Chapter - I

Introduction

Economic development is one of the main objectives of every society in the world and economic growth is fundamental to economic development (Anwer and Sampath, 2000). There are several economic and non-economic factors affecting economic growth and development. Foreign trade plays an important role in the economic development and growth of a country (Meier, 1980). It serves as an important engine of economic growth and development. Foreign trade as a highway of learning and thus foreign ideas and creativity imported by foreign trade are an impetus to domestic creativity and growth and thus has a deep impact on welfare, stability, and development of an economy. The opening up of trade sometimes works as a sort of industrial revolution in a country whose resources were previously underdeveloped. An outstanding outward-oriented industrialization is superior to inward-oriented industrialization as a policy of economic development, and open economies have generally found to outperform than less open ones (Sachs and Warner, 1995). Industrial development and growth of 1970s and 1980s in some North East and South East Asian economies have also been in line with the lesson that external orientation and foreign trade generate a propelling force for economic development. Trade liberation can lead to significant income increases and effectively promote development by allowing the optional allocation of resources in an economy. Foreign trade is important to the economy because of the country’s need to import a variety of products. India exports a huge number of products and imports equally a good number of required products.

Amongst the other strategic sectors of an economy, export sector is considered as a catalyst agent for sustaining and accelerating process of economic growth (Aggarwal, 1982). Countries devote home resources to exports because they can obtain more goods and services by
international exchange than they would from the same resources devoted to direct home production. Depending upon marginal propensity to consume and propensity to import, exports have multiplier effect on gross national income (Bannock et al., 1992). Exports, by fostering specialization helps to benefit from comparative advantage; utilizing the full capacity of plant size where domestic demand is less than full capacity production; getting benefit of greater economies of scale due to large market; expanding aggregate demand; increasing the rate of investment and technological changes; enabling import of essential raw materials and capital goods, result industrialization and thus rapid economic growth in developing economies (Chennery, 1979; Kavoussi, 1984; Ram, 1987; and Moon, 1998). A country can reap lot of benefits from an export oriented trade policy as an export-oriented industrialization encourages high taking and seizing opportunities, which are basic requirement for economic development (Bhagwati, 1976).

In most development planning, the importance of exports to domestic growth has been approached in terms of importation of goods and services. In other words, export growth is seen as a determinant of import capacity which, in turn, is a determinant of the level of domestic activity. But it is misleading to assess the contribution of the export sector solely in terms of foreign exchange earnings, as many underdeveloped countries, while stressing exports, also hope to reduce their relative dependence on foreign markets as economic development proceeds at a more rapid pace. Thus, it is stressed that the export sector assumes a much broader and useful role than that reflected in terms of foreign exchange earnings (Hultman, 1967).

Export expansion can play an instrumental role in promoting rapid economic growth. Since exports are a component of GDP, rapid export growth means an even faster growth of GDP, through the Keynesian multiplier process. Moreover, export expansion increases efficiency in the
economy, which further stimulates economic growth. This increase in efficiency takes place in three ways: firstly, through the exploitation of increasing returns to scale by producing for a larger market, as Adam Smith emphasized. Secondly, through more efficient allocation of resources by specialisation in accord with comparative advantage, elucidated by David Ricardo and thirdly, through fiercer competition, which encourages innovation, product and process improvements, and cost reductions. In a developing country, by relaxing the foreign exchange constraint and increasing import capacity, export orientation can provide another fillip to the growth process. Export promotion of labour-intensive products has often been cited as an important antidote among the numerous remedies to solve the problem of unemployment in developing countries. Contributions on this subject have been made in several monographs by ILO, and other writers, (Hellener, 1973; Lydall, 1974; Taylor, 1976), where the major gains in employment in developing countries are gleaned through a greater liberalization of imports of labour-intensive manufactures into developed countries. The two examples are of Hong Kong and Taiwan; they have successfully employed outward-looking industrialization as a panacea for absorbing their under-utilized man-power (Taylor, 1976).

However, structural theorists have questioned the wisdom of relying heavily on external markets, particularly for third world economies (Myrdal, 1957). Because their traditional exports frequently lie in sectors that offer unattractive demand pattern and limited inter-sectoral linkages, significant expansion of existing industries may be neither possible nor desirable and thus the economic growth may suffer with greater reliance on exports (Prebisch, 1962 and Cline, 1982). In spite of the criticism by the trade pessimists, export-oriented or outward-oriented development strategy has gained popularity especially during the last decade of twentieth century as many developed and developing
countries liberalized their foreign trade policies and participated in the free trade movement launched by the concluding round of GATT agreement.

The world economy has changed rapidly both in horizontal and vertical spectrum. The changes in the world economy have made it clear that no nation can isolate itself completely from the rest of the world and survive (Aggarwal, 2002). The recent explosion of the information technology has generated new waves of dynamism and reduced virtually the entire world into a global village. This process of increasing economic integration and growing economic interdependence among the nations of the world is widely known as globalization (Singh, 1999). The decade of 1990s and early years of twenty first century have witnessed profound changes in international economic environment. The period has been led by the implementation of multilateral Uruguay Round of General Agreement on Tariffs and Trade (GATT) under the auspices of World Trade Organisation (WTO) and a sharp growth in the number of regional trading agreements. On one hand, there is liberalization requiring member countries to open up and liberalize their economies by reducing trade barriers and to undertake policy reforms. On the other hand, more and more countries are opting for various sorts of trading agreements that provide preferential access to the member countries and discriminate against non-member countries (Chand, 2006). In nutshell, the period since 1991 has been marked by rapid structural changes in international economic environment. Multilateralism supported by regional integration and liberalization of trade policies in many developing and developed economies have provided an export friendly environment at global level as peak levels of tariff barriers to trade among countries have declined sharply and non-tariff barriers have also been abolished.
Trade is an outstanding feature of internationalization of economic system. All the factors of production are not adequately available in a country. Hence, for grafting their varied needs, countries engage in international trade. As Ohlin (1952) stated that international trade mitigates the disadvantages of disproportionate geographical distribution of productive resources. International trade decidedly increases the exchangeable value of possessions, means of enjoyment and wealth of the countries concerned. Thus, international trade plays an important role in economic development and growth of a country (Krueger, 1980). India is not exception to this rule. The growing importance of foreign trade is the single indicator of increasing globalization. Indian economy has been experiencing globalization in the sense that it is fastly integrating with world economy (Kirti and Radhakrishnan, 2004-05). India commenced its major thrust towards globalization in July 1991, with two simultaneous forces, unilateral and multilateral playing a pivotal role. Unilateral economic reforms were undertaken with regard to exchange rate, foreign investment, external borrowing, and foreign trade policy (Chadha, 1999). Trade policy reforms formed an integral part of the overall structural reform process instigated by IMF through the structural adjustment programme (RBI, 2001-02). These reforms encompassed liberalization in areas such as industrial policy, import licensing, import tariffs and export subsidies, etc. The multilateral aspect of India’s trade policy refers to India’s commitments to the World Trade Organization (WTO) with regard to trade in goods and services, Trade Related Investment Measures (TRIMs), Trade Related Intellectual Property Rights (TRIPs). This open trade regime has been viewed as the least vulnerable form of globalization with enormous opportunities for higher growth emanating from higher exports (Krueger, 1998). This New Trade Regime is a momentous in India’s economic history as it witnessed a successful transition of India from a closed, slow growing economy to
an open economy that has now found a place amongst the fastest
growing economies in the world (Chadha, 1999).

Exports, being a major part of a India’s external sector, have
assumed a place of paramount importance and play a significant role in
economic development process through generating investible surplus and
financing imports by earning foreign exchange (Kaur, 1993). The 1991
economic reforms were intended to address fiscal and current-account
imbalances and to put the Indian economy on a path to sustainable
growth. The sequencing of the reform process, whereby fiscal and
monetary reforms preceded trade liberalization has been said to explain
India’s soft landing. The unilateral liberalization also coincided with the
Uruguay Round of Trade Negotiations (1986–1994), which, inter alia,
resulted in binding non-optimal agreements on a comprehensive array of
issues (Stiglitz, 2003).

India’s trade policy regime was highly complex until the early
1990s. Protective measures have taken three forms: tariff barriers that
limit imports, non-tariff quantitative restrictions (QRs) and outright
prohibition of imports. There were also various categories of importers,
import licenses and methods of importing (Matoo and Stern, 2003).
Several estimates claimed that 93 per cent of India’s local production of
internationally tradable goods was still protected by some type of QRs on
imports in 1990-91. The export and import (EXIM) policy in effect from
1992 to 1997 significantly reduced trade restrictions and liberalized the
import of capital goods and raw materials. These economic reforms also
made a break from the earlier approach by replacing the positive list
approach of listing license free items on the Open General License (OGL)
with a negative-list approach. However, quantitative restrictions,
including import-licensing requirements, were maintained on a number
of products on balance-of-payments grounds. These items were listed in
the negative list of imports in India’s official Export and Import Policy. Items in the negative list were highly regulated and fell into three broad categories: banned or prohibited items; restricted items requiring an import license, and canalized items that could be imported only by government trading monopolies. The import licenses were non-automatic in nature and were also subject to other conditions such as limited coverage (for instance, the special import license included 10 per cent of the Harmonized System (HS) lines, subject to restrictions) and an “actual user” stipulation. The major changes included an expansion of the list of products eligible for import under special licenses (EXIM Policy, 1992-97).

Although the 1991 reforms first did away with import licensing on virtually all intermediate and capital goods, consumer goods, which accounted for nearly 30 per cent of the tariff lines, remained subject to import licensing (WTO, 1998). The Government’s view was that Indian exports were subject to supply constraints, and thus unresponsive to price changes resulting from altering the exchange rate. Essential imports were similarly considered price-inelastic. But luxury imports were not. Given that the import basket would contain some of both, it was argued that the targeted QR system was the most efficient way of managing large volumes of luxury imports. In this respect, the QR regime operated successfully to discourage imports of a number of products such as meat, fish, cereals, malt and starches, cocoa, chocolate, nuts, fruit juices, wine, beer spirits and vinegar. It was only after a successful challenge by the United States and others at the WTO Dispute Settlement Body (DSB) that these goods were released from QRs in two phases, culminating in April 2001.

One element of the trade liberalization was the lowering of import tariffs. In 1990-91, the highest tariff stood at 355 per cent, with a simple
average of 113 per cent and the import-weighted average of tariff lines of 87 per cent. This was further reduced to 71 per cent in 1993-94 and to 41 per cent in 1995-96. The average applied rate remained at 17 per cent in 2004. Import tariffs were reduced gradually by lowering the top tariff rates while rationalizing the tariff structure through a reduction in the number of tariff bands. By 1992-93, the applied rates for protective tariffs and total imports had fallen to 33 per cent and 38 per cent respectively. India’s economic reforms continued to focus on the manufacturing sector. In Uruguay Round (UR) of multilateral trade negotiations, India increased its binding coverage in industrial goods to 69.8 per cent of its tariff lines, from 6 per cent. Notwithstanding trade liberalization, India still has high tariffs compared with the rest of the world. Some two per cent of the tariff lines have peak rates of duty. Examples include edible oils, alcoholic beverages, and motor vehicles. The structure is also characterized by tariff peaks and tariff escalation. The average MFN tariff rates, during 2001-02 for raw materials, semi-manufactured and finished goods were 23.6 per cent, 32.4 per cent, and 31.4 per cent respectively. As result of progressive reduction in custom duty rates and exemption on various counts, peak rates fell sharply 40 per cent in 1999-2000 to 10 per cent in 2008-09 (GOI, 2009-10).

Among the reforms recommended by the New Economic policy, exports are the major focus of India’s foreign trade policy. Export is of vital importance for the growth of the Indian economy and various considerations are to be taken to improve the export performance in all aspects. While the pre-reform period was characterized by policies that promoted import substitution, important initiatives have subsequently been introduced to promote exports. Motivated by the success of China’s Special Economic Zones (SEZs) and the Shannon Free Trade Zone in Ireland, among others, the Government of India introduced SEZs under
its Export-Import Policy of 2000. Since then, the establishment of several SEZs has been approved. In addition, some of the existing export processing zones are expected to be converted into SEZs. This new policy aims to provide an internationally competitive environment for exports. In a major initiative to boost export-led growth, the new five-year Foreign Trade Policy of 2004–2009 lifted all quantitative restrictions on exports, and announced additional incentives for SEZs as well as schemes such as the Duty Entitlement Pass Book (DEPB), advance licensing, and Export Promotion of Capital Goods (EPCG). The policy also provides an incentive package for the computer hardware sector and simplifies procedures to reduce transaction costs, besides adopting a new commodity classification for imports and exports. The Medium Term Export Strategy (MTES) of the Department of Commerce forms part of the Government’s Tenth Five Year Plan. Its principle aim was to increase India’s share of world exports from 0.8 per cent in 2002 to one per cent by 2007, which implies a substantial growth in export volumes from current levels. Among the many recommended policy changes designed to achieve this goal, the MTES includes criteria for judging the usefulness to India of non-WTO trade agreements, be they bilateral or regional. Thus, the trade policy reforms in recent past with their focus on liberalization, openness, transparency and globalization as well as creation of WTO have provided an export friendly environment with simplified procedure for trade facilitation (Economic Survey, 2004-05).

1.2 Relevance of the study

Exports have assumed vital importance for Indian economy both in pre and post independence periods, due to a number of reasons. Many comprehensive studies on Indian exports since 1951 have been conducted. These are Singh, 1964; Benerji, 1975; Nayyar, 1976; Panchmukhi, 1978; Wolf, 1982; Singhal, 1985; Kaur, 1993. Most of these covered the period up to the end of 1970s and some up to the end
of 1990s. Apart from above mentioned studies, there are no major comprehensive studies on Indian exports, rather than some partial studies during both pre and post reforms period. The present study covers the period 1991 onwards and is an attempt in filling the gap in available literature. The period covered under the study has been characterized by vigorous changes within the economy as well as at global level. The economic environment during this period has dramatically changed within the economy following economic policy reforms of 1991. Inward looking import substitution trade policy has been replaced by outward looking export promotion trade strategy. Apart from various economic reforms undertaken since 1991, Indian economy has also had to reorient itself to the changing multilateral trade discipline at global level with newly written WTO framework. Creation of WTO after conclusion of Uruguay Round (1986-94) brought out renewed order to the multilateral trading system by applying multilateral disciplines and has provided a lot of scope, as well as challenges for export expansion. An attempt is made through the study to decipher and quantify the impact of this domestic and global economic transformation on various aspects of Indian exports. The relevance of the study is further enhanced by taking into account increasing popularity of regional trading agreements at world level and particularly in Asian region, which opened the opportunities for country’s export sector to reap the benefits of comparative advantage, lower tariff, and non-tariff barriers.

1.3 Objectives of the Study

The specific objectives of the study are as under:
1. to assess the impact of economic reforms and WTO on India’s exports;
2. to analyze the growth, direction and structure of India’s exports during the post-reform period;
3. to examine the export-instability in terms of commodities, markets and overall earnings;
4. to estimate the price and income elasticities of demand for India’s principal export commodities;
5. to assess the competitiveness of Indian exports; and
6. to examine the relative export-performance of India in the context of world exports.

1.4 Hypotheses
The following hypotheses had been formulated for empirical testing:
1. India’s exports recorded diversification in terms of commodities and markets;
2. India’s exports performed well in relation to world exports and that of principal exporters;
3. the manufactured exports experienced higher export earning instability than that of primary exports;
4. price and income elasticities of demand for India’s exports remained favourable during the study period;
5. India’s exports registered growth based on their competitiveness during post-reform period; and
6. Economic Reforms and WTO have desirable effect on various aspects of India’s Exports.

1.5 Research Methodology
The study is entirely based on the secondary data. The period covered under the study is of fifteen years (i.e. from 1991-92 to 2005-06). The attempt is to present a comprehensive picture of Indian exports by putting the things in a most disaggregative manner. A representative bundle of thirty commodities at SITC digit-3 level has been selected by taking into account their continuous presence in India’s exports, which covers more than seventy-five per cent of India’s exports during the concerned period. The selected commodities are: fish (fresh and simply preserved) (SITC-031); rice (SITC-042); fruits (fresh and nuts excluding oil nuts) (SITC-051); tea and mate (SITC-074); feed-stuff for animals
excluding unmilled feed-stuff (SITC-081); iron ore and concentrates (SITC-281); petroleum products (SITC-332); organic chemicals (SITC-512); synthetic organic dyestuffs, natural indigo and lakes (SITC-531); medicinal and pharmaceutical products (SITC-541); plastic materials, regenerated cellulose and resins (SITC-581); chemical materials and products (SITC-599); leather (SITC-611); articles of rubber (SITC-629); textile yarn and thread (SITC-651); cotton fabrics (woven) (SITC-652); textile fabrics (woven) (SITC-653); made-up articles, wholly or chiefly of textile material (SITC-656); floor coverings, tapestries, etc. (SITC-657); lime, cement and fabric building materials excluding glass/clay material (SITC-661); pearls and precious and semi-precious stones (SITC-667); ingots and other primary forms of iron and steel (SITC-672); iron and steel bars, rods, angles etc. (SITC-673); universals plates and sheets of iron or steel (SITC-674); copper (SITC-682); machinery and appliances non-electrical parts (SITC-719); electric power machinery and switchgear (SITC-722); road motor vehicles (SITC-732); clothing (except fur clothing) (SITC-841); footwear (SITC-851); and jewellery (gold, silver, platinum jewellery excluding watchcases and imitation jewellery) (SITC-897).

The direction and composition of exports have been analyzed with the use of percentage and ratio methods by taking into account the yearly and over period changes in trade flows. Export growth, both in terms of value and volume, have been calculated by using the exponential function. The commodity concentration and geographical concentration of exports have been examined by using Hirschman-Gini's Index. Export Instability Index (EXPII), defined as the standard deviation of the observed deviations from the estimated exponential time trend, has been used to examine the instability of exports. The components of the variance of the logarithm of earnings are examined in case of selected export commodities to assess the relative importance of price and quantity fluctuations.
The elasticity indices have been calculated for the exports by using the double-log specification with the method of Ordinary Least Square (OLS) that provides direct estimates of the magnitude and nature of elasticities both for the price and income variables. In order to test the overall significance of regression equation, the coefficient of determination ($r^2$) has been tested with the help of F-test. The first order regressive form of autocorrelation has been tested with the help of Durbin-Watson (D-W) statistics. T-test has also been calculated to test the significance of individual coefficients. The competitiveness of exports has been assessed by using relative prices and global market share; Revealed Comparative Advantage (RCA) Index; Revealed Systematic Comparative Advantage (RSCA) Index, and Net Trade RCA index. Constant Market Share (CMS) model has been used to examine India's export performance during the concerned period.

1.6 Data Sources


1.7 Chapter Preview:

The Study consists of eight chapters. Chapter I deals with introduction and relevance of the study. It also describes research methodology used in the various chapters in brief and highlights the major data sources. Chapter II describes the export related issues of
economic reforms and World Trade Organisation (WTO); and also provides an overview of the previous research work in the same area in detail.

Chapter III presents the scenario of growth, direction, and structure of India’s exports during the period from 1991-92 to 2005-06. Results conclude that growth performance of export has been outstanding as growth of India’s exports was found to be much higher than that of the growth of world exports. Increasing share of developing countries emerged as one of the interesting feature during this period. Terms of trade found to be favourable to India’s overall exports during the study period.

In Chapter IV, Instability of India’s exports during 1991-92 to 2005-06 has been examined at disaggregative level (SITC digit 3). It is found that majority of the selected commodities have registered high growth and low instability during the study period. Whatsoever the instability has been found, it was primarily due to the quantity as well as supply variables. Further, manufactured exports experienced higher export earning instability than that of primary exports among the selected exports.

The analysis of elasticities of demand for Indian exports in Chapter V highlights that both relative prices of exports and income of the importing countries have great importance in determination of quantity demanded for India’s selected exports during the study period. Furthermore, export demand has been found to be more elastic to income of importing countries than price of the exports.

Analysis of competitiveness of Indian exports has been exhibited in the chapter VI at disaggregative level of SITC digit 3. The analysis based on the relative and absolute prices of India’s selected export commodities and their market shares reveals price and non-price competitiveness of India’s selected exports during the study period. The analysis based on
the RCA and RSCA indices reveals comparative advantage in case of majority of selected commodities. Net Trade RCA index highlights low import intensity in case of majority of the export items.

Chapter VII demonstrates the factors and forces underlying India’s export performance during the concerned period. Results contend that increasing world demand for exports has played a significant role in India's outstanding export performance. Apart from expanding world demand, India's export performance primarily has been attributed to competitiveness of exports and market distribution of exports. India's exports exhibited competitiveness in all the selected markets except Japan, Switzerland, and Bangladesh. The performance of majority of exports except agricultural and allied exports has been subject to their competitiveness in world export market. Further competitiveness of exports in majority of markets helped in the improvement in market share of India in respective markets and in world export market as a whole.

Lastly, Chapter VIII summarizes the broad conclusions emerged out of the analysis and highlights major policy implications. Some policy recommendations in the context of the results have also been presented therein.

1.8 Limitations of the Study

The study examines the performance of India’s exports at disaggregate level in the global exports. The performance of selected commodities has not been examined in detail in any specific market, to which they have been exported, due to the macro approach which has been followed in the analysis. The study highlights the need of market-wise analysis of India’s exports separately as all the commodities could not be covered within an individual study.