Chapter I

HYPOTHESIS
1.1 (i) INTRODUCTION:

Economists and policymakers have often agreed on the role of government in providing infra-structure and maintaining stable macro-economic stability, but they have disagreed on policies toward trade and industry. The form of government intervention in this area leads to alternative strategies. For analytical convenience we broadly divide trade strategies into two groups outward oriented and inward oriented. An outward oriented strategy is one in which trade and industrial policies do not discriminate between production for domestic market and exports, neither does it discriminate between the purchases of domestic and foreign goods this strategy is often referred to as export promotion strategy. On the other hand an Inward oriented strategy is one in which the trade and industrial policies are biased in favour of domestic production over the export market. This approach is known as import substitution because protection switches demand to products produced domestically and tends to discourage exports.

Commercial Policy, Industrial Policy and Exchange Rate Policy can all be used as instruments of inward oriented strategy by means of licensing.
and quantitative restrictions. Governments also use fiscal policy to provide subsidies or impose taxes. The foreign exchange rate for allocation of foreign exchange may be administered and certain sectors may be given preferential treatment.

The World Bank studied forty one developing countries over the period 1963-85 and categorized them according to the orientation into four groups as under:

- Strongly outward-oriented - e.g. Singapore, Hong-Kong
- Moderately Outward-oriented - e.g. Brazil, Israel, Turkey
- Moderately inward-oriented - e.g. Indonesia, Mexico
- Strongly inward-oriented - e.g. India, Argentina, Ethiopia

It was observed that some countries moved from one category to another over the years for example Uruguay which belong to the category of strongly inward oriented moved to moderately outward oriented category. However India throughout maintained strong inward orientation.

1.2 (i) EVOLUTION OF THE HYPOTHESIS:

Self-reliance was an important concept for a country like India emerging from colonial rule into a bipolarised world, prophesing socialism and capitalism. The origin of the socialistic policies may have been concern for the poor but soon politicians found that it was a winning combination of populism and power to perpetuate their own positions. It suited political parties,
beaurocracy trade unions and the illeterate. In pursuance of this broad objective of self-reliance and democratic socialism India adopted import substitution policies.

The extensive import substitution reduced the imports of the substituted products but led to an increase in the demand for raw materials, intermediate products and capital machinery, as domestically produced inputs were not sufficient or up to the mark. Almost all industries were insulated from competition by means of quantitative controls, non-tariff barriers and high tariffs. Consumer goods industries were given high protection by the ban on the import of consumer goods. The domestic market of a continental size and a throbbing internal demand was a safe haven for the producers and very little effort was directed towards exports.

1.2 (ii) The protection of the domestic market and the resulting high costs of locally produced goods were recognised as an impediment and in the recent past the government has been making some efforts to remove this distortion, despite this the overall export performance continued to be disappointing. The performance reflected the superior profitability of the domestic market and pointed to the fact that the export incentives did not offset the disadvantage. During the 1980's the government has been thinking about policy changes to make the trade policy more effective. In 1984 the Abid Hussain Committee and in 1985 the Narsimhan Committee were appointed to review the structure of the import export policy and the related incentives. Both these committees emphasised the need to make export more profitable and the desirability of reducing quantitative restrictions. In response to these views the government
announced a number of policy changes, which are claimed to be liberalisations. Notable among these changes are reduction in import controls by the expansion of O.G.L., removal of export taxes, streamlining of administration and an increase in the quantity of subsidies. The hypothesis aims at establishing a relationship between these changes introduced with reference to the trade policy and their effect on the export performance. It wishes to study the efficacy of the liberalised import export policy as a tool of export promotion.

1.3 (1) STATEMENT OF THE HYPOTHESIS :

The liberalised import export policy is not an effective tool in the promotion of exports. It has the inherent capacity to perpetuate the existing imbalances in the foreign trade sector. The changes introduced have not been able to address the root cause of our sluggish performance in international trade.

In 1985 the government, for the first time, announced a three year import-export policy with certain changes which aimed at:

(a) Providing stability to the policy.
(b) Encouraging sustained export growth
(c) Streamlining procedures
(d) Supporting indigenous Research and Development promoting self-sufficiency.

The hypothesis puts forward the reasoning that the policy changes introduced have been very superficial, lacking clarity or stability. Hence the present exim policy is not an effective tool of export promotion.
The import-export policy plays a crucial role in the development of the economy and the export sector. For a long time it was known as the import and export control policy reflecting the psychology of the government. However in the recent years its promotional role was recognised and the title was changed to Import and Export Promotion policy. Currently the government plays a promotional role by providing certain exemptions and incentives to the export sector. These mainly relate to the following:

(a) Expansion of the Open General License category of imports to facilitate import of inputs for modernisation.

(b) Replenishment Licenses provided to exporters to enable them to import export related inputs. These licenses are transferable hence carry a premium.

(c) Duty Free licenses are allowed to exporters to provide inputs at international prices.

(d) Duty Drawback is granted on imported inputs on which customs duty has been paid to make prices competitive.

(e) Cash compensatory support as given to exporters to compensate for unrebated indirect taxes and market developments.

(f) Canalising agencies are expected to promote inputs at low cost. Fiscal concessions are granted in the payment of direct taxes like Income-tax exemption.
1.4 (ii) The hypothesis attempts to establish a relationship between these variables and the export performance in the recent years. The efficacy or the lack of it has been established not by the fiscalist approach which compares only the net outflow with the net inflow of foreign exchange but on the cost and benefit of the present regime of controls and incentives. Various factors relating to costs have been identified and have been compared with the benefits in terms of export expansion or modernisation. The entire export promotional system in India which operates through the Import Export Policy needs to be scientifically oriented. The present schemes have a very limited impact on the export expansion and diversification and is therefore an ineffective tool for export promotion.

To arrive at the analytical and logical conclusion regarding the hypothesis certain assumptions have been made to eliminate the effect of relatively unimportant variables. These assumptions are enumerated below:

ASSUMPTIONS:

(a) The World trading environment is not likely to experience any drastic change apart from the ones already considered in the analyses.

(b) The Indian export sector will not be subject to any major change due to a discovery of natural resources or a major indigenous invention.

(c) The export sector's performance can be measured not merely by the foreign exchange earnings but also by the following factors:

- Improvement in the quality of production
- Increase in the quantity exported
- Improvement in price competitiveness
- Better delivery schedules
- Change in the direction of trade
- Its effect on economy's modernisation.

(d) The qualitative effects of a policy change are best judged by analysing the encumberances and impediments experienced before the change and the amelioration on effectiveness after the changes.

(e) Statistical figures relating to export earnings or import expenditures are subject to limitations such as - falling value of the Indian currency, price effect due to inflation, manipulations arising out of the imposition of taxes, company policies of merging or sub-dividing earnings and expenditures. Hence a objective opinion based on the factors mentioned in point (c) above forms a better basis of judgement and not the export earnings of the firms.

(f) The Secondary data at the national level can be used to support the trend observed by means of the analyses of the primary data. This will help to substantiate the tested hypothesis.