process different from that used by Pfizer. The resulting drug is sold much cheaper by Ranbaxy as Storvas.

Using these reverse engineering methods, Indian companies developed generic versions of patented drugs. These generic versions brought down the prices of drugs in the international market. A case in point was that of retroviral drugs to treat HIV-AIDS. These drugs cost more than a $1,000 for one month per patient. Obviously poor countries in Africa could not afford to treat AIDS patients with these expensive drugs. Indian companies supplied the generic versions for less than $100 per person per month. After a long battle at the WTO, there was a ruling in favour of the right to export cheap generic versions in the interest of public health.

The Indian drug companies brought a big change in the international trade in drugs through their cheaper generic versions. But with TRIPS, the IP law in India too has been changed to provide patent protection to products and not just processes. With this a profitable trade niche for Indian companies was reduced. Of course, generic drugs still come into play when drug patents expire. The Indian pharma companies have also been forced to move into the area of new drug discovery. But this is both costly and time-consuming, requiring deep financial pockets, as it is said. In attempting to move upwards from reverse engineering into new drug discovery, some of the Indian companies have had to join the international pharma majors, e.g. Ranbaxy with the Japanese Daiichi.

Before proceeding we should look into the question of why intellectual property rights have got prominence in international trade issues. As we saw in earlier section, there has been a splintering of tasks in production. Firms in the developed economies concentrate on design, branding and marketing while outsourcing manufacturing, mainly to firms in Asia. Within this division of labour in production, the surplus profits or rents are concentrated in the design and marketing segments, while the manufacturing segments get only the usual or normal profits. The reason for this distribution of income along the chain is that there is a monopoly position in the design stage, since this is intellectual property, protected by law. On the other hand, the manufacturing tasks can be carried out by any number of firms in Asia. With competition in this manufacturing segment, profits are brought down to their normal level.

This division of labour in production, designetc, by developed country firms and manufacturing by developing country firms, is the key reason why developed countries are so insistent on the protection of their intellectual property rights. With Asia and Latin America both having substantial reverse engineering capabilities, without intellectual property rights protection, the rents or surplus profits of developed country firms would soon be eroded.

Check Your Progress 2

1) How did firms from developing economy get entry into developed economy markets?

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2) List the various modes of trade in services.

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3) Name the items of India's trade in services.

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4) What do you mean by reverse engineering method?

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5) Why have intellectual property rights got prominence in international trade issues?

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20.4.4 Agriculture and Livelihoods

Another area of contention in trade policy is that towards agriculture. Agreements in this area have been stalled by the collapse of the Doha Round of WTO negotiations. The USA and European Union (EU) both provide large subsidies to their farmers. These are categorised in WTO terms under different colours — Red as trade distorting, such as an export duty or export subsidies, or Green for general support to the sector. But such general support also helps the subsidy-receiving farmers to export at lower prices. This brings down the price of agricultural commodities and could enable the developed countries to increase their agricultural exports. The developed countries have been pressing for an agreement to reduce or, even eliminate controls on agricultural imports.

India has insisted on maintaining controls on agricultural imports, even exports for that matter. The argument is basically that agriculture is not the production of a commodity, but is also the means of livelihood of crores of small and medium farmers in the country. Particularly where new jobs in low-skill manufacturing are not growing so fast, India wants to protect its agriculture from cheap exports promoted by subsidies from the developed economies.

In a similar fashion, India has not allowed free exports of agricultural commodities. Higher quality basmati rice can be freely exported, but general rice or wheat exports are allowed only when stocks pile up in FCI godowns. This leads to a stop-go food grains trade. Neighbouring countries, Nepal and Bangladesh, both depend on their ability to import rice from India to feed their own populations. They are adversely affected by such stop-go export policies. The result is that there is a large informal trade in rice and even fertilizer (the sale of which is subsidised in India) across the large borders with Nepal and Bangladesh. PDS rice, which is also highly subsidised, also comes into this informal cross-border trade.

20.4.5 Regional Trade

Regional trade is very limited in South Asia — just around 3 per cent for a long time and now just below 5 per cent of total international trade of the South Asian countries. This should be contrasted with regional trade of 30 per cent for East Asia and SE Asia. On all sides of the South Asian borders, there have been misgivings about increasing regional trade. India being largest economy in the region, owes clear responsibility in promoting regional trade.

Starting with the Gujral Doctrine, the Government of India declared its intention to grant unilateral concessions to neighbours in order to stimulate regional trade. Recently the Government announced the removal of all restrictions on imports of garments from Bangladesh. It has also entered into an Investment Protection Treaty with Nepal. All this will help stimulate regional trade.

But attempts to reduce protectionist barriers face concerted obstacle, from the still relatively inward-looking economic policies of South Asian countries. There are politically strong lobbies within each country that feed on the general policy of looking for subsidies as a way of dealing with problems of loss of competitiveness, rather than looking at ways to increase productivity in order to remain competitive. When, for instance, the India- Sri Lanka Free Trade Agreement (ISLFTA) resulted in spice imports from Sri Lanka displacing local spice production, there was an immediate demand by Kerala spice producers for protection against Sri Lankan imports. This is not unusual in India. These lobbies remain opposed to trade-opening measures if their markets are likely to be affected. Rather than subsidies, the way forward is to look for measures that would increase competitiveness.

India-Pakistan trade is largely carried out through Dubai, which obviously increases the cost of trade. Despite this cost increase, Indo-Pak trade via Dubai is about $2 billion per year. Were trade to be carried out more directly, there would be a clear increase in trade between the two countries. India, with it current emphasis on infrastructure, has imported substantial quantities of cement from Pakistan. This is facilitated by the use of the land route, rather than the third party Dubai route.

Numerous chemicals are imported by Pakistan. But besides these imports, there is a long negative list of items that are not to be imported. This includes pharmaceuticals, where Indian firms with their generic production are much cheaper than current Pakistani production. But the strong lobbies that wish to protect domestic production result in the long negative list.

At the same time, it should be noted that there is also an increase in strength of lobbies that support trade opening. In the recent situation with regard to commodity exports between India and Pakistan, some trading lobbies have clearly acted against the political interests. While Pakistani traders obviously wanted to take advantage of India's onion shortage, increased export was stifled by Pakistan political interests that wanted to restrict these exports. Similarly, when Indian cotton traders wanted to increase exports of raw cotton to Pakistan (where the cotton crop was affected by the floods), this was opposed by Indian textile owners, who wanted to profit from the bumper Indian cotton harvest. In the absence of exports, the bumper harvest would lead to a fall in the price of raw cotton, benefitting the textile mill owners.

What should be the basis of regional trade policy? This is a matter of much debate. In the development ladder, there is a difference between 'developing economies', 'less developed countries' (LDCs) and 'emerging economies'. Emerging economies, such as India and China, have both technology and scale advantages over both LDC and other developing economies.

Most Regional Free Trade Agreements (RFTAs) are based on the principle of equal access to each other's markets. Equal access, however, is likely to lead very unequal trade outcomes, when countries are at different levels of development. Countries with different economic capabilities, due to differential access to capital, technology and scale, would not be able to compete on equal terms. Consequently, a RFTA with a development agenda needs to incorporate the system of non-reciprocal access. Non-reciprocal access means that the more developed economies grant unilateral concessions to the less developed economies. Thus, India has opened up its garments sector to Bangladesh, without demanding that Bangladesh do the same in return. The reason for such non-reciprocal access is that the less developed countries need access to the larger markets of the more developed countries.

Non-reciprocal access is now generally accepted with regard to LDCs. In the pre-WTO period non-reciprocal access was part of the trade agreements in the form of what was called Special and Differential Treatment (SDT). Non-reciprocal access, however, has come in a number of multilateral trade agreements, such as the USA's AGOA (African Growth and Opportunity Act) and the EU's 'Anything but Arms' for Africa.

This principle can be extended to a South Asian Free Trade Agreement or SAFTA. This would recognise that India, as an emerging economy, has an advantage over the smaller and or poorer economies. Such non-reciprocal access would enable SAFTA to utilise the size and strength of the Indian economy to act as an engine of growth for the region.

A system of non-reciprocal access in SAFTA would help overcome the fears of the small South Asian countries, which fear domination by India. At the same time, it will force Indian firms to move up the value chain. South Asian regional trade faces many political obstacles. But an imaginative trade policy by India is beginning to make an impact on the region.

20.4.6 TRADE – LABOUR AND ENVIRONMENTAL STANDARDS

There has been much discussion of the connections between trade and labour and environmental standards. International trade is clearly connected with a difference in labour standards, certainly at the level of wages. Countries with a large labour force tend to have lower wages levels and, thus, to specialise in the production and export of labour-intensive products and tasks. Sometimes the labour involved could be of morally repugnant types, such as child labour or forced/bonded labour. Should commodities produced by such forms of forced labour be allowed in international trade?

This was a subject of much international discussion in the 2000s. The developing countries, including India, insisted that trade policy was not the appropriate instrument or the WTO the appropriate forum, to discuss issues of labour standards, which should be taken up by the International Labour Organisation (ILO). They insisted that there should not a linking up of trade access and labour standards.

At the level of trade policy it has been internationally agreed that trade action, such as banning imports made with child labour or forced labour, should not be used as an instrument for improving labour standards. But, it should be noted, that many private codes of buyers, such as Nike, Marks and Spencer, or any other big buyer — the labour codes that they expect their suppliers to adhere to include matters such as the non-employment of child labour. Even though Indian law permits non-hazardous work after the age of 14, these global buyers usually insist on 18 years as the cut-off age.

Thus, even if at the level of inter-governmental trade policy labour standards do not come into discussion, in actual trade, in actual contracted selling of garments and other such products, the issue of child labour very much comes into the picture. Thus, there in fact has been some improvement in non-employment of child labour in many areas of garment production. But, even in this, it should be noted that such non-employment is really only enforced and monitored at the factory level. In tasks, such as hand embroidery, which are often out-sourced to the household level, it is difficult to monitor the employment of child labour — unless a switch is made to, say, community-level centers for hand embroidery or to factory-level work.

There are many other issues of forced labour or of labour rights, such as the right to form trade unions, in which there are violations. But these issues have not got as much attention as child labour. Recently, however, not in India but in China, there has been a lot of publicity over poor work and wage conditions in Foxconn, a major contract manufacturer for the American Apple company.

If trade depends on differences in labour standards between countries, is there a similar role for differences in environmental standards? Environmental standards are generally weaker and poorly enforced in developing as compared to developed countries. Will there then be a tendency for polluting industries to be exported to the 'pollution havens' of developing countries? Does poor environmental standards became a factor, in addition to low wages, in the location of polluting industries in developing countries? Poor environmental standards would certainly contribute to an export of polluting tasks to developing countries. There is a cost involved in meeting environmental standards. In order to avoid such costs, there would be a tendency to export polluting industries to developing countries, where such monetary costs may not be incurred by the firm concerned.

But here two points should be noted. Not all that is exported as waste actually has no value. An article that is no longer usable, is not therefore 'waste'; it would have many useful components; it could even be repaired and resold on the seconds market. Second is that the handling of such waste often provides a large number of jobs.

Take the example of ship-breaking. At the end of its life as a ship, the ship is taken to Alang Port in India. There it is broken up. Iron and steel goes to steel rerolling mills. Marine engines are often repaired and used as generators. In fact, most of what makes a ship is separated and sold for re-use. Thus the notion of waste, as something that has no value is a misnomer here. What is waste goes back as inputs into production of different types. Further, most of the labour involved in such breaking up and separating is labour-intensive, it is inevitable that such tasks will be located in developing countries where labour is relatively cheap.

Consequently, the treatment of waste creates many jobs and yields many useful inputs into new production. What, however, is needed is to see that hazardous and dangerous materials are not handled inappropriately. For instance, ships often contain asbestos and mercury, the handling of both of which requires care and appropriate technology. The international Basle Convention on the handling of waste requires that such hazardous material be properly handled and removed before the ship, for instance, is sent for breaking up to a developing country. This, of course, is often violated. But it can be checked, as the Indian Supreme Court did when it insisted that the French aircraft carrier, *Clemenceau*, could not be brought to India until all hazardous materials were removed.

On the other hand, as in the matter of eliminating child labour, it should be noted that participation in international trade can lead to an improvement in environmental standards. For instance, the Indian processes of tanning leather and dyeing cloth, both of which largely take place in the informal sector, often use very dangerous chemicals. The import of leather products or garments made with such dangerous chemicals is often banned by the developed countries. As a result of this, some of these supply chains have been cleaned up, as for example the leather product supply chain around Chennai. But such improved labour and environmental standards often remain confined to just the exporting chains; similar chains producing for the domestic market remain without such improvements.

20.5 EXPORT- IMPORT POLICY 2009-14

The long-term exim policy for the period 2009-14 was announced on August 6, 2009.This policy has been formulated in the backdrop of an unprecedented contraction in exports, tax refunds for exporters, lower transaction costs, promises of better infrastructure and a broader strategy to ship more Indian goods and services to new markets in Latin America, Oceania and Africa instead of traditional, but recession-stricken markets in Europe and North America are some of the highlights of this policy.

20.5.1 Objectives

The short-term objective of the policy is to arrest and reverse the declining trend of exports and to provide additional support especially to those sectors which have been badly hit by recession in the developed world.The policy aims to achieve an annual export growth of 15 per cent, with an annual export target of \$200 according to the situation.

The government hopes the country would return to a high export growth path of around 25 per cent per annum, and double exports of goods and services, both by 2014. In the long-run the policy aims to double India's share in global trade by 2020, which stood at 1.64 per cent in 2008.Other long-term objectives of the policy include to:

- accelerate the country's transition to a globally-oriented vibrant economy to derive maximum benefits from expanding global market opportunities.
- stimulate sustained economic growth by providing access to essential raw materials, intermediates, components, consumables and goods required for augmenting production.
- enhance the technological strength and efficiency of Indian agriculture, industry and services, thereby improving their competitiveness, and encouragement of internationally accepted standards of quality.
- provide consumers with good quality product at reasonable prices.

20.5.2 Major Features

- **Support for Market and Product Diversification**

i) Incentive schemes under Chapter 3 have been expanded by a way of addition of new products and markets. Twenty six new markets have been added under Focus Market Scheme. These include 16 new markets in Latin America and 10 in Asia-Oceania.

ii) The incentive available under Focus Market Scheme (FMS) has been raised from 2.5 per cent to 3 per cent. The incentive available under Focus Product Scheme (FPS)has been raised from 1.25 per cent to 2 per cent. Large number of products included for benefits under FPS.

iii) Market Linked Focus Product Scheme (MLFPS) has been expanded to products in pharmaceuticals, synthetic fabrics, value added rubber and plastic, textile made-up knitted and crocheted fabrics, glass products, iron and steel products, aluminium.

- **Technological Upgradation, EPCG Relaxation, DEPB**

i) EPCG Scheme at Zero Duty for engineering and electronic products, basic chemicals and pharmaceuticals, apparels and textiles, plastics, handicrafts, and leather. Not available for current beneficiaries of other schemes like TUFS, or Status Holder scheme.

ii) To increase the life of existing plant and machinery, export obligation on import of spares, moulds under the EPCG Scheme has been reduced to 50 per cent of the normal specific export obligation.

iii) Taking into account the decline in exports, the facility of Re-fixation of Annual Average Export Obligation for a particular financial year in which there is decline in exports from the country has been extended for the 5-year policy period 2009-14.

iv) To accelerate exports, additional Duty Credit scrips shall be given to status holders @1 per cent Scrips of the FOB value of past exports. The Duty Credit scrips can be used for procurement of capital goods. This facility will be available till March 31, 2011.

v) The policy permits transfer of the Duty Credit scrips being issues to status holders. The transfer can be made only to status holders and scrips can be used only to procure cold chain equipment.

- **Stability/Continuity of the Foreign Trade Policy**

i) To impart stability to the policy regime, the Duty Entitlement Passbook (DEPB) Scheme is being extended by a year till December 31, 2010. The interest subvention of 2 per cent for preshipment credit for 7 sectors extended till March 31, 2010 in Budget 2009.

ii) DEPB rate shall also include factoring of custom duty component on fuel where fuel is allowed as a consumable in Standard Input-Output Norms.

iii) Income Tax exemption to 100 per cent EOUs and to STPI units IT Act has been extended for the financial year 2010-11 in Budget 2009-10.

iv) The adjustment assistance scheme initiated in December, 2008 to provide enhanced ECGC cover at 95 per cent to the adversely affected sectors is continued till March 2010.

- **Sops for Export-oriented Units**

i) EOUS have been allowed to sell products manufactured by them in DTA up to a limit of 90 per cent instead of existing 75 per cent, without changing the criteria of 'similar goods', within the overall entitlement of 50 per cent for DTA sale.

ii) To provide clarity to the customs field formations, the revenue department will issue a clarification to enable procurement of spares beyond 5 per cent by granite EOUs. EOUs will be allowed to procure finished goods for consolidation, subject to certain safeguards.

iii) Board of Approvals (BOA) will consider extension of block period by one year for calculation of Net Foreign Exchange earning of EOUs. EOUs will be allowed credit facility for the component of SAD and Education Cess on DTA sale.

- **Thrust for Value-Added Manufacturing**

i) To encourage Value Added manufactured export, a minimum 15 per cent value addition on imported inputs under Advance Authorisation Scheme has been prescribed. Project Exports and a large number of manufactured goods brought under FPS and MLFPS.

- **Flexibility Provided to Exporters**

i) Payment of customs duty for exports obligation shortfall under Advance Authorisation/DFIA/EPCG. Authorisation has been allowed by way of debit of Duty Credit scrips. Earlier, the payment was allowed in cash only.

ii) Import of restricted items, as replenishment, will be allowed against transferred DFIAs. Time limit of 60 days for re-import of exported gems and jewellery items for participation in exhibitions has been extended to 90 days in case of USA.

- **Simplification of Procedures, Reduction in Transaction Costs**

i) To facilitate duty-free import of samples by exporters, number of samples/

pieces has been increased from the existing 15 to 50. Customs clearance of such samples shall be based on declarations given by the importers for value and quantity of samples.

ii) To allow exemption for up to two stages from payment of excise duty in lieu of refund, in case of supply to an advance authorisation holder (against invalidation letter) by the domestic intermediate manufacturer.

iii) No fee shall now be charged for grant of incentives under Chapter 3. For all other 18 Authorisations, maximum fee is being reduced to Rs. 100,000 from Rs. 1,50,000 and Rs. 50,000 from the existing Rs. 75,000 (for EDI applications).

20.5.3 Evaluation

Positive Features

- The Foreign Trade Policy identifies the three major pillars that would support India in achieving the target of doubling its export of goods and services by March 2014. The three pillars are: improvement in export-related infrastructure, lowering of transaction cost and providing full relief on all indirect taxed and levies.
- The overall approach of the policy pronouncement recognises the vulnerability of certain sectors, which are employment-oriented and sensitive. Thus, a number of initiatives have been announced that should enable enhanced market access through revamped schemes such as the focus market, focus product and market-linked focus product schemes.
- It is noteworthy that the incentive available under the focus market scheme has been raised by half a per cent to 3 per cent and the incentives in focus product scheme from 1.25 per cent to 2 per cent. Along with the marginal increase in the rate of incentive, the coverage has also been extended fairly significantly. The 26 new markets that have been added to the focus market scheme include 16 in Latin America and 10 in Asia-Oceania, including comparatively larger markets such as South Africa, Brazil and Mexico and this would enable our exporters to get the benefits under the schemes which were hitherto denied to them.
- The new policy initiatives relating to import of capital goods are indeed timely. The EPCG scheme has really been benefiting the upgrade and modernisation of India's export manufacturing sector and the new incentive of giving access at zero duty capital goods import facility should go a long way in speeding up the process of technology upgrade.
- The policy would give special thrust to the employment-oriented sectors that had witnessed job losses in the wake of recession, especially in the fields of textiles, leather and handicrafts.
- The steps announced with regard to electronic message exchange between Customs and the Directorate General of Foreign Trade (DGFT), stoppage of double verification of shipping Bills by Customs for DGFT Schemes and exhortation to Export Promotion Councils to issue RCMC Certificates through EDI are welcome.
- While enhanced benefits for market development and promotion schemes would enable the exporting community to explore new export destinations, incentives for technological upgradation such as zero duty EPCG benefit and

1 per cent additional duty credit for status holders for several important sectors would greatly help in stepping up India's competitiveness.

Negative Features

- One area of concern the FTP has not highlighted is the fall in imports in tandem with exports, continuing a decline that started in early 2009. Lower non-oil imports indicate a slowdown in the domestic investment. Lower imports have narrowed the merchandise trade deficit in the BoP, an outcome that would be favourable had it been achieved through robust export performance.
- Another worry relates to growing protectionism abroad, especially in the developed countries. India which has recently concluded trade agreements with South Korea and ASEAN hopes to play a major role in restarting Doha development round of talks. Some of India's export promotion schemes such as DEPB scheme are not compatible with the WTO rules and need to be taken up for review.
- While inclusion of 17 technical products in the focus product scheme was a welcome step, limiting benefits such as one per cent additional duty scrips for status holders and zero duty for imports under the EPCG scheme to units that were not taking benefit from the Technology Upgradation Fund Scheme was disappointing, as most textile units were covered under the scheme and they would be denind the benefits.
- Addition of more countries under the market-linked focus product scheme would be of no use as the list of products eligible for incentives under the scheme covered only garments, made-ups, knitted fabrics and synthetic textile fabrics. Countries like Cambodia and Vietnam, which have been covered by this facility, are among major exporters of garments. On the other hand, they import substantial quantities of yarn and woven fabrics. However, these products have not been extended the benefits, except synthetic textile fabrics.
- It is true that globally all major indicators such as industrial production, unemployment, per capita investment and consumption, have taken a big hit. WTO estimates that world trade will decline by 9 per cent during 2009. If this is so, the question to be addressed is what can a domestic trade policy do to counter global trends. Solutions have to found so that India's exports recover in the face of such a massive demand slump, particularly in the developed world. The FTP is silent on this account. There is no reason why the FTP should not attempt measures to shore up India's exports.
- The policy has incentivised import of capital goods with Actual User Condition, by providing additional duty credit scrips at the rate of 1 per cent of FOB value of export to status holders in specified sectors. To what extent would this be beneficial is doubtful, as most of the status holders are merchant exporters and hence they would find it difficult to meet the requirement of the Actual User Condition.
- The new FTP seems to be founded on the belief that time-tested export promotion schemes have contributed to export growth and, therefore, must be retained. So, it fails to make a significant break from the past, it creates more reasons for the exporter to go the licensing offices and do more paperwork. It puts more power in the hands of the officers in the licensing offices and thus creates more avenues for corruption.

- The policy does not compensate for a comprehensive and competitiveness enhancement strategy in the form of a stimulus package as Indian goods are over 20 per cent costlier countries like China, Bangladesh, Vietnam and Cambodia. The higher cost is due to higher credit rates, wages for labour and transaction costs.
- While the pillars of foreign trade growth-infrastructure, reimbursement of duties and reduction in transaction costs-have been addressed, the policy has restricted itself the near-term objective of sustaining the current level of exports. The policy has done little from the stability points of view as fiscal sops have been offered only till 2011. Besides, something should be done for exporters obtaining cheaper bank finance, something that has been happening in countries which are our competitors.
- Mere fiscal incentive will not spur export growth. Today, the core problem is that there is no demand for our export products because of global recession. So what we need to do is to make our exports more competitive so that we score over our competitors. For this, our logistics costs have to come down from current 13 per cent to 8 per cent, which is the cost internationally. For this all, related ministries have to come together and improve facilitation of exports as well as imports.

Check Your Progress 3

1) State the meaning of the term 'stop-go' food grains trade.

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2) What is the basis for having Regional Free Trade Agreement?

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3) Identify three major pillars of Exim Import policy 2009-13 aiming to the export of goods and services.

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4) Describe three disadvantages of trade policy 2009-13.

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20.6 LET US SUM UP

Trade policy refers to all the policies related to both exports and imports. After independence, Indian trade policy was characterised by export pessimism and import controls. This situation began to change in 1980's and control regime was abandoned after 1991 economic reforms. In the changed situation of world trade, firms in the developing economies have managed to get entry into developed economy markets. India account a substantial share of world trade in IT and BPO services – its contribution to Indian exports and GDP has been growing rapidly. Due to division of labour in production, design by the developed countries etc. intellectual property rights have got prominence in international trade issues. Agricultural products due to subsidy to its farmers by developed countries is another area of controversy in trade policy. Regional trade is confined to only 3 per cent in South Asia and there have been misgivings about increasing regional trade. India being largest country in the region owes prime responsibility in promoting regional trade. The long term export-import policy 2009-14 aims to double India's share in global trade by 2020 and accelerate the country's contribution to global vibrant economy to derive maximum benefits from expanding global market opportunities.

20.7 EXERCISES

1) 'India's trade policy prior to 1991 was derived from the policy of self-reliance' – In the light of this statement critically evaluate India's trade policy.
2) Explain the important issues which are crucial and hence need to be addressed in India's trade policy.
3) Evaluate the Export-Import Policy 2009-14.

20.8 KEY WORDS

WTO – World Trade Organisation : Set up as the successor to the General Agreement on Trade and Tariffs (GATT). Its headquarters is in Geneva, Switzerland. The WTO is a membership based organisation. A member, on being accepted, agrees to all the instruments of the organisation. Unlike GATT, the WTO has a dispute resolution mechanism. Any member is free to take up a case against any other member. This allows for formal equality, but it is often difficult, because of the cost of engaging lawyers in Geneva. But India, for instance, has filed and won cases against the US. Voting in the WTO, as in the UN General Assembly, is 'one country, one vote'. But decisions are usually arrived at through informal consultation mechanisms.

MNC – Multi-national Corporation : An MNC, sometimes also called a TNC or Trans-national Corporation, refers to a corporation that has subsidiaries or branches, in more than one country. The branches may often be 100 per cent owned by the parent corporation, but they may also be with minority investment. MNCs are general understood to be from developed countries, or rich countries. The oil majors, such as Exxon or BP (British Petroleum) and the automobile manufacturers, such as Ford, General Motors, Mercedes-Benz, Nissan or Honda. Recently, however, many MNCs have come from up the bigger middle income countries. India's Tata or China's Haier are examples of MNCs from rising economies.

IMF – International Monetary Fund : The IMF, along with the World bank, was set up at the Bretton Woods Conference in 1944, towards the end of the Second World War. The World Bank deals with development finance, the IMF's mandate is to manage international monetary, exchange rate and related global macro-economic matters. It serves as a type of lender of last resort for countries with balance of payments and other international payments problems. It describes itself an "an organisation of 187 countries (as of July 2010), working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty." Loans from the IMF usually comes attached with conditions about domestic monetary and fiscal policy. There is an unwritten convention that the head of the IMF will be a European, while that of the World Bank will be an American. At present, with the growing strength of the BASIC powers (Brazil, South Africa, India and China) there is a growing challenge to these conventions about the head of these organisations.

Cut-make-trim, or CMT : Refers to the task of final assembly or making of a garment, **cut** (the fabric), **make** (the garment) and add the **trim**. This is the final task in manufacturing a garment. It is labour-intensive and is now largely carried out in the labour-abundant economies of Asia, where labour is relatively cheap.

General Agreement on Trade in Services – GATS : This is the agreement on trade in services, which forms part of the WTO agreements. The preceding GATT did not have any agreement dealing with services. At that time, until the 1990s, there was not much trade in services. But over the last three decades or so, trade in services has grown very substantially. GATS covers four kinds of trade in services. They are:

Mode 1 – Cross-border supply. Indian supply of IT and call centre services to USA, EU or other countries is a good example of cross-border supply of a service.

Mode 2 – Consumption abroad, such as tourism or international events, such as the Olympics or the Cricket and Football World Cups.

Mode 3 – Commercial presence. This is where a supplying company sets up an overseas branch to supply the services, as in banks (Citibank or Standard Chartered in India; or State Bank of India in the USA) or insurance companies (Lombard in India).

Mode 4 – presence of a 'natural person' as opposed to a corporate person. This in simple language is migration.

BPO Services – Business Process Outsourcing Services : This refers to the out-sourcing of various business services from one country to another. The well-known 'Call Centers' dealing with customer services, taking orders, or dealing with complaints are examples of BPOs. The provide a service from India for companies located elsewhere in the world. BPO services have expanded from the initial customer service related call centers, to encompass many business services – accounts, booking of tickets, managing payrolls, etc.

Remittances : These are the amounts of money sent from migrants working in one place to their families located somewhere else. There can be both domestic and international remittances. With the growth of migration, both domestic and international, remittances have become important to many economies. In the case of international remittances, they not only provide support for their families they also bring in valuable foreign exchange into a country. India's deficit in the balance of trade is almost entirely covered by remittances from Non-Resident Indians (NRIs) working in other countries.

Intellectual Property Rights– IPR : This refers to the ownership of a creation of the mind, which can be a technology, discoveries and inventions; musical, literary and artistic works; words and symbols. The idea of intellectual property is two-fold: to express the moral and economic right of the author or creator; and to provide an incentive for the creation of new works, promote discoveries or inventions. When a person or a corporation has an exclusive right to use a discovery or invention, say a new medicine, then there can be a monopoly price for that product. This high price and the extra profit so earned is expected to provide an incentive for new knowledge and inventions. But knowledge is a public good, in that the consumption by one person does not reduce its consumption by another person. For example, one student's learning economics does not diminish any other persons knowledge of economics. On the contrary, we may argue that the more the knowledge of economics or anything by a large number of persons, the more likely is to be not only the spread but even the advance of knowledge. Consequently, there is a conflict between the incentive to make inventions and discoveries and the spread of knowledge. The high price of a medicine, say for treating cancer of HIV/ AIDS, may lead to the inability of large numbers to not afford treatment. In such cases of public health or medial emergency, it has been ruled in the WTO, that countries may insist on compulsory licensing or production of generics.

Regional Trade : Refers to trade within a region, such as Europe, or Asia or parts of Asia. Regional trade has often led to Regional Free Trade Agreements (RFTAs). The best example of a RFTA is the European Union, within which all trade is free of tariffs and controls. The South-East Asian countries have the ASEAN Free Trade Agreement. Besides the factor of RFTAS, there is also the matter that regional trade is often of an informal cross-border type. With long land boundaries many commodities are traded between, say, Indian and Bangladesh and much of this trade does not enter into official records. Most regions or sub-regions are now covered by FTAs. This gives the economies the ability to use economies of scale in accessing each other's markets.

20.9 SOME USEFUL BOOKS

Basu, Kaushik and AnnemieMaertens, editors, (2011): *The New Oxford Companion to Economics in India*, Oxford University Press, New Delhi

Bhagwati, Jagdish, (2004): *In Defence of Globalisation*, Oxford University Press, New Delhi

RBI, Annual Report.

Ministry of Finance, Economic Survey 2011-12.

20.10 ANSWER OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 20.3
2) See Section 20.3
3) See Section 20.4

Check Your Progress 2

1) See Sub-section 20.4.1
2) See Sub-section 20.4.2
3) See Sub-section 20.4.2
4) See Sub-section 20.4.3
5) See Sub-section 20.4.3

Check Your Progress 3

1) See Sub-section 20.4.4
2) See Sub-section 20.4.5
3) See Sub-section 20.5.3
4) See Sub-section 20.5.3