

**CHAPTER 1**  
**INTRODUCTION**

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**1.1 Role of International Trade**

The buying and selling of goods and services across national borders is known as international trade. International trade is the backbone of our modern, commercial world, as producers in various nations try to profit from an expanded market, rather than be limited to selling within their own borders. There are many reasons that trade across national borders occurs, including lower production costs in one region versus another, specialized industries, lack or surplus of natural resources and consumer tastes.

However, international trade among different countries is not a new a concept. History suggests that in the past there were several instances of international trade. There is plenty of evidence of continuous trade and exchange of ideas between India and China, through the centuries without either political cooperation or conflict<sup>1</sup>. Traders used to transport silk, and spices through the Silk Route in the 14th and 15th century. In the 1700s fast sailing

ships called Clippers, with special crew, used to transport tea from China, and spices from Dutch East Indies to different European countries.

The economic, political, and social significance of international trade has been theorized in the Industrial Age. The rise in the international trade is essential for the growth of globalization. The restrictions to international trade would limit the nations to the services and goods produced within its territories, and they would lose out on the valuable revenue from the global trade.

International trading provides countries and consumers the chance to be exposed to those services and goods that are not available in their own country. International trading lets the developed countries use their resources effectively like technology, capital and labor. As many of the countries are gifted with natural resources and different assets (labor, technology, land and capital), they can produce many products more efficiently and sell at cheaper prices than other countries. A country can obtain an item from another country if it cannot effectively produce it within the national boundaries.

International trade has flourished over the years due to many benefits it has offered to different countries across the globe. With the help of modern production techniques, highly advanced transportation systems, transnational corporations, outsourcing of manufacturing and services, and rapid industrialization, the international trade system is growing and spreading very fast.

### ***International trade and economic growth***

International trade has played an important role as a major driver of economic growth for the latter half of the 20th century. Nations with strong international trade have become prosperous and have the power to control the world economy. International trade has a major role in economic development of any country. International

trade has significant role in following key areas of economic development:

1. Through specialization and increased world output, international trade expands the range of commodities available to the population and thus increases choice and welfare of the population. International trade provides countries with access to resources, which they may not have naturally. It provides access to markets for products which may not be consumed domestically. In this way, international trade stimulates economic growth.
2. Trade leads to increased and more efficient use of a nation's resources. As seen from the Heckscher - Ohlin model, it leads to factor price equalization and a rise in the real incomes of resource owners.
3. An outward looking trade policy is superior to partial or complete isolation. International trade leads to higher output, increased consumption and higher rewards for those sectors where a country has comparative advantage.
4. International trade helps to attract foreign investment to exploit a country's comparative advantage. This can also result into investment in other sectors of the economy. For example, mining and export of minerals can lead to new investments in power generation, plantation agriculture, tourism, etc. when markets and good relations are created abroad. Expanded markets would lead to increased supply of foreign investment, domestic savings and skilled labour. The international trade helps expand economy by outward shift of Production Possibility Frontier (PPF) and allows consumption outside of PPF<sup>2</sup>. Under the field of macroeconomics PPF represents the point at which an economy is most efficiently producing its goods and services

and, therefore, allocating its resources in the best way possible<sup>3</sup>.

5. Export-led growth creates linkages which stimulate the development of other industries. A steady growth of an export industry, such as textiles may create sufficient demand for some input such as dyes to warrant its production. This is the backward linkage associated with trade. For example, the wheat industry in North America created sufficient demand for rail transport and farm equipment so that these industries had to be established.
6. International trade may lead the development of infrastructure such as roads, rails, power plants and telecommunications to facilitate trade.
7. Foreign trade, especially the export sector may encourage the development of local entrepreneurs and skilled labour. Trade leads to travel and exposure to different places and cultural, which can promote learning and enhance experience.
8. International trade enhances competitiveness of domestic industry as domestic industry is required to compete with international products which may be of superior quality and at a lesser price.

From an individual company's point of view international marketing offers following benefits <sup>4</sup>:

- i) Enables overcoming domestic marketing constraints like saturated market, small size of market, recession in domestic market etc.
- ii) Helps to achieve economies of scale of production.
- iii) Company can tap growth opportunities in other countries.
- iv) Sometimes selling in international markets may enable to earn high profits in overseas markets than domestic market.

- v) Company can avail benefit of government policies and regulations like tax concessions and other incentives.
- vi) Company can enjoy spin-off benefits like improvement image of a company and develop better products in domestic market also due to development of quality culture in company.

## **1.2 Review of theories of International Trade**

Broadly international trade theories can be classified into two types viz. Classical theories and Modern theories. Classical theories were based on number of assumptions related to various aspects like nature of markets, technology, demand, and returns to scale etc. These theories were not questioned till end of 19<sup>th</sup> century. After this period, many assumptions became invalid due to rapid technological changes, structural changes in economies of many countries, increasing imperfections of markets, state interventions in trade markets and growth of multinational companies. This necessitated reexamination and modifications of these theories according to changes in trading environment between countries. These modified theories are called as Modern theories of international trade<sup>5</sup>.

### **Classical theories**

#### **C 1. The Theory of Absolute Advantage**

This theory was developed in 1776 by Adam Smith, an economist. He states that a country should export a commodity that can be produced at a lower cost than can other nations. Conversely, it should import a commodity that can only be produced at a higher cost than other nations. According to Adam Smith, international trade occurred because of the absolute advantage by a particular country in a particular product and absolute advantage enjoyed by another country in another product.

## C 2. *The Theory of Comparative Advantage*

This theory was developed by a British economist David Ricardo (1772-1823) which is an extension of theory of labour value and its application to the trade between countries. "The Labour Theory of Value" states that the relative prices of goods are determined by the amount of labour embodied in the goods. Countries which have abundant labour, have low labour/wage costs and hence enjoy absolute advantage in production of some goods.

The principle of comparative cost by Ricardo is based on the principle of different costs of similar goods in different nations. In different countries the cost for the same products are different because of geographical division of labour and specialization in production. Due to differences in climate, natural sources, efficiency of labour etc. a country can definitely produce a particular commodity at lower cost. In nut shell, Ricardo states that "Each country will specialize in production of those commodities in which it has greater comparative advantage or least comparative disadvantage".

Ricardo asserted that comparative difference in costs is the condition for international trade. A country will export that product in which it has comparative advantage and import the product in which its comparative disadvantage is less. In other words, each country will tend to export those products the comparative costs of which are lower at home than abroad and import those the comparative costs of which are lower abroad than at home.

The main difference between Adam Smith's theory and Ricardo's theory is the comparative costs as against absolute costs. Ricardo proved that for the trade to happen between countries absolute advantage is neither relevant nor

necessary and that comparative advantage is sufficient. The principle of comparative advantage provides the basis for specialization amongst nations. If each country devotes its resources to what it can produce more cheaply than others, then maximum benefits of foreign trade will be enjoyed by all countries.

The present day economists have rejected comparative cost theory on account of following reasons:

- i) Ricardo has taken into account labour as only one factor of production. Quality of labour input varies within as well as between different countries.
- ii) This theory has not considered other factors of production like land, capital and enterprise which should have been considered along with labour. A country would export a product if its international price is more than the domestic opportunity cost.
- iii) This theory would fail if the trading partners are of unequal size.
- iv) The theory ignores other costs like freight , insurance etc. associated with trade.
- v) The theory has not considered product demand which also dictates the price of the product.

### *C.3 The Theory of Reciprocal Demand*

This theory was developed by John Stuart Mill (1806-1873), an English economist. Mill's theory considers demand side of international trade as both supply and demand matter for trade to take place between countries. According to Mill within the limits set by comparative cost conditions, international value of goods traded will depend upon the strength of each country's demand for the other country's product. Thus, Mill's theory is an improvement of Ricardo's

theory as it emphasizes the role of prices in international trade. The limitation of this theory is that it accepts many assumptions underlying the theory of Comparative Advantage.

### **Modern Theories**

#### *M.1 Factor Endowments Theory or Hecksher- Ohlin Theory.*

Swedish economists Hecksher and Ohlin developed this theory independently in 1920 and 1933 respectively. This theory is based on a few propositions as given below:

- i) International trade is based on differences in prices as between nations.
- ii) Costs of production i.e. payments to factors differ from country to country which are called as factor prices.
- iii) Due to differences in availabilities of factors of production, factor prices differ in different countries in relation to demand of that country. Hence, products differ in factor requirements while countries differ in factor endowments.

According to Hecksher-Ohlin, a country may use factors of production in different combinations or proportions in the production of goods, which is called as "Factor Proportions" or "Factor Intensity". According this theory, a country exports that commodity which it can produce by using its abundant factor more intensely and imports that commodity which it cannot afford to produce by using the scarce factors intensely. Thus, a capital-rich country will be a low cost producer of capital goods and a country with abundant labour will be a low cost producer of labour intensive goods like cloth, wheat etc.

This theory concludes that differences in comparative costs or advantages in countries can be on account of differences in factor endowments.



Following are some criticism points against Hecksher-Ohlin theory;

- i) It is unrealistic in character as it is based on simplified and unrealistic assumptions like perfect competition, full employment of productive resources etc.
- ii) This theory fails to explain "Leontief Paradox". According to this theory relative factor prices are determined by the supply of productive factors in the two countries. However, in reality the relative factor prices are determined not only by the supply of productive factors but also by the demand for their services. If the demand factor is more powerful than the supply factor, then it is possible that the capital abundant country may specialize in production and export of labour intensive goods. This is called as "Leontief Paradox".  
Leontief, who studied factor composition of USA exports and imports, concluded that USA exports were labour intensive and imports were capital intensive in spite of the fact that USA is capital abundant.
- iii) According to this theory trade occurs due to differences in relative commodity prices in two countries, which is due to differences in factor prices, arising from differences in factor endowments in two countries. Critics of this theory say that commodity prices determine the factor prices and not vice versa.
- iv) This theory is static in nature.
- v) Factors of production are mobile between the countries and hence the basic assumption that these are immobile is wrong.

### **M.2 Factor Price Equalization Theory**

This theory is an extension of Hecksher-Ohlin theory and was developed by Professor Samuelson in 1948. According to

this theory, if a country increases the production of a commodity using its abundant factor, the demand for the abundant factor will increase leading to price increase of that factor. Similarly, the demand for the scarce factor will decline and bring down its price. Thus, the prices of two factors come together or converge in the same country. At the same time, opposite trends may develop in other trading partner countries with regard to their abundant/scarce factors. This will tend to equalize factor prices in the two countries.

Samuelsson's theory assumes perfect competition, existence of free markets and free mobility of factors of production between the trading partners. However, in reality, such equalization does not take place and even if such equalization of factor prices takes place, trade between the countries continues.

### ***M.3 Theory of International Factor Movements***

In today's modern world Multi National Corporations (MNCs) do transfer specific natural resources, factor services and technology, on account of their multi country operations. Professor Peter Gray considered the role of MNCs in the flow of goods and services between countries and established link between foreign direct investment, international production and international trade. According to him, capital and technology can move to countries where complimentary resources like labour are available cheap. Thus, available global supplies of resources get reallocated among countries through MNCs, resulting in larger production in world and larger trade in world.

### ***M.4 Recent Developments in Trade Theories***

- i) Neo-Technology theories of trade emphasize

technological innovations and technology gaps which exist between companies and countries as a major determinant of trade.

- ii) According to Intra-industry theory of trade, trade between countries occurs due to economies of scale and product differentiation.
- iii) According to Theory of Strategic Trade Policy, international trade occurs due to policy intervention by the state. This intervention may be in the form of export subsidies, tax concessions, differential interest rates and domestic market protection through tariff and non-tariff barriers.

However, in reality, in present dynamic situations of world trade none of these trade theories fits fully. This is on account of constant changes in comparative advantages, factor combinations, technology changes and state intervention.

### **1.3 Overview of India's International Trade**

#### **1.3.1 Phases of Development of International Trade of India**

Developments of India's international trade can be broadly divided and studied through three different phases as under;

- a) Pre- Independence Phase
- b) Post – Independence Phase
- c) Post Trade –Liberalization Phase.

Following paragraphs briefly take overview of these three phases.

##### **a) Pre-Independence Phase**

India has a global trading background for past many centuries. Even in the years before the birth of Christ, India was trading with the different countries of Europe in the West and the lands to the East up to China.

India was carrying out trade with far-off lands in West Asia and beyond, well before 1500 BC. During this period India

had trade surplus with whole world which used to be settled by inflow of gold<sup>6</sup>. During Mughal period from 1526 to 1707 AD, there was economic and cultural revival in India as also satisfactory progress of trade and industry.

During the period, 1780–1860, India changed from being an exporter of processed goods for which it received payment in bullion, to being an exporter of raw materials and a buyer of manufactured goods. In the 1750s, mostly fine cotton and silk was exported from India to markets in Europe, Asia, and Africa. By the second quarter of the 19th century, India's exports were mainly of raw materials like raw cotton, opium, and indigo.

Between 1800-1825, China was the world's largest economy followed by India and France. The gross domestic product of India in 1825 was estimated at about 50 per cent that of China. British cotton exports reached 3 per cent of the Indian market by 1825<sup>7</sup>.

From the late 18th century British cotton mill industry began to lobby the government to both tax Indian imports and allow them access to markets in India. Starting in the 1830s, British textiles began to appear in the Indian markets, with the value of the textile imports growing from £5.2 million 1850 to £18.4 million in 1896. The British colonial rule created an institutional environment that stabilized the law and order situation to a large extent. The British foreign policies however stifled the trade with rest of the world. They created a well-developed system of railways, telegraphs and a modern legal system. The infrastructure

the British created was mainly geared towards the exploitation of resources in the world.

In the British era, India's trade included heavy exports of textiles and heavy imports of bullion into India through the East India Company. The foreign trade of India had settled down to a typical colonial pattern by the end of the British rule. After British rule, India's international trade was concentrated in the countries of British Empire. This trade was mostly handled by British and European houses and foreign exchange was controlled by foreign banks. Before 2<sup>nd</sup> world war India was exporting more than imports on account of unilateral transfer of payments to Britain, to arrange for salaries and pensions of British officers. Second World War changed nature of India's foreign trade. The British Government commandeered from poverty-stricken people of India large supplies of foodstuffs, leather-ware besides iron and steel. During this period India had a positive trade balance with Britain.

World trade and economy was severely affected by 1<sup>st</sup> world war, the great depression period between 1929-1934 and 2<sup>nd</sup> world war. Between 1919- 1939, both imports and exports of India declined. During 2<sup>nd</sup> world war exports increased substantially while imports remained at same level. Systematic planning was started in India after independence. This was necessary to achieve various goals like achieving an all around economic self-sufficiency transforming the backward agrarian economy into an industrial nation as well as ensuring its huge population a better quality of life after independence.

b) *Post-Independence Phase*

During the 2<sup>nd</sup> world war, Government of India had imposed controls on imports and exports of some items which were extended even after the war. In 1947, "Import and Export (Control) Act" was passed which was continued for next forty five years. India's foreign trade has followed the pattern of ups and downs of the economic growth and the development of the country.

During the first decade and a half after independence India's export earnings remained stagnant. Exports as a percentage of world exports declined sharply from 2.5% in 1947 to 0.9% in 1966. This lack of performance on the export front was policy induced and not due to independent external factors beyond India's control<sup>8</sup>.

During fifties and early sixties international trade was dominated by imports. The average export performance during the Third Five Year Plan (1962-66) improved significantly over the average for the Second Five Year Plan. The characteristic of this period was that besides continuing export of traditional products like oil cakes and meals, iron ore, cashew kernel, coffee and jute manufactures, export of new products like engineering goods and chemical and allied products was also started. The devaluation of 1966, together with import liberalization was expected to start a new era of export-oriented growth. However this did not happen because the devaluation and accompanying policy measures proved abortive due to variety of reasons. The stagnation in exports from the country continued till the early 1970's, followed by significant growth in the rest of the decade. The period of mid-sixties to mid-seventies was marked by both exports and import-substitution efforts. The exports growth

was not sustained in the early 1980's. Importance of exports was well recognized in early eighties. By this time, importance of

exports for providing the crucial foreign exchange resources and contribution towards greater efficiency in resource use, better technology, and better quality was well understood. It was also agreed that imports had a developmental role to play. From 1985-86, export growth picked up significantly and continued till 1989-90, however it was reduced during the economic crisis of 1991 to 1993.

From 1959-60 to 1990-91 India's trade balance is negative except two years viz. 1972-73 and 1976-77 when exports were more than imports. In early eighties yearly trade deficit was averaging Rs.5700 Crs. which increased to average Rs. 7500 Crs. after mid-eighties.

Table 1.1 shows India's exports, imports and trade balance from 1959-60 to 1990-91.

Table 1.1  
India's Exports, Imports and Trade Balance

Year	Exports (Rs. Crs.)	Imports (Rs. Crs.)	Trade Balance (Rs. Crs.)
1959-60	640	961	- 321
1960-61	642	1122	- 480
1961-62	661	1092	- 431
1962-63	685	1131	- 446
1963-64	793	1223	- 430
1964-65	816	1349	- 533
1965-66	806	1409	- 603
1966-67	1157	2078	- 921
1967-68	1199	2008	- 809
1968-69	1358	1909	- 551
1969-70	1413	1582	- 169
1970-71	1535	1634	- 99
1971-72	1608	1825	- 217
1972-73	1971	1867	104
1973-74	2523	2955	-432
1974-75	3329	4519	- 1190
1975-76	4036	5265	- 1229
1976-77	5142	5074	68
1977-78	5408	6020	- 612
1978-79	5726	6811	- 1085
1979-80	6418	9143	- 2725
1980-81	6711	12549	- 5838
1981-82	7806	13608	- 5802
1982-83	8803	14293	- 5490
1983-84	9771	15831	- 6060
1984-85	11744	17134	- 5390
1985-86	10895	19658	- 8763
1986-87	12452	20096	- 7644
1987-88	15674	22244	- 6570
1988-89	20231	28235	- 8004
1989-90	27658	35328	- 7670
1990-91	32558	42095	- 9537

(Source: "Foreign Trade & Balance of Payments", September 2010,  
Centre for Monitoring Indian Economy, Mumbai)



c) *Post-Liberalization Phase*

India initiated series of economic reforms in 1991 aimed at establishing macro-economic balance, economic growth and regain external credit worthiness.

These reforms appear to have paid significant dividends at the macroeconomic level. The Indian economy recovered smartly from the crisis, real GDP growing at an annual average rate of 6.4 percent between 1992 and 1998. Prior to 1991, India was the archetypical import substituting regime with one of the most complicated and protectionist regimes in the world. However, following steps towards the unshackling of its trade regime, India's simple average tariff rate has come down significantly from 128 percent in 1991 to about 34 percent in 2000<sup>9</sup>. The trade-weighted tariffs declined from 87 percent in 1991 to around 30 percent by 2000, while the maximum tariff rate fell to 45 percent in 1997, having hovered at 355 percent in 1991. More precisely, India's trade liberalization efforts can be broadly divided into two periods. The first five years from 1991 to 1996 was a period of intense liberalization as tariffs fell dramatically. The second half of the 1990s can at best be characterized as a period of consolidation of, but definite deceleration in, the pace of tariff compression in general; the average tariff rate remained largely unchanged. In fact, while the simple average tariff rate remained more or less constant, there was a slight increase in the trade-weighted tariffs from a low of 25 percent in 1996 to 30 percent by 2000. Without attributing causation, it is interesting to note that this corresponds to the decelerating trend in economic growth in the latter half of the 1990s compared with the first five years since the crisis of 1991. In 1991-92 there was sharp decline in trade deficit over 1990-91, due to growth of 35.3% in exports over previous year. Even though,

exports are growing continuously from 1991-92, trade deficit was also continuously increasing on account of rising imports.

In 1992, "Import and Export (Control) Act" was superseded by the "Foreign Trade (Development and Regulation) Act, which addressed new liberalized export and import policy of the Government. In March 1992, government also announced a five year Export and Import Policy. Trade reforms were aimed at reducing import duties over a period.

India has been able to gradually increase its share in global merchandise trade and exports from 0.58 percent and 0.44 percent in 1980 to 0.74 percent and 0.69 percent, respectively, in 1999. While this increase may not appear particularly striking at first, it is, considering that India's share in world merchandise trade was more or less on a declining trend during the early 1990s. Between 1990 and 1999 India's merchandise trade and exports grew at an annual compound average of 8.2 percent and 9.0 percent, respectively.

The vision and the roadmap provided by the Foreign Trade Policy (2004-09) for a five year period with clearly enunciated objectives and strategies has been instrumental in putting exports on a higher growth trajectory<sup>10</sup>. The growth performance of exports has been an outcome of a conscious and concerted effort on the part of the Government to bring down transaction costs and facilitate trade. The export growth in India in the recent years is partly on account of a favorable international environment resulting from a sustained growth in average world real GDP by more than 5 per cent and world trade by more than 9 per cent since 2004. This has led to booming trade volumes in the world market. However, this alone does not entirely explain India's unprecedented export growth. In the recent years, Government has made a conscious and concerted effort to reduce trade barriers, bring down

transaction costs and facilitate trade. Exports from India have also responded to these domestic reform measures and policy initiatives.

India's merchandise exports reached a level of Rs. 845534 Crs. during 2009-10 registering a very negligible growth of 0.57% as compared to a growth of 28.19% during the previous year. Notwithstanding the deceleration of the growth in 2009-2010, India's export sector has exhibited remarkable resilience and dynamism in recent years. Our merchandise exports recorded a compound annual growth rate (CAGR) of 22.0 per cent during the five year period from 2004-05 to 2008-09 as compared to the preceding five years when exports increased by a lower CAGR of 14.0 per cent. According to latest WTO data (2009), India's share in the world merchandise exports increased from 0.8 per cent in 2004 to 1.3 per cent in 2008. India also improved its ranking among the leading exporters in world merchandise trade from 30th in 2004 to 21st in 2009. India's exports have not been affected to the same extent as that of other economies of the world during the phase of global slowdown.

The Government had set an export target of US \$175 Bn. for 2009-10. With merchandise exports reaching US \$178.7 Bn. in 2009-10, the actual exports exceeded the target by 2.1 per cent which is a remarkable achievement during a period of recession in India's major export destinations<sup>11</sup>. Imports during 2009-10 were Rs. 1363736 Crs. as against Rs. 1374436 Crs. during 2008-09 registering a negative growth. During 2009-10 trade deficit declined marginally as there was a mild recovery in exports and a marginal decline in imports. The trade deficit in 2009-10 was Rs.518202 Crs., which was lower than the deficit of Rs. 533680 Crs. during 2008-09.

Table 1.2 shows India's exports, imports and trade balance from 1991-92 to 2010-11.

Table 1.2  
India's Exports, Imports and Trade Balance

Year	Exports (Rs. Crs.)	Imports (Rs. Crs.)	Trade Balance (Rs. Crs.)
1991-92	44042	47841	- 3799
1992-93	53688	63375	- 9687
1993-94	69749	73177	- 3428
1994-95	82673	89971	- 7298
1995-96	106356	122678	- 16326
1996-97	118817	138920	- 20103
1997-98	130101	154176	- 24075
1998-99	139752	178332	- 38580
1999-00	159095	215529	- 56434
2000-01	201356	228307	- 26951
2001-02	209018	245200	- 36182
2002-03	255137	297206	- 42069
2003-04	293367	359108	- 65741
*2004-05	375340	501065	- 125725
*2005-06	456418	660409	- 203991
*2006-07	571779	840506	- 268727
*2007-08	655864	1012312	- 356448
*2008-09	840755	1374436	- 533681
*2009-10	845534	1363736	- 518202
*2010-11(Apr-Dec)	751633	1126513	- 374880

(Source: "Foreign Trade & Balance of Payments", September 2010, Centre for Monitoring Indian Economy, Mumbai and Department of Commerce, website for \* marked years)

### *1.3.2 Composition of International Trade*

The pattern of exports for last fifteen years shows that over the years, share of India's exports of agriculture and allied products is declining while that of ores and minerals has remained more or less steady. It is also observed that share of manufactured goods is fluctuating from 66-77%. Share of petroleum product exports has also grown substantially from 1.5% in 1995-96 to 16.5% in 2010-11. Table 1.3 gives India's exports of Principal Commodities.

Table 1.3  
Exports of principal Commodities (Rs. Crs.)

	<b>Commodity / Year</b>	<b>1995-96</b>	<b>2000-01</b>	<b>2005-06</b>	<b>2010-11</b>
<b>I)</b>	<b>Primary products</b>	<b>24274.1</b>	<b>32555.6</b>	<b>72508.4</b>	<b>161103.5</b>
a)	Agriculture & Allied products	20344	27288.2	45220.1	112521.8
b)	Ores and Minerals	3930.1	5267.4	27288.3	48581.6
<b>II)</b>	<b>Manufactured Goods</b>	<b>79433.3</b>	<b>156858.4</b>	<b>321260.8</b>	<b>765898.5</b>
a)	Leather & Manufactures	5861.2	8883.1	11943.5	17264.9
b)	Chemical & related products	12032	26889.2	65389.8	132038.4
c)	Engineering Goods	14687.7	31150.4	96156.9	313398.4
d)	Textile & Textile Products	26865.4	51554.7	72617.8	106216.4
e)	Gems and Jewellery	17644.2	33733.4	68752.6	185852.9
f)	Handicrafts (excluding handmade carpets)	1451.5	3022.1	2045.3	1062.20
	g) Other manufactured products	891.4	1625.6	4355	10065.5
<b>III)</b>	<b>Petroleum Products</b>	<b>1517.8</b>	<b>8541.7</b>	<b>51532.8</b>	<b>190781.1</b>
<b>IV)</b>	<b>Others</b>	<b>1128.2</b>	<b>5615.4</b>	<b>11115.9</b>	<b>39691.5</b>
	Total Exports	106353.3	203571	456417.9	1157474.6

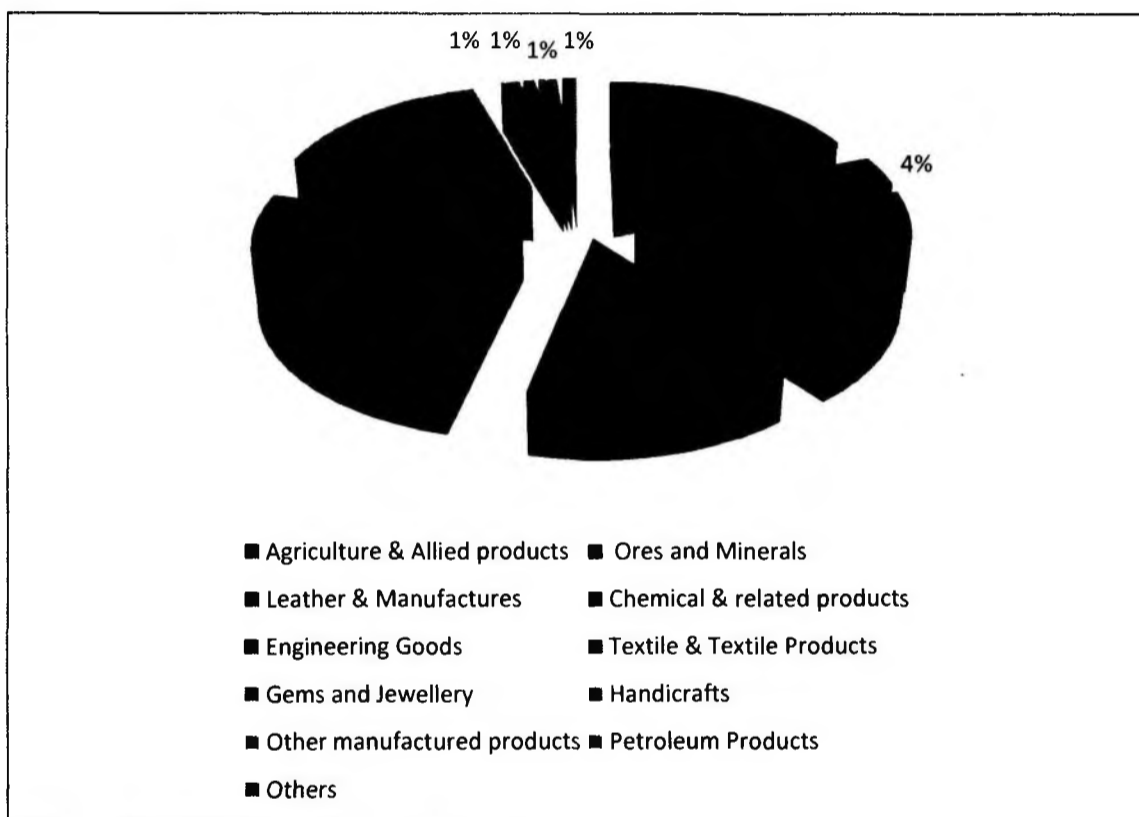
(Source: *Handbook of Statistics on Indian Economy 2010-11*, published by Reserve Bank of India)

It is also observed that within category of manufactured goods, share of engineering goods has increased handsomely from 14% in 1995-96 to 27% in 2010-11. Share of chemical and related products has remained unchanged, while that of leather and manufactures has gone down from 6% in 1995-96 to 2% in 2010-11. Textile and textile products share has decreased from 26% in 1994-95 to only 9 % in 2010-11. Percentage share of gems and jewellery products has remained unchanged between 1994-95 to 2010-11.

Graph 1.1 and 1.2 show percentage shares of principal commodities in total exports of India in 1994-95 & 2010-11 respectively.

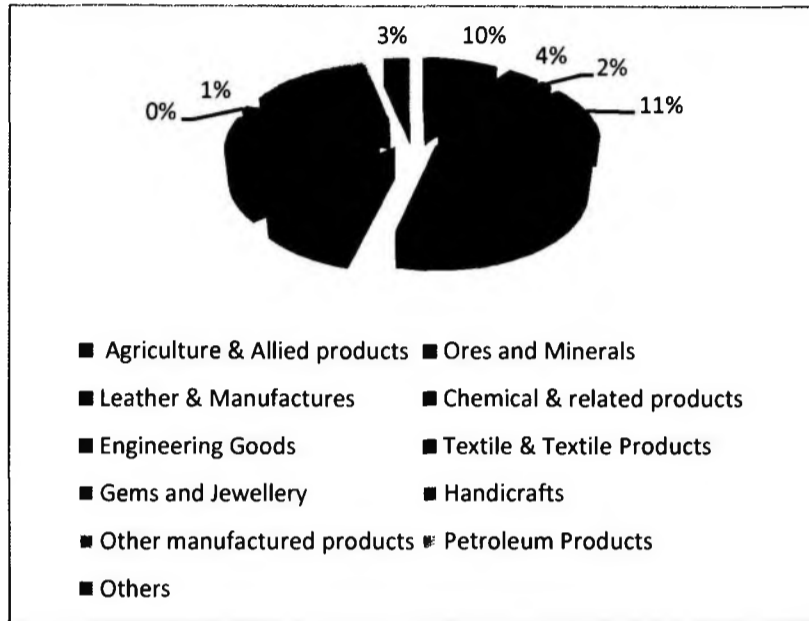
GRAPH 1.1

Shares of principal commodities in total exports in 1994-95



GRAPH 1.2

Shares of principal commodities in total exports in 2010-11



In terms of export market share in International markets, India has maximum presence for products like spices, marine products, precious and semi-precious stones. However, in recent years India's exports are shifting towards higher technology intensive manufactures.

Table 1.4 gives India's Imports of Principal Commodities.



Table 1.4

## India's Imports of Principal Commodities (Rs. Crs.)

	Commodity/Year	1995-96	2000-01	2005-06	2010-11
<b>I</b>	<b>Bulk Imports</b>	<b>47881</b>	<b>95095</b>	<b>270449</b>	<b>685110</b>
a)	Petroleum , Crude & Products	25174	71497	194640	482714
b)	Bulk Consumption Goods (cereals, edible oils, pulses, sugar etc.)	3243	6593	12248	39732
c)	Other Bulk Items (fertilizers, non ferrous metals, paper, crude rubber etc.)	19464	17005	63561	162664
<b>II</b>	<b>Non Bulk Imports</b>	<b>74797</b>	<b>135777</b>	<b>389959</b>	<b>920204</b>
a)	Capital Goods (machine tools, machinery, electronic goods, computer goods etc.)	34554	40847	166762	326352
b)	Mainly Export related items	17586	36815	82530	226170
c)	Others (Gold, Silver, Coke, Coal, medicinal products etc.)	22657	58115	140667	367682
	Total Imports	122678	230872	660408	1605314

(Source: *Handbook of Statistics on Indian Economy 2010-11*,  
published by Reserve Bank of India)

As far as imports are concerned, petroleum products dominate right from beginning. Share of petroleum, crude and products in total import bill of India has increased from 21% in 1995-96 to 30% in 2005-06. However, since opening up of economy stress on import substitution has reduced and imports of capital goods and other intermediary products for export purposes have increased continuously since 1995-96. Within petroleum imports there has been a shift from import of petroleum products to crude imports on account of increase in refining capacities in country. India has also become a net exporter of finished petroleum products in 2001-02 as against net importer earlier. Share of POL in imports has increased while that of food items is fluctuating as per domestic demand.

To summarize, it can be said that there have been compositional shifts in the structure of India's imports. Higher technology-intensive and export-oriented products imports are gaining share in total imports.

### *1.3.3 International Trade Partners*

International trade was restricted to UK and other commonwealth countries prior to independence. However, it has shown substantial changes during last 60 years.

The change in top five trading partners of India for exports and imports from 1994-95 to 2009-10 are as given in Table 1.5.

Table 1.5  
Changes in Top Five Trading Partners of India

Year	Exports	Imports
1994-95	USA, Japan, UK, Germany, Hong Kong	USA, Germany, Japan, Kuwait, Saudi Arabia
1999-00	USA, Hong Kong, UAE, UK, Germany	Belgium, USA, Nigeria, UK, Switzerland, Japan
2004-05	USA, UAE, China, Singapore, Hongkong	China, USA, Switzerland, UAE, Belgium
2009-10	UAE, USA, China Singapore, Germany	China, UAE, Saudi Arabia, USA, Switzerland

(Source: Analysis done by researcher based on data compiled from Export Import Databank, Department of Commerce, New Delhi)

From above table, one can easily conclude that as far as India's exports during last fifteen years are concerned, China and Singapore have emerged as new export destinations in place of Japan and UK. Similarly, in case of imports, China and Switzerland have replaced Germany and Japan as import destination.

#### **1.4 Overview of Foreign Trade Policy of India**

The Ministry of Commerce and Industry deals with the promotion and regulation of foreign trade in India. In exercise of the powers conferred by the Foreign Trade (Development and Regulation) Act 1992, the Ministry notifies a trade policy on a regular basis with certain underlined objectives<sup>12</sup>.

Main plank of the trade policy of free India was protection of indigenous industry through a variety of controls, like import duties and preference for indigenous goods in respect of government purchases. Protectionism in India's foreign trade policy has operated more through the foreign exchange controls and through customs duties on the imports. Foreign exchange constraint being a major problem, it was but logical that import substitution became the keystone of India's foreign trade policy.

Whenever any Indian manufacturer could produce an item which was previously imported, the import of this item was immediately banned by the import control authorities. In particular, through the powerful Directorate-General of Technical Development (DGTD), an all out drive was launched to establish indigenous capacities in respect of every important item which was being imported.

During the period from 1962 to 1966, some export promotion policies were introduced, but these were related mainly to and integrated with the system of import controls. The devaluation of the rupee in June 1966 was intended to help exporters but due to the lack of the follow-up measures it failed to serve its purpose.

The earlier trade policies were based on the objectives of self-reliance and self-sufficiency. While, the later policies were driven by factors like export led growth, improving efficiency and competitiveness of the Indian industries, etc.

A new era in foreign trade policy of India was started when the Government made a Statement on Trade Policy in parliament on August 13, 1991 which aimed at reducing controls, simplifying procedures and to create a congenial environment for trade<sup>13</sup>.

Before 1985-86, the annual export-import policy was announced at the beginning of the financial year. A three year export-import policy for the period 1985-88 was announced in 1985-86. After

this next three year policy for 1988-91 was announced in March 1988.

The government of India announced sweeping changes in the trade policy during the year 1991. As a result, the new Export-Import policy came into force from April 1, 1992. This was an important step towards the economic reforms of India. In order to bring stability and continuity, the policy was made for the duration of 5 years. In this policy import was liberalized and export promotion measures were strengthened.

The major aspects of the EXIM policy (1992-97) were as under:

- a) Introduction of the duty free export promotion capital goods (EPCG) scheme.
- b) Strengthening of the Advance Licensing System.
- c) Waiving of the condition on export proceeds realization.
- d) Rationalization of schemes related to Export Oriented Units and units in the export processing zones.

Government further liberalized this export-import policy on March 31, 1993.

EXIM Policy 1997-2002 aimed at consolidating the gains made in earlier policy, restructuring the schemes to achieve further liberalization and increased transparency in the changed trading environment. It recognized the fact that there is no substitute for growth which creates jobs and generates income. The policy focused on the need to let exporters concentrate on the manufacturing and marketing of their products globally and operate in a hassle free environment. Vide this policy Government set an ambitious target of attaining an export level of US\$ 90-100 Bn. by 2002 and achieve 1% share in world trade.

The new Government at the Centre announced Export and Import Policy for the year 1998-99 on 13<sup>th</sup> April 1998, on account of its commitments made by India at the World Trade Organization,

removed import restrictions on a large number of consumer goods and liberalized all major export promotion schemes. Revised EXIM Policy 1999-00 was announced by the Government on 31<sup>st</sup> March 1999, which freed import of 894 items of consumer goods, agricultural products and textiles from licensing requirements. Besides, 414 items were removed from the “restricted list” allowing these to be imported against special import licenses. EXIM Policy for 2000-01 declared by the Government on 31<sup>st</sup> March 2000, envisaged 20% export growth in dollar terms by bringing in rationalization in export promotion schemes and introduced a series of sector-specific initiatives. EXIM Policy 2001-02 completed the process of removal of import restrictions initiated in 1991, by removal of import restrictions on remaining 715 products. This policy also proposed setting up of agricultural export zones to boost agricultural exports and increasing returns of the farming community. The Government announced EXIM Policy 2002-07 on 31<sup>st</sup> March 2002 introduced many institutional, infrastructural and fiscal measures to promote exports. Some of these included permission to Offshore Banking Units (OBUs) in SEZs, modifications in Electronic Hardware Technology Park (EHTP) scheme etc.

With economic reforms, globalization of the Indian economy has been the guiding factor in formulating trade policies. The reform measures introduced in the subsequent policies have focused on liberalization, openness and transparency. They have provided an export friendly environment by simplifying the procedures for trade facilitation.

The announcement of a new Foreign Trade Policy for a five year period of 2004-09, replacing the hitherto nomenclature of EXIM policy by Foreign Trade Policy (FTP) was another step in this direction. It has taken an integrated view of the overall

development of India's foreign trade and provides a roadmap for the development of this sector. A vigorous export-led growth strategy of doubling India's share in global merchandise trade in next five years, with a focus on the sectors having prospects for export expansion and potential for employment generation, constitute the main plank of the policy. All such measures are expected to enhance India's international competitiveness and aid in further increasing the acceptability of Indian exports. The policy sets out the core objectives, identifies key strategies, spells out focus initiatives, outlines export incentives, and also addresses issues concerning institutional support including simplification of procedures relating to export activities.

#### **Main Features of India's Foreign Trade Policy for 2009-14**

Ministry of Commerce and Industries in cooperation with the office of Director General of Foreign Trade (DGFT) formulates foreign trade policy. Government has announced various schemes like Duty Entitlement Passbook Scheme (DEPB), Export Promotion Capital Goods scheme (EPCG) , Focus Market Scheme, Focus Product Scheme, Export Oriented Unit (EOU) scheme etc. for promotion of trade.

Important highlights of Foreign Trade Policy for the period 2009-2014 are as under:

- DEPB scheme extended till 31/12/2010.
- Under EPCG scheme there will be zero duty rate for specified sector, Export Obligation reduced to 50% of normal to increase the life of existing plant and machinery, Re-fixation of Annual Average Export Obligation for particular financial year in case of decline in exports extended under new policy.
- Focus Market Scheme expanded to include 26 new markets in Latin-America and in Asia- Oceania. Incentive for this scheme raised from 2.5% to 3%.

- Focus Product Scheme incentive raised from 1.25% to 2%.
- Duty Drawback provided on export of gold jewellery.
- EOU's have been given extension of block period by one year for calculation of Net Foreign Exchange earnings.
- Advance Authorization Scheme has prescribed minimum 15% value addition on imported inputs.
- Number of duty free import samples by exporters increased from 15 to 50.
- Conversion of Shipping Bills from one Export Promotion Scheme to another will be permitted within three months, instead of one month earlier.
- Registration Cum Membership Certificate (RCMC) will be issued online.
- Electronic Message Exchange between Customs and DGFT for incentive schemes also will be in vogue.
- Directorate of Trade Remedy Measures to reduce grievances of MSMEs.

### **1.5 Trade Agreements Signed by India**

Regional Trading Arrangements (RTA's) are viewed by Government of India, as 'building blocks' towards the overall objective of trade liberalization<sup>14</sup>. Hence, the country is participant in a number of RTA's which include Free Trade Agreements (FTA's); Preferential Trade Agreements (PTA's); Comprehensive Economic Cooperation Agreements (CECA's); etc. Some of these agreements are bilateral while some are in a regional grouping. Major agreements are as under:

#### **i) Agreement on South Asia Free Trade Area (SAFTA)**

This agreement was signed by all the member States of the South Asian Association for Regional Cooperation (SAARC) during the twelfth 'SAARC Summit' held in



Islamabad during 4-6th January, 2004. As a result, SAFTA came into force from 1st January, 2006.

SAARC was established in Dhaka on December 7-8, 1985 with the following objectives:-

Promoting the welfare of people of South Asia; accelerating economic growth and social progress; promoting active collaboration in economic growth and social progress; promoting active collaboration in the economic, social, cultural, technical and scientific fields; strengthening cooperation in international forums on matters of common interest; and cooperating with international and regional organizations with similar aims and purposes. Its members include Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka and Afghanistan which became member in April 2007.

The objectives of SAFTA are to promote and enhance mutual trade and economic cooperation among the 'Contracting States' by eliminating barriers to trade in, and facilitating the cross-border movement of goods between the territories of the Contracting States; Promoting conditions of fair competition in the free trade area, and ensuring equitable benefits to all Contracting States, taking into account their respective levels and pattern of economic development; Creating effective mechanism for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and establishing a framework for further regional cooperation to expand and enhance the mutual benefits of this Agreement.

SAFTA will be implemented through the different instruments like Trade Liberalization Program, Rules of

Origin, Institutional Arrangements, Consultations and Dispute Settlement Procedures and Safeguard Measures.

SAFTA prescribes a phased Tariff Liberalization Programme (TLP) according to which all the member states would reduce their tariffs, at the MFN applied rate existing as on 1st January 2006, to zero to five percent within ten years of the agreement coming into force<sup>15</sup>. This TLP would cover all tariff lines except those items kept in the Sensitive List by each country. With the SAFTA Agreement coming into force, there would be no more negotiations under SAFTA.

During the fourteenth SAARC Summit held in New Delhi on 3-4 April 2007 India, inter alia, unilaterally announced that before the end of 2007, India would allow the LDC countries of SAARC duty free access to its markets, and India would also further reduce the Sensitive List of SAFTA for these countries. In pursuance of this, India has notified tariff reductions to zero per cent for SAARC LDC countries under SAFTA, with effect from 1st January, 2008. India thus completed SAFTA TLP one year ahead of the stipulated three years from 1st January, 2006 for completion of TLP by the NLDCSs for LDCSs. India has also reduced its Sensitive List under SAFTA for these countries from 744 items to 480 items.

SAFTA Ministerial Council (SMC) consisting of Ministers of Commerce/Trade of the Member States is the highest decision making body of SAFTA and the SMC is supported by a Committee of Experts (COE) with nominees from member states. The fifth meeting of the COE and SMC was held on

October 26- 27, 2009, and 28th October 2009 respectively at Kathmandu, Nepal.

Since SAFTA came into force in 2006, India's trade with SAARC countries has not shown very significant improvement. Table 1.6 gives trends in India's trade with SAARC countries during last four years.

Table 1.6  
India's Trade with SAARC countries (US \$Bn.)

Year	Exports		Imports	
	Total	% Share of SAARC countries	Total	% Share of SAARC countries
2006-07	126.41	5.12	185.74	0.81
2007-08	163.13	5.91	251.65	0.84
2008-09	185.30	4.62	303.70	0.60
2009-10	178.75	4.69	288.37	0.57
2010-11 (Apr-Sep)	105.35	4.55	161.45	0.56

(Source: DGCIS, Kolkata)

The SAARC Agreement on Trade in Services (SATIS) was signed in the sixteenth SAARC meeting held in April 2010 at Thimpu in Bhutan. This marks the first step in expanding the scope of the SAFTA agreement which is essentially a goods agreement at present.

Highlights of India's trade with SAARC countries during April-September 2011 are as under:

- a) Bangladesh was the largest trading partner of India in the SAARC region.
- b) India has recorded a negative growth rate of exports with Afghanistan and Pakistan.

- c) The lowest decline in exports was recorded for Afghanistan at – 31.92%.
- d) Except for Bhutan, India runs a trade surplus with all other trading partners.

**ii) *Asia-Pacific Trade Agreement (APTA)***

This agreement formerly known as the Bangkok Agreement was signed on 31st of July 1975 as an initiative of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP).

APTA/ Bangkok agreement is the 'First Agreement' on trade negotiations among the developing member countries of ESCAP. It is a preferential tariff arrangement that aims at promoting intra-regional trade through exchange of mutually agreed concessions by the members (developing country) of the ESCAP region. The Bangkok Agreement is essentially a preferential trading arrangement designed to liberalize and expand trade progressively in the ESCAP region through such measures as the relaxation of tariff and non-tariff barriers and trade-related economic cooperation. The developing countries and associate members of ESCAP are eligible to accede to the Agreement.

The original signatories to the Agreement were Bangladesh, India, Lao People's Democratic Republic, the Republic of Korea and Sri Lanka. Lao PDR has not issued customs notification on the tariff concessions granted, and hence to this extent, is not an effective participating member. China's accession to the Agreement was accepted at the Sixteenth Session of the Standing Committee of the Bangkok Agreement in April 2000.

The objectives of the agreement is to promote economic development through a continuous process of trade

expansion among the developing member countries of ESCAP and to further international economic cooperation through the adoption of mutually beneficial trade liberalization measures consistent with their respective present and future development and trade needs, and taking into account the trading interest of third countries, particularly those of other developing countries.

Some features of APTA are as under<sup>16</sup>:

- a) Open for accession by all developing member Countries of UNESCAP, APTA is the only truly region-wide trading arrangement spanning east, southeast and south Asia, with the potential to extend to other sub regions.
- b) The only operational trade agreement linking China and India, two of the fastest growing markets of the world with a consumer base of 2.4 billion people, as well as other major markets such as the republic of Korea.
- c) The agreement with the longest effective implementation period in Asia-Pacific.
- d) Simple, common Rules of Origin with minimum local value content requirement of 45 per cent f.o.b. (35 per cent for LDCs), compare favorably to other RTAs. A set of operational procedures for the certification and verification of the origin of goods was adopted in October 2007, the first time such a common agreement was reached among developing countries in the region.
- e) Provides special and differential treatment for countries with special needs, especially LDCs.

- f) Notified to WTO in 2007. (APTA's predecessor, Bangkok Agreement, was notified to GATT in 1976.)

Third Session of the Ministerial Council of the Asia-Pacific Trade Agreement was held on 15 December 2009, Seoul, Republic of Korea. In December 2009, the Participating States entered into the Framework Agreement on the Promotion, Protection and Liberalization of Investment and the Framework Agreement on Trade Facilitation. The total trade volume of APTA members has skyrocketed from a mere 140 million Dollars in 1976 to 3.1 trillion Dollars in 2008<sup>17</sup>.

**iii) Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)**

BIMSTEC (Bangladesh India Myanmar Sri Lanka and Thailand Technical and Economic Cooperation), a sub-regional economic cooperation grouping was formed in Bangkok in June 1997. Myanmar joined the grouping later in December 1997. Bhutan and Nepal too joined in February 2004. Its membership involves 5 members of SAARC (India, Bangladesh, Bhutan, Nepal & Sri Lanka) and 2 members of ASEAN (Thailand, Myanmar). Thus, it is visualized as a 'bridging link' between the two major regional groupings i.e. ASEAN and SAARC.

At its first summit held in Bangkok on July 31, 2004, the acronym BIMSTEC was renamed as "Bay of Bengal Initiative for Multi Sectoral Technical and Economic Cooperation." Initially, cooperation was proposed into 6 sectors. But, during the 11<sup>th</sup> Senior Official Meeting in New Delhi in August 2006, it was agreed that the areas of cooperation should be expanded to 13 sectors and each sector will be led by members in a voluntary manner. Transport

& Communication, Tourism and Environment and Disaster Management, Counter-Terrorism And Transnational Crimes are the sector lead by India. BIMSTEC member countries agreed to establish the BIMSTEC Free Trade Area Framework agreement in order to stimulate trade and investment in the parties, and attract outsiders to trade with and invest in BIMSTEC at a higher level. The Framework Agreement on the BIMST-EC FTA was signed on 8<sup>th</sup> February, 2004 in Phuket, Thailand. The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) brings together 1.3 billion people or 21 percent of the world population, a combined GDP of over US\$ 1.8 trillion and a considerable amount of complementarities. Despite these impressive figures, intra-BIMSTEC trade is less than 5%. BIMSTEC has a trade negotiating committee which is working on the list of goods regarding a framework agreement signed in 2004. BIMSTEC engagement that has potential of generating trade worth 43 to 59 billion dollars under a proposed free trade agreement (FTA), which is yet to be finalized<sup>18</sup>.

India hosted the 1st meeting of BIMSTEC Network of Think Tanks in February, 2010. BIMSTEC Transport Infrastructure and Logistics Study were endorsed by the 12th BIMSTEC Ministerial Meeting. Plenary of the 13th BIMSTEC Ministerial Meeting was held 22/1/2011 in Myanmar. During this meeting the memorandum on the establishment of the BIMSTEC Energy Center in India was signed. India hosted the meeting of taskforce on BIMSTEC Energy Centre and Senior officials meeting between 7-8 February 2011. This meeting is expected to help early operationalization of the Energy Centre.

India is also taking steps to expedite establishment of BIMSTEC centre on Weather and Climate<sup>19</sup>. In order to support capacity building and share expertise on emerging and reemerging diseases, India has been offering over 450 scholarships annually to BIMSTEC Countries. India has established BIMSTEC Information centre and contributed its share of US\$ 10,000 for BIMSTEC Tourism Fund. This Centre will help disseminate information regarding tourist destinations in the member countries to give impetus to growth of tourism. Permanent Secretariat of BIMSTEC will be hosted by Bangladesh. Sri Lanka has taken responsibility and nominated the first Secretary General. Nepal has taken over the next Presidency of the BIMSTEC which is rotational every year.

**iv) Framework Agreement on Comprehensive Economic Cooperation between India and the Association of South East Asian Nations (ASEAN) Th 12186**

India's engagement with the ASEAN started in the year 1991. India's focus on a strengthened and multi-faceted relationship with it is an outcome of ASEAN's economic, political and strategic importance in the larger Asia-Pacific Region and its potential to become a major partner of India in trade and investment. Also, it now provides a land bridge for India to connect with the Asia-Pacific-centered economic crosscurrents shaping the 21st century market place. While, ASEAN seeks access to India's professional and technical strengths, India and ASEAN have convergence in their security perspectives.

ASEAN has a membership of 10 countries viz. Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.





India is one of the four 'Summit level Dialogue Partners' of ASEAN.

Initial agreement was signed between ASEAN and India on 8<sup>th</sup> October 2003 in Bali (Indonesia). The key elements of the agreement are FTA in Goods, Services and Investment, as well as Areas of Economic Cooperation. The Agreement also provided for an Early Harvest Programme (EHP) which covers areas of Economic Cooperation and a common list of items for exchange of tariff concessions as a confidence building measure.

The areas of economic cooperation are Trade Facilitation, Manufacturing and services sector Cooperation, Trade and Investment Promotion.

The Parties agree to implement capacity building programs and technical assistance, particularly for the New ASEAN Member States, in order to adjust their economic structure and expand their trade and investment with India.

The final agreement was signed on 13 August 2009. The free trade area came into effect on 1 January 2010. In 2008, the total volume of ASEAN-India trade was US\$ 47.5 billion. ASEAN's export to India was US\$ 30.1 billion – a growth of 21.1 per cent in comparison with that of 2007. ASEAN's imports from India were US\$ 17.4 billion – a growth of 40.2 per cent in comparison to that of 2006. ASEAN and India signed the ASEAN-India Trade in Goods (TIG) Agreement in Bangkok on 13 August 2009, after six years of negotiations. The signing of the ASEAN-India Trade in Goods Agreement paves the way for the creation of one of the world's largest FTAs – a market of almost 1.8 billion people with a combined GDP of US\$ 2.8 trillion. The ASEAN-India FTA will see tariff liberalization of over 90 percent of products traded between

the two dynamic regions, including the so-called “special products,” such as palm oil (crude and refined), coffee, black tea and pepper. Tariffs on over 4,000 product lines will be eliminated by 2016, at the earliest. The ASEAN-India TIG Agreement entered into force on 1 January 2010. The 7th ASEAN-India Summit in Cha-am Hua Hin, Thailand on 24 October 2009 agreed to revise the bilateral trade target to 70 billion USD to be achieved in the next two years, noting that the initial target of USD 50 billion set in 2007 may soon be surpassed. ASEAN and India are currently working towards the early conclusion of the ASEAN-India Trade in Services and Investment Agreements.

**v) *India-Mercosur Preferential Trade Agreement (PTA)***

A Framework Agreement was signed between India and MERCOSUR on 17<sup>th</sup> June 2003. The aim of this Framework Agreement is to create conditions and mechanisms for negotiations in the first stage, by granting reciprocal tariff preferences and in the second stage, to negotiate a free trade area between the two parties in conformity with the rules of the World Trade Organization. As a follow up to the Framework Agreement, a Preferential Trade Agreement (PTA) was signed in New Delhi on January 25, 2004. The aim of this Preferential Trade Agreement is to expand and strengthen the existing relations between MERCOSUR and India and promote the expansion of trade by granting reciprocal fixed tariff preferences with the ultimate objective of creating a free trade area between the parties.

MERCOSUR is a trading bloc in Latin America formed in 1991 and comprising Brazil, Argentina, Uruguay and Paraguay. It was formed with the objective of facilitating the free movement of goods, services, capital and people among

the four member countries. It is the fourth largest integrated market after the European Union (EU), North American Free Trade Agreement (NAFTA) and ASEAN.

Annexes to this Agreement were incorporated on March 19, 2005. By this PTA, India and MERCOSUR have agreed to give tariff concessions, ranging from 10% to 100% to each other on 450 and 452 tariff lines respectively. India-MERCOSUR PTA came in to operation from 1st June, 2009.

**vi) *Comprehensive Economic Cooperation Agreement (CECA) with Singapore***

India and Singapore signed a Comprehensive Economic Cooperation Agreement (CECA) on 29 June, 2005 to enhance trade and investment ties between them. The CECA comprises of a free trade agreement on trade of goods and services, a bilateral agreement on investment promotion, protection and cooperation and an improved double taxation avoidance agreement. It also includes Mutual Recognition Agreements on quality certification of goods and services, liberalized visa rules for professionals, and undertakings to cooperate on several sectors like customs, dispute settlement, intellectual property rights, education and e-commerce. This CECA was reviewed once in 2007.

Singapore trade minister Lim Hang Kiang visited India in May 2010, for talks with commerce minister Anand Sharma to review the progress of CECA. Trade between India and Singapore in merchandise goods has increased multi-fold. However, services still lag behind. Indian government stressed on ways to step up liberalization in services. The synchronization between professional institutes in India and their counterparts in Singapore has not happened so far,

and India has taken serious note of this. India has told Singapore that allowing immediate free movement of skilled people and substantially higher investment in India's capital markets are essential for the survival of the five-year old Comprehensive Economic Cooperation Agreement (CECA) with the island state<sup>20</sup>.

India plans to wrap up the review of this flagship trade treaty within a year, far less than the time usually allotted for such talks to conclude. The short span is an indication of its unhappiness over the pace of the opening up of services and capital investment, despite five years of the operation of the agreement.

The Indian government is also peeved at the fact that of the 1,780 foreign institutional investors registered with Sebi, very few are of Singapore origin. This is an asymmetry which the government feels can be rectified if the Singapore government leans on the investors to correct their Shanghai market bias. The CECA was designed to bring in financial sector investment to exploit opportunities as India liberalized the sector. There has been no progress between the two countries especially in mutual recognition agreements (MRA). Some "incremental progress" has been made in banking. It is not in Singapore's interest to allow Indian working professionals to enter the country because of its close proximity to China. Singapore imports mostly from China therefore, it does not make sense for them to liberalize services with India. According to the agreement in services, the two countries agreed to allow free movement of IT professionals, chartered accountants, architects, engineers and doctors.

It has been reported that the bilateral economic roadmap will include a target to double annual bilateral trade by 2015.

and an expansion of the CECA's product coverage and parity with the rules of origin in other free trade agreements (FTAs) signed by India<sup>21</sup>. There will reportedly be a broadening of cooperation, beginning with science and technology and intellectual property rights. The ministers also discussed the current state of play in the negotiations towards the India-Association of Southeast Asian Nations (ASEAN) Services and Investment Agreement. In addition, they reviewed the progress under the ASEAN+6 dialogue and reaffirmed their commitment towards a Comprehensive Economic Partnership in East Asia.

**vii) *Comprehensive Economic Partnership Agreement (CEPA) with South Korea***

India and South Korea signed the Comprehensive Economic Partnership Agreement (CEPA) opening up trade and investment between the two countries on 7<sup>th</sup> August 2009. The CEPA comprises six agreements relating mainly to opening up of trade in goods, services and customs. It is expected to give a boost to the more than USD 10 billion bilateral trade. India's exclusion and sensitive list contains mostly agricultural, textiles and auto sector items. The CEPA came into force from 1st January, 2010. The first meeting of the Joint Committee at Ministerial level to review the implementation of CEPA was held on 20<sup>th</sup> January, 2011 in New Delhi.

**viii) *Comprehensive Economic Partnership Agreement (CEPA) with Japan.***

India signed CEPA with Japan on 16/2/2011 to give greater impetus to trade and investments between the two nations. This agreement is the most ambitious agreement signed by

India so far with a developed country. This agreement came into force from August 1, 2011. The agreement is most comprehensive of all the agreements concluded by India so far as it covers more than 90% of trade, a vast gamut of services, investment, IPR, customs and other trade related issues.

The highlight of CEPA is the provision of abolition of tariffs over a period of ten years on goods that account for over 94 per cent of the two-way trade flow between India and Japan.

The Japanese government has put 87% of its tariff lines covering about 94% of Japan's imports under immediate reduction of tariff to zero<sup>22</sup>. A large number of these items are of India's export interest and include sea food; agricultural products such as mangoes, citrus fruits, spices; instant tea; most spirits such as rum, whiskies, vodka etc; textile products such as woven fabrics, yarns, synthetic yarn, readymade garments; petro chemical and chemical products; cement; jewellery etc. On the other hand India's 17.41% tariff lines covering about 8% of India's imports will go to zero duty immediately. These items include majority of items in the textiles sector and other items such as SIM and Memory cards, indicator panels of LCDs and LEDs, electronic calculators, cash registers, automatic data processing machines, input-output units, electric inverters and battery chargers etc. In case of India, tariffs on 66.32% of tariff lines will be brought to zero in ten years on to give sufficient time to industry to adjust to the trade liberalization.

This agreement will help to increase bilateral trade between the two countries from a present level of US \$ 12.6 billion to US \$ 25 billion by 2014.

**ix) Other agreements**

Some other agreements made by India are as under:

India-Sri Lanka Free Trade Agreement (ISFTA) - 1998

India-Chile Preferential Trade Agreement (PTA) - 2006

India-Afghanistan Preferential Trade Agreement (PTA) - 2003

India-Bhutan Trade Agreement - 2006

India-Nepal Trade Treaty- 2009

Bilateral Trade Agreement between India and Bangladesh-  
2006

Free Trade Agreement (FTA) Between India and Gulf  
Cooperation Council (GCC) –under negotiation.

Comprehensive Economic Cooperation and Partnership  
Agreement (CECPA) Between India and Mauritius – under  
negotiation.

**1.6 Tax Reforms by Chelliah Committee**

In 1991, the government set up a special committee, the Raja Chelliah Committee on Tax Reforms, to review the country's tax system and make appropriate recommendations<sup>23</sup>. This committee submitted its report in January 1993, consisting of major recommendations as given under:

- i) Lowering rate and narrowing spread of corporate taxes.
- ii) Avoiding double taxation.
- iii) Reducing rate difference between domestic and foreign companies.
- iv) Rationalizing capital gains tax.
- v) Rationalizing wealth tax.
- vi) Tariff reduction.
- vii) Rationalizing excise duty.

In the context of this study, tariff reduction is relevant. In the area of custom duties, this committee made following important recommendations:

- a) Reduction in general level of tariffs.
- b) Reduction in dispersion of tariff rates.
- c) A rationalization of the system with abolition of the numerous end-use exemptions and concessions.

However, the committee has cautioned that “the process of reforms should be gradual, so as to moderate the impact of adjustment both in terms of possible revenue loss and the pace at which the industry is exposed to competition.

The Government accepted most of the recommendations of committee and decided to implement these in a phased manner. The Government has considered customs duties to be the critical area, as much of these affect the country’s competitive position in the world market. Consequently, these duties have been reduced in the budgets of the years 1991-92 and 1992-93. Since the revised rates of import duties were still considered to be much higher than those in our competitor countries, especially on capital goods, Government decided to further reduce these in 1993-94 budget. For simplifying the tariff structure and the assessment process, the separate auxiliary duty has been merged with the basic customs duty. Various factors which led to these reforms were as under:

- i) The need to simplify the rate structure.
- ii) To give some relief on articles of mass consumption.
- iii) To help the domestic capital goods industry so as to increase its competitiveness.
- iv) Assist industries suffering from depressed demand conditions.

### **1.7 Selection of Research Topic**

This research topic was selected taking into consideration following important factors:



- i) International trade in general and Exports in particular assume significant importance from point of view of any country as they contribute to the exchequer of the country. India has come up significantly from the days of foreign exchange shortage which compelled the country to undertake path of economic reforms and opening up of economy. The country's focus has now changed from import substitution to export growth. Hence, it was decided to undertake a study which will focus on India's trade relations.
- ii) Selection of China for this research study was not only based on its geographical neighborhood to India and its similarities with India like large population, rural urban disparities etc. but also due to the fact that China has emerged as a force to reckon with in world economic order and trade between India and China is increasing at an astounding pace in recent years. The inking of trade agreements between India and China has opened up new vistas of furthering trade between the two countries. It is expected that the cross border trade between these two countries would expand on account of opening of the Nathu La Pass in Sikkim.
- iii) Selection of Japan as third country for this study was on account of fact that Indo Japan relations are centuries old. Japan had special relations with India, when Buddhism was introduced to Japan via the Korean Peninsula. Since 1952, Japan and India maintained diplomatic relations and enjoyed cordial relations based on trade, economic and technical cooperation. Japan and India have traditionally enjoyed cordial and friendly relations. Last but not the least, there are more than 100 Japanese companies operating in India at present either independently or through their Joint

Ventures. This fact shows that there exist strong economic ties between India and Japan.

## **1.8 Research Project Outline**

### **1.8.1 Research Objectives**

The broad research objectives are as given next:

- i) To take overview of Indo-Japan and indo-China trade during 1995-2005.
- ii) To study India's trade relations with both the countries especially in the light of WTO and globalization.
- iii) To identify key factors driving growth of trade with these two countries.
- iv) To take review of success and failure stories of the leading exporters and importers in India who have trade ties with Japan and India.

### **1.8.2 Hypothesis**

This research project makes following hypotheses:

- H 1 The pendulum of India's foreign trade is swinging to the east, especially China and Japan.
- H 2 China and Japan offer immense scope for growth of trade relations with India.

## **1.9 Methodology**

This research project utilizes exploratory research method. Methodology used for this research project was combination of desk research and field research.

### **1.9.1 Desk Research Methodology**

Desk research involved exhaustive literature survey by scanning of various secondary sources of data and information. Aim of desk research was to gather all published information related to this subject like trends in World trade between 1995-2005, its region wise and major product group wise breakup, and share of world merchandise exports of India, Japan and China. Besides, during

desk research in depth study of India's foreign trade with Japan and China during the study period was also conducted. This study resulted in identification of value wise top twenty products imported from and exported to Japan and China from India. The research also aimed to identify various issues related to India's trade with these two countries through articles, monographs, reports, seminar papers published earlier. A historical overview of economies of China, Japan and India was also obtained through various sources. Experiences and opinions of experts on trade with these two countries were also gathered through similar sources. During these efforts various sources of information like books, seminar papers, reports prepared by government departments and other institutions, news paper cuttings, news bulletins, trade reports, etc. were exhaustively referred. Search through appropriate web sites was an integral part of desk research. Annexure 1 gives bibliography of desk research sources used.

#### *1.9.2 Field Research Methodology*

In order to have grass root level and authentic information on present status of trade with these two countries primary sources of information were used. During the field research personal interaction was held with the officials of Indo-China Chamber of Commerce & Industry, Japan External Trade Promotion Organization and World Trade Centre to have an umbrella view of trade and to understand key factors driving trade of India with China and Japan. Personal discussions were also held with select industries, importers and exporters in Pune and Mumbai who have at present active trade relations with China and Japan. The selection of these contacts was done by using purposive sampling. To have an all India coverage, this checklist was emailed to more than one hundred industries and traders in major cities throughout India but response for mailing was tepid.

Personal interviews with industries and traders in Pune and Mumbai threw light on many aspects of trade like their experiences in dealings with their counterparts in China and Japan; products traded, past trends of their volume of trade, future prospects for trade, precautions to be taken, present barriers to increase trade, problems faced, role of support agencies etc. All interviews were held with top rank persons both in industries, importers/exporters, Chambers of Commerce and industry associations by prefixing appointments with them. In order to ensure objective oriented discussion a check list was used to receive feedback during personal interviews. However, to gather extra information on research topic beyond questions in check list, many additional questions were asked during interviews. Check list used to gather feedback during personal interviews is given in Annexure 2.

### **1.10 Significance of Research Project**

It is felt that the outcome of this research project has significance from point of view of different agencies like industries, importers and exporters, educational institutions and government departments.

#### **1.10.1 Significance from point of view of industries**

Senior representatives from industry would get ready made data on value wise top fifty products imported from and exported to China and Japan from India over ten years. This would enable them to think of undertaking production of these products and targeting these two countries while planning their export strategies. Similarly list of top fifty imported products would guide them to focus on products which can be sourced from China and Japan. They are also likely to be benefited from data provided by experts on how to develop trade with these countries and data on

precautions to be taken in dealing with China by Indo China Chamber of Commerce and Industry.

#### *1.10.2 Significance from point of view of importers and exporters*

Importers and exporters would be able to take benefit of experiences shared by their peers and also experts. Similarly, this report may provide an appropriate platform to voice their concerns and reaching them to government departments when suitable opportunity exists in future.

#### *1.10.3 Significance from point of view of government departments*

Government departments would get ready made feedback of industries and importers/exporters which would enable them to remove bottlenecks in furthering trade between India and these two countries. They may formulate new trade policies or modify existing trade policies based on this feedback.

#### *1.10.4 Significance from point of view of educational institutions*

This research study is likely to provide platform for teaching the subject of international marketing with reference to China and Japan. Secondly, this study can be used as a base document to undertake in depth studies for a particular industry sector/group of products identified in top twenty list which has good potential to import in or export from India. This study is expected to improve overall knowledge base about China and Japan amongst both faculties and students.

### **1.11 Limitations**

This study has some limitations as given below:

- i) Primary research was restricted to Pune and Mumbai. Hence, in person feedback of industries, importers and exporters in other cities was not possible. To overcome this problem, efforts were made to reach them by email; however the response received was tepid. All India feedback might have given better picture and strengthened findings.

- ii) Some trade promotion organizations were not enthusiastic for personal interviews because according to them research was a low priority area for them as against day-to-day work of trade promotion activities. This research was treated by them as an academic exercise which is the researcher's job and it will benefit only the researcher and not to their organization.
- iii) Financial budget being limited it was not possible to undertake visits out of Maharashtra.
- iv) This study mainly focuses on merchandise trade and does not include in its scope services sector.

### **1.12 Chapter Summary**

International trade is the backbone of our modern, commercial world. International trading provides countries and consumers the chance to be exposed to those services and goods that are not available in their own country.

Classical theories of international trade were based on number of assumptions related to various aspects like nature of markets, technology, demand, return to scale etc. Modern theories are based on reexamination and modifications of classical theories according changes in trading environment.

India was carrying out trade with far-off lands in West Asia and beyond, well before 1500 BC. During British era India's trade include substantial exports of textiles and heavy imports of bullion into India through the East India Company. After British rule India's international trade was concentrated in the countries of British Empire.

In 1947, "Import and Export (Control) Act" was passed which was continued for next forty five years. During fifties and early sixties international trade was dominated by imports. The period of mid-

sixties to mid-seventies was marked by both exports and import-substitution efforts.

India initiated series of economic reforms in 1991 aimed at establishing macro-economic balance, economic growth and regain external credit worthiness. During 2009-10, exports were Rs. 845534 Crs. And imports were Rs. 1363736 Crs., showing negative trade balance of Rs. 518202 Crs.

The pattern of exports for last twenty years shows that over the years, share of India's exports of agriculture and allied products is declining while that of ores and minerals has remained more or less steady. It is also observed that share of manufactured goods is fluctuating from 66-77%. It is also observed that within category of manufactured goods exports share of engineering products is increasing while that of leather and textile products is decreasing.

As far as imports are concerned, petroleum products dominate right from beginning. However, since opening up of economy stress on import substitution has reduced and imports of capital goods and other intermediary products for export purposes have increased.

Analysis of last 15 years shows that, in case of exports, China and Singapore have emerged as new export destinations in place of Japan and UK. In case of imports, China and Switzerland have replaced Germany and Japan as import destination.

Main plank of the trade policy of free India was protection of indigenous industry through a variety of controls, like import duties and preference for indigenous goods in respect of government purchases. However, things started changing since India opened its economy in 1991. Drastic changes have been introduced in every EXIM Policy declared thereafter. The reform measures introduced in the subsequent policies have focused on liberalization, openness and transparency. They have provided an

export friendly environment by simplifying the procedures for trade facilitation. Last foreign trade policy declared was for the period 2009-14.

India has entered into various regional trade agreements like SAFTA, APTA, and BIMSTEC etc. Besides, it has signed bilateral agreements with Singapore, South Korea and Japan. However, most important amongst these is Comprehensive Economic Partnership Agreement with Japan signed in February 2011. The highlight of CEPA is the provision of abolition of tariffs over a period of ten years on goods that account for over 94 per cent of the two-way trade flow between India and Japan. Bilateral trade between India and Japan is expected to reach US \$ 25 Bn. by 2014 on account of this agreement.

This chapter also gives research objectives, hypothesis, methodology used to accomplish the objectives and limitations.



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