CHAPTER - III

TRADE POLICY REFORMS IN INDIA AND CHINA

3.1 Introduction:

Both India and China adopted inward looking import substitution policies in 1950s that awarded little importance to foreign trade. Thereafter both suffered on account of inefficiency in production and technological backwardness. China, in response, opened its economy in 1978 whereas India adopted liberalization policies much later in 1991. The analysis of existing literature in the preceding chapter makes it clear that these two countries have chosen their own path of reforms. They have achieved a lot during this process in terms of growth and it is argued that their trade liberalization policy directs their improved performance. In contemporary scenario, however, China is much ahead of India as it is the largest exporter in the world, second largest importer and also the second largest economy in the world. China’s growth rate has been consistently higher compared to that of India’s. The present chapter attempts to carry out an in depth analysis of trade policy reforms in China and India and has been divided into 4 sections. In section 3.2 there is an analysis of trade policy reforms of China and section 3.3 covers the trade policy reforms of India. Section 3.4 is devoted to a comparative analysis of the trade policy reforms to highlight the similarities and dissimilarities between the two countries in this regard.

3.2. Trade Policy Reforms in China:

In the present section firstly there is a brief review of economic history of China and then we discuss the reforms adopted by China specifically in its external sector along with characteristics of its foreign trade sector.

3.2.1. Economic History of China:

Historically China held a dominant place in the world economically and politically in the first half of 19th century. It was the world’s largest

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1. This section based on article by Jaggi et.al “China’s economic reforms :Chronology and statistics.”
economy in 1820, accounting for an estimated 32.9 percent of the global GDP (Maddison)\(^2\). It was only in 1850s when Britain left China behind by being the largest economy in the world. After 1850s its economic and political power declined. Its monarchy rule became so weak that western powers forced unequal trade treaties upon it and the country faced civil and international wars. The central government steadily ceded power to host of warlords and foreign nations. Finally, in 1949 the Communist Party People’s army emerged to unite the nation under the leadership of Mao Zedong and China was united under consolidated leadership almost after a century. However the next forty years under socialist ideology under Mao’s leadership were bloody and chaotic. Initially, China took anti-West and pro-Soviet stance. Mao advanced ‘Great Leap Forward’ to instil zeal and promote economic growth. Under this policy, Mao initiated People’s commune movement to foster a communistic agrarian society. But this system encouraged bad incentives. Bad weather of 1960 led to famine which resulted in economic turmoil, starvation and rural revolt. Almost twenty to thirty million people lost their lives due to malnutrition and famine. Due to the failure of Great Leap Forward, split between Chinese leadership emerged openly for the first time. Furthermore, a major rift opened with the Soviets, leading to break in relations with the Russians. In 1960-65 Premier Zhou Enlai and Chen Yun altered Chinese policy direction, food production increased, private plots were re-established, limited markets were reopened, and modern inputs such as use of fertilizers became policy priorities. In 1966, Mao promoted “Cultural Revolution” and called on youth as “Red Guards” to spread revolutionary zeal. They were trained in attacking professionals and intellectuals and wreak havoc on education system. The Cultural Revolution that was started as a political struggle paralyzed the normal life and threw the economy into turmoil. However during Mao era, the Chinese economy achieved some successes, as inflation remained low, budget deficits were small and external imbalances were minor and low foreign debt and improvements in social indicators such as health care and education. But these gains were associated by rising

\[2. \quad \text{The Organization for Economic Cooperation and Development, Chinese Economic Performance in the Long Run, 960-2030, by Angus Maddison, 2007.}\]
distrust and dissatisfaction in the country. As in 1993 IMF Occasional paper noted:

“The Question arises as to the factors that provided the impetus for economic reforms and their scope...Although no crisis was apparent at macroeconomic level, there was growing discontent with the system, especially in rural area...Chinese leaders increasingly recognised that unless the technological disparities between China and her neighbours has effectively addressed, then output gaps would only widen (IMF 1993).”

In 1970s it was realised that China was falling behind and a more pragmatic environment emerged. Premier Zhou Enlai realised that Chinese industry required foreign technology and sought to improve China’s economic relations with other countries. China re-established diplomatic relations with Japan, and set the stage for Japanese backed industrial projects. China turned to Europe for fertilizers, however self –sufficiency was still stressed at commune level. In 1972, US President Richard Nixon visited Beijing and signed Shangai communiqué paving the way for China to import US technology. Death of Chairman Mao ended the Cultural Revolution but triggered a succession struggle. Next premier Hua Guofeng’s ten years development plan was designed to reinvigorate the economy through foreign trade. The plan resulted in a surge in capital goods imports which resulted in serious balance of payment problems. The difficulty forced the leadership to abandon ideological opposition to borrowing from abroad. As a part of this new stance, China established incentives and deregulation to attract and govern foreign investment. As economic complications increased there was a need of stronger economic leadership which led to the return of Deng Xiaoping. In 1978, Deng philosophy of capitalistic techniques in a socialistic economy was adopted due to failure of development plan and Cultural Revolution. The first phase of economic reforms (1978-1984) focused on agriculture and attempted to balance the foreign economic relations.

3.2.2. Trade Policy Regime in China:

Trade, like all economic activities, was organised in late Mao’s China
around the principle of self-reliance. This slogan had clear implication for China’s economic relations prior to Deng’s reforms. It required full utilization of domestic resources, rejection of foreign technology in favour of accumulating indigenous experience, reliance on domestic saving and establishment of a comprehensive system in China. Two motivations for self reliance were military security and mastery of manufacturing technology. Before 1978, China’s foreign trade was conducted by twelve state and foreign trade corporations which procured and traded the quantities as directed in the central plan. The state budget absorbed all profits and losses. The state administration exchange control (SAEC), a retention system, was established under which exporters surrendered their actual foreign exchange and were issued retention quotas by SAEC equivalent to a proportion of their foreign exchange earnings (IMF 1993). An interesting feature of the pre-reform Chinese trade regime was the limited importance of conventional trade policy instruments such as tariffs, quotas and licences. Price based measures, such as tariffs, were obviously unimportant since planning system was based on quantity decisions rather than behavioural responses to prices. There was little need of quotas or licenses since the quantities to be imported could be controlled through monopoly trading corporations.

Reforms in China’s trade policy in 1978 had four major dimensions:

- Increasing the number and type of enterprises eligible to trade beyond handful of centrally controlled foreign trade corporations.
- Developing the indirect trade policy instruments such as tariffs, licensing, quotas and duty exemption schemes that were absent or unimportant under the planning system.
- Reducing and ultimately removing exchange rate distortions.
- Reforming prices so that they could play a role in guiding resource allocation.

China’s trade reform process can be divided into two phases as described by Kungwung (1997):

“If we think of liberalization as a process over time, combining a shift from inward oriented to outward looking policies plus a reduction in the
degree of government intervention, then the process of China’s trade liberalization will be well understood by dividing China’s trade reforms since 1978 into two phases. The first phase is viewed as the move towards liberalization based on the introduction of export incentives via reform of the foreign trade system which reduced bias against export, although import restrictions remained the same or even increased. The later phase is characterised by a reduction in the level of intervention.”

Between 1979 to 1992, China gradually reformed its economic system and opened its borders with objective of establishing and improving “Socialist Market Economy”. During that period China adopted a combined import substitution and export promotion strategy with a view to encouraging export by those labour intensive industries in which it had comparative advantage and promoting development of those capital and technology intensive industries in which it did not. So in early 1990s, the trade regime in China could be described as a so called “protected export promotion system”. However reforms in second phase have focused more on import regime. As the core role of market mechanism in China’s economic system has been officially affirmed by its leaders and it has sought to rejoin GATT/WTO and as a part of the preparation of rejoining, government has started the reduction and elimination of tariff and non-tariff barriers. During reform period a gradual step-by-step approach was adopted by China. This process started with establishment of a few special economic zones for some specific industries. Decentralisation of administrative system was introduced at three levels as right and responsibilities were transferred to local authorities from central government to encourage local state owned companies to develop international trade linkages. Second more decision making power was given to trading enterprises and these enterprises were allowed to retain part of their exchange earning thus enabling them to operate in foreign exchange market. Thirdly during 1986-1991, China decreased import tariff of some commodities (total 6300) by 30 to 85 percent. However, these reforms were not sufficient because there was regional imbalance in the economy and conflicts aroused between different levels of authorities. A new phase with speedier trade liberalization was started in 1992 with in line with
international norms and this period is characterised by following reforms in China’s External sector:

- Quantitative restrictions were reduced substantially and even abolished altogether.

- The tariff rates were reduced more broadly and significantly average tariff rate was reduced from 43.2 percent in 1992 to 9.9 percent in 2011.

- Exchange rate reforms were implemented as exchange rate unification and currency convertibility at a unifying rate.

- Administrative reforms by developing trade related regulatory and international law system. All these administrative reforms will smoothen the process of international trade by bringing Chinese trade practice more in line with international standards.

- The reform programme has been extended to service sector and foreign direct investment. The liberalization of service industry combined with FDI encouragement has given a further impetus to development of international trade.

- China joined WTO as member in 2001 and complies with all WTO commitments and Regulations.

3.2.3. Trade policy in China after accession to WTO:

China has in recent times started using its trade and foreign investment policy actively to meet its industrial and developmental goals, most notably the development of private sector. Under foreign trade law, China’s trade policy objective is to accelerate its opening to the world, develop foreign trade and promote sound economic development. Economic reforms have resulted in considerably reduced trade barriers including tariff, import and export prohibitions, licensing and other restrictions. The Ministry of Commerce, in China has the main responsibility for policy co-ordination and implementation in respect of all trade related issues. It is responsible for formulating laws, regulations and policies related to domestic and international trade and foreign investment. A large number of trade related
laws have been reviewed and revised as a part of China’s accession to WTO in 2001. In addition to this; overall hierarchy of legislation policy is often implemented in the forms of trials. The gradual nature of China’s reforms is also reflected in its trade and investment policies. Trade policy has gradually shifted away from direct intervention in the economy aimed at promoting import substitution and exports. Import barriers have been reduced and investment is permitted in a large number of sectors particularly if the investment involves high environmentally sound technologies. The government has gradually reduced its intervention in the economy; however, it provides guidance to the economy reflecting inter alia domestic supply considerations. FDI policy has largely directed investment into manufacturing sector particularly export processing activities. After becoming member of WTO in 2001, China has provided MFN status to all WTO members except EL Salvatore and the territories of some European Union members. At the same time, it is also pursuing regional and bilateral agreements. According to the various trade policy reviews of WTO, China’s main trade policy objectives are:

- To accelerate its opening to the outside world and develop foreign trade and promote sound economic development.
- To increase manufacturing value added and ensure continued growth in exports.
- To utilize foreign capital to improve industrial structure and technological capabilities including encouraging FDI in new and high technology industries, modern services and agriculture.
- To encourage qualified domestic companies to invest abroad by giving them more credit, insurance and foreign exchange support.
- To strengthen guidance and co-ordination for enterprises investing abroad.
- According to the trade policy review 2010, China has recently concentrated more on opening up of its service sectors.
- According to its 12th five year plan (covering 2011-15), China places
emphasis not only on export and inward foreign investment but also on imports and outward foreign investment. In this context China aims to stabilise exports, expand imports and thus reduce the trade surplus. The authorities intend to achieve this objective through import facilitation measures as well as further preferential trading agreements.

- The 12th five year plan aims to reform China’s economy into one that is more driven by growth of domestic demand. It is anticipated that this will push the consumption of imported goods and services.
- China aims to further strengthen the multilateral trading system. At the same time, it has been intensifying its pursuit of bilateral and regional free trade agreements. It has been strengthening economic linkages with major trading partners and deepen cooperation with emerging markets and developing countries.

3.2.4 Major Characteristics of Current Chinese Foreign trade Policy:

- China has become world’s largest exporter and second largest importer of goods and services in 2012. Its important trading partners for exports and imports are EU, the United States, Japan and the ASEAN countries.
- China remains one of the largest recipients of FDI in the world. The Government also encourage Chinese companies to invest abroad in energy, raw material, agriculture services and infrastructure.
- Tariff remains one of China’s important trade policy instruments. In 2011, tariff revenue accounted for 2.7 percent of total tax revenue down from 2.8 percent in 2010. The average applied MFN rate was 9.5% in 2011. Applied rates are close to bound rate and bound rates are low thereby imparting the tariff with a high degree of predictability.
- Non–Tariff Measures have also been reduced progressively as China implemented its commitments to WTO. Import quotas as well as trading rights were discontinued at the end of 2004 while import prohibitions and licensing have been reduced progressively. The administration of import licensing regime has also been simplified progressively.
• China maintains import prohibitions largely for health and safety reasons and under international conventions. Apart from these prohibitions China has continued to use non-tariff border measures as instruments in its trade and investment policies. State trading is still used to manage trade in certain imports and exports of inter alia some agricultural products, crude and processed oil.

• China has used its trade and foreign investment policy actively to meet its industrial and developmental goals, most notably the development of private sector.

• China’s export regime is still characterised by various restrictions notably prohibitions, licensing, quotas, taxes and less than full rebates of VAT on exports. These restrictions are adjusted from time to time to reflect the changing international environment and to save energy, protect the environment and conserve the natural resources.

• China has identified the promotion of innovations as national development strategy. It has been ranked 29th in the world in 2014 by global innovation index whereas India’s rank is 76th in the world. In June 2008 the state council issued the outline on national intellectual property strategy with a view to enhancing IPR protection and promoting the creation and utilisation of intellectual property and thus encouraging innovation activities.

• China continues to have a large and persistent surplus of national saving over domestic investment and the external counterpart of a current account surplus in its BOP. Addressing the structural imbalances in its economy and making growth less dependent on overseas demand for China’s manufactured exports remains important policy challenge for the authorities.

• Many aspects of China’s trade and investment policy regime remain complex, leaving scope for administrative discretion and corruption. According to a 2011 corruption perception index which measures corruption among public officials and politicians, China (out of 183 countries) ranked 75th with a score of 3.6 out of 10.
3.2.5 Foreign Direct Investment Policy Reforms in China:

During the socialist period under Mao-Tse-Tung (1949-1978), the Chinese government opposed FDI flows because economic strategy was based on import substitution process of self reliance and economic independence. But after 1978 China began an economic transition from communism towards a social market economy in which foreign investment was gradually accepted. The first step in 1979 consisted in establishing special economic zones, that is specific location in which FDI was promoted through lower taxes, simplified bureaucracy and duty free import of components. China experimented with opening up to foreign investment in selected coastal cities and in special economic zones/ industrial parks with a focus on attracting export-oriented manufacturing FDI. Presently foreign invested enterprises account for over half of China’s exports and imports. They provide 30 percent of Chinese industrial output. China is the largest recipient of FDI as developing country and the second largest recipient of FDI in the world after United States. It has been quite open to FDI in almost all manufacturing and most service industries. Foreign investment has been encouraged mainly in manufacturing with a particular emphasis on high value added production. In this regard one of the key features of FDI regime is that China provides better than national treatment in its taxation policies for foreign invested enterprises.

The overseas Chinese Diaspora had a profound and tangible effect on its economy. Investment from Hong Kong and Taiwan has made major contribution to China’s rapid growth of foreign trade after trade reforms. Hong Kong’s entrepreneurs began shifting manufacturing facilities to China attracted by lower labour cost and improved infrastructure. This link with Hong Kong has not only brought much needed capital to China but also supplied new technology and modern management practices. China’s highly decentralised FDI approval and policy implementation creates opportunities for healthy competition for FDI among local authorities, but can also lead to excessive red tape and corruption. China has also started to encourage outward FDI largely to upgrade technical skills and to secure supplies of key raw materials such as petroleum and iron ore. Government is also promoting firms to invest abroad as China is investing in the petroleum sector abroad.
(Indonesia, Kazakhstan, Myanmar, Sudan and Yemen) as well as in aluminium, iron ore and cock industry (Brazil). Some Chinese enterprises have also started to purchase shares in foreign enterprise. Government classifies foreign investment projects into four categories: Encouraged, Permitted, Restricted and Prohibitive. The projects in the encouraged category are those that use improved technology and are less polluting while restricted and prohibitive are those that use outdated technologies, over exploit scarce natural resources and tend to harm environment. Foreign investors in the encouraged category are permitted to import capital equipment duty free. In addition they may enlarge their scope of business with approval if they are engaged in construction and operation of infrastructure, facilities related to energy, transportation and urban utility sectors which need a larger amount of investment and a long pay off period.

3.2.6 Exchange Rate Policy Reforms:

In pre-reform era, China’s exchange rate at an overvalued level subsidized the imports of high priority capital goods which could not be produced domestically. This overvaluation of domestic currency led to excess demand for foreign exchange relative to supply resulting in a rigid foreign exchange control system. Under the restricted system, the exporters had to surrender 100 percent of foreign exchange earnings to the government and there were limitations on rights of individuals to hold foreign currency and strict control over outflow of capital. Then in early 1980s, exporters were allowed to retain a share of their foreign exchange earnings. So they were able to finance imports without any government permission to purchase foreign exchange. In 1994, government devalued currency from nominal exchange rates of RMB 1.5 to RMB 8.7 per dollar to fix official exchange rate at the rate prevailing in the parallel foreign exchange market and thus the dual exchange rate regime ended in China. RMB exchange rate regime was further reformed on 21 July 2005, putting in place a managed floating exchange rate system based on market supply and demand with reference to a basket of currencies. In deciding the modalities, content and timing of the exchange rate reforms, the Chinese government took full account of their impact on macro economy and financial stability, economic growth and employment as well as the impact on its neighbouring countries. The long term objective of the reform of China’s foreign exchange management system is full
convertibility of RMB under both current and the capital account (The RMB became convertible under current account in 1996). China has been steadily moving towards capital account convertibility. On June 2010, China began a reform of Renminbi exchange rate mechanism with a view to gaining more flexibility in Renminbi exchange rates. Emphasis was laid on the law of supply and demand and adjustments based on a basket of currencies within a specified floating range on foreign exchange market. According to a government report submitted to the National People’s Congress in March 2012, China intends to improve the exchange rate determination mechanism for Renminbi and maintain the stability of Renminbi exchange rates around its equilibrium level, push forward the convertibility of Renminbi under the capital account gradually and enlarge the scope of Renminbi usage in cross border trade settlement and investment.

3.2.7. Import policy:

a) Tariff Barriers:

China applies three type of tariff on its trading partners, (a) MFN tariff rate to all WTO members, (b) Preferential tariff rates applied to countries with whom China has signed bilateral trade agreements (c) unilateral tariff rate for more than 40 least developed countries. Average applied MFN rate was reduced from 15.6 percent in 2001 to 9.4 in 2013. The average MFN rate for agriculture and non-agriculture products were 13.6 and 8.6 respectively in 2013. All of China’s tariff lines are bound at ad valorem rates. As it is clear from table 3.1 the average applied MFN tariff rates are close to bound rates, imparting a high degree of predictability in China’s MFN Tariff. Bound rate varied from zero to 65 percent for agriculture products and zero to 50 percent for non-agriculture products. China accords preferential tariff rates under various bilateral and regional trade agreements or arrangements. Though it was a latecomer in regional trade agreements but China has become an active participant. It has also enlarged the geographic scope of its agreements. Initially it signed agreements with neighbours such as Hongkong, ASEAN and Asia pacific trade agreement countries. It has since moved further afield, negotiating agreements with New Zealand, Chile, Peru and Costa Rica. China is also pursuing negotiations or undertaking joint studies on possible RTA/FTA with Australia, Norway, Switzerland and India. Average applied preferential tariff rate range from 3.5 percent to 9.1 percent. In 2007 China applied preferential tariff unilaterally to 37 LDCs; the average tariff ranged from 9.0 to 9.5 percent depending on the origin of goods.
Table: 3.1 Structure of MFN Tariff in China (2001 to 2013)

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<td>1. Bound Tariff lines (% of all lines)</td>
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<td>100</td>
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<td>2. Simple Average Bound Rate</td>
<td>N.A</td>
<td>12.4</td>
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<td>a) Agricultural products</td>
<td>N.A</td>
<td>17.9</td>
<td>16.4</td>
<td>15.0</td>
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<td>b) Industrial Products</td>
<td>N.A</td>
<td>11.4</td>
<td>10.4</td>
<td>9.6</td>
<td>9.1</td>
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<td>3. Tariff Quotas (% of lines)</td>
<td>N.A</td>
<td>0.8</td>
<td>0.7</td>
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<td>4. Duty Free Tariff Lines</td>
<td>N.A</td>
<td>4.3</td>
<td>5.9</td>
<td>6.4</td>
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<td>5. Simple Average Applied Rate</td>
<td>15.6</td>
<td>12.2</td>
<td>11.1</td>
<td>10.2</td>
<td>9.7</td>
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<td>a) Agricultural products</td>
<td>23.2</td>
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<td>6. Tariff Quotas (% of lines)</td>
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<td>7. Duty Free Tariff Line</td>
<td>3.0</td>
<td>4.9</td>
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<td>9.4</td>
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<td>8. Overall Standard Deviation</td>
<td>12.2</td>
<td>9.1</td>
<td>8.4</td>
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<td>9. Coefficient of Variation</td>
<td>0.8</td>
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b) Non-Tariff Barriers

- **Value Added Tax:** Imports like domestic products are subject to value added tax. The current VAT rates are 17 percent and 13 percent for most of the goods. However, some imports may be subject to tax reduction such as those produced in special economic zones (SEZ).

- **Excise Tax:** In addition to custom duties and VAT, an excise is applied at the border on luxury items including cigarettes, alcoholic beverage, gasoline, and motor vehicles. The excise rate for domestically produced goods and imports is the same except for lower tax and exemption on some imports in special economic zones for export processing.

- **General Import Restrictions:** In 2005, the products subject to import prohibition includes some products of animal origin, opium, mineral products, rubbers, chemicals, and raw hides, skin and leathers, clothing, ash of precious metals, base metals, precision equipment, and games. These restrictions are maintained due to health and environmental safety concerns.

- **Import Prohibition under Processing Trade:** Processing trade refers to products that are imported for the purpose of export after being processed in China. 143 HS eight digit tariff lines were subject to import prohibition under processing trade. These include some agriculture products, minerals, fertilizers, waste, and scrap metals and used toys.

- **Licensing and Import Quotas:** In 2005, China had notified three import licensing regimes, import licenses, automatic import licences, and tariff rate quotas for imports. Under China’s protocol of accession to the WTO, quotas are to be phased out gradually by 1st January 2005. At this juncture, China removed all import quotas and the items are no longer subject to import licensing.

- **State Trading:** Under China’s protocol of accession, products imported by state trading enterprises are grain, vegetable oil, sugar, tobacco, crude oil, and processed oil, chemical fertilizers, and cotton.
• **Trading Rights:** The right to trade was restricted to some 35,000 qualifying enterprises at the time of China’s accession to WTO. The qualifications criteria included a minimum registered capital requirement of 5 million US$ at the time of accession. Foreign invested enterprises were permitted to export and import but only those products which were used in their own production and exports. All these restrictions stand removed now.

3.2.8 **Export Policy:**

• **Export Prohibitions:** Presently products listed under export prohibition are prohibited from being exported mainly because of China’s international obligations and domestic concerns regarding environmental and human health protection and preservation of natural resources. China maintained general export prohibition on a total of 45 items at the HS-8 digit level in 2011.

• **Export Quotas:** The government believes that their export restrictions could help conserve natural resources or protect the environment. Hence rare earth has been subject to export quota and licence since 1999. Quotas for coal exports were set at 38 million tonnes for 2011. China also introduced export quotas or rare earth ferroalloy on 20 May 2011.

• **Export Licences:** China’s export licensing requirements are implemented mainly to fulfil its obligations under international agreements. In 2011, 246 lines at the HS-8 digit level were subject to export licensing. China also maintained state trading on some exports with a view to ensure stable domestic supply, avoid drastic price fluctuations in international markets; safeguarding food safety and protecting exhaustible and non-recyclable natural resources and environment. Exports which are subject to state trading include maize, rice, coal, crude and processed oil, cotton, antimony and antimony products, tungsten and tungsten products, silver and tobacco.

• **Export Finance, Insurance and Guarantees:** China provides export
credit financing mainly through its official export credit agency, the Export-Import Bank of China and it also provide export credit insurance by the China export and credit insurance corporation (SINOSURE). Apart from these facilities, Chinese government provides other export assistance like online information provided by MOFCOM to facilitate exports such as information on goods and markets, support for small and medium sized enterprises to participate in overseas exhibitions and to acquire international certification.

- **SEZs and other developmental zones:** As part of its gradual liberalization, one of the initial major steps taken by China was to set up the special economic zones. The zones were established principally to attract foreign investment to certain sectors that China believed were important for its development, and to process and export products from the zones. They were established in Shenzhen, Shantou, Hainan, Zhuhai, and Xiamen. They include over 100 national economic and technological development zones, 15 national bonded areas, and 14 border and cooperation regions.

  The SEZs have been expanded gradually into other kinds of zones, including those specialized in high technologies, free-trade zones and bonded areas to encourage processing and transhipment, and border economic cooperative areas to develop certain parts of the country. The number of these zones is currently difficult to determine due to their widespread use by provincial governments to attract investment.

- **Special economic zones (SEZs) Economic and technological development zones (ETDZs):** were initially set up in 1984. By the end of 1998, 14 EDTZs had been approved by the State Council. There are currently 49 ETDZs, 27 in the eastern coastal region, and 22 in the mid-west region of China. They are established mainly in the coastal cities and other “open cities”, and are aimed at developing the high-
tech industry, focusing on industrial projects, absorbing foreign funds and building up an export oriented economy.

- **Free-trade zones (FTZs):** there are currently 15 FTZs covering an area of almost 43 square kilometres. By the end of 2001, the total number of approved enterprises operating in the FTZs was 27,978, of which 13,180 were foreign funded. According to the China Association of Development Zones, by the end of 2001, FTZs accounted for 4.2% of national trade.

- **High tech industrial development zones (HIDZs):** emphasize the development of high technology industries. There are currently 53 State Council approved HIDZs.

- **Border economic cooperative areas (BECAs):** were first set up in 1992 to exploit resources in border regions and for regional development purposes. There were 14 BECAs in 2001, covering 32 square kilometres; they included over 3,000 companies, 400 of which were foreign or foreign-funded enterprises.

- **Coastal open cities and coastal open areas:** there are currently 14 coastal open cities and 260 coastal open areas. In addition, there are six open cities along the Yangtze river, 18 capital cities of interior provinces, 11 national tourism areas, Shanghai Pudong New Area, and Suzhou Industrial Park, all of which are eligible for preferential tax treatment and other incentives. Foreign-invested enterprises that invest in west China are eligible for a 50% income tax reduction for an additional three years following the expiry of the normal tax holiday period.

3.3. **Trade Policy Reforms in India:**

This section is devoted to the review of trade policy reforms in India, beginning with a brief analysis of economic history of India.
3.3.1. Economic History of India:

Nearly a decade before independence, the national planning committee was set up by the Indian National Congress under the Chairmanship of Pt. Jawahar Lal Nehru. The Committee viewed that:

“In context of modern world, no country can be politically and economically independent even within the framework of international interdependence, unless it is highly industrialised and has developed its power resources to the utmost. Nor can it achieve or maintain high standards of living and liquidate poverty without the aid of modern technology in almost every sphere of life. An industrially backward country will continuously upset the world equilibrium and encourage the aggressive tendencies of more developed countries. Even if it retains its political independence, this will be nominal only and economic control will tend to pass to others.”

Thus the origin of economic nationalism in India can be traced back to the belief held by those fighting the war of economic independence with British Rule. *Laissez Faire* and free trade policy were perceived to be major cause of India’s backwardness. After independence this legacy of vision was natural to affect the trade policies adopted in post-independence era. Its objective was to minimise imports by increasing indigenous production. Import tariffs based on tariff commission were initially used to provide infant-industry protection to selected industries and India adopted an inward looking policy of industrialisation, depending on encouraging domestic production for Indian markets behind high tariff and high degree of effective protection to domestic industry. Trade as an engine of economic growth was far from the sight of Indian policy makers and they viewed exports necessary only for generation of foreign exchange earnings to meet that part of import bill, not covered by external assistance. In the second half of twentieth century, Indian participation in world market declined steadily. In 1948, its share in world merchandise exports was 2.2 percent (higher than China’s 0.9 percent or Japan’s 0.4 percent) which fell to 0.5 percent in 1983 and recovered only
marginally 0.7 percent in 2000. In contrast, Japan progressively increased its share from 0.4 percent in 1948 to a peak 10 percent in 1993. Whereas China’s share first increased to a high 1.3 percent in 1963 then fell to a 1.0 in 1973, later recovering dramatically to 4 percent in 2000 after opening to world economy in 1978 (Uma Kapila 2009).

There is no widely accepted single measure that quantitatively captures the level of integration of a given economy with the rest of the world but the ratio of export plus imports to GDP is a common measure. India’s trade ratio in 1980 was merely 16.6 percent compared with China’s 22.3 percent, South Korea’s 75.5 percent and Thailand’s 54.4 percent. India has become more integrated with world economy since then but far behind China. India’s trade ratio increased to 24.2 percent in 1999, while China’s trade ratio more than doubled during the same period to 49.2 percent (Srinivasan 2003). Panagariya (2004), and Bhat (2012) have identified three phases of India’s trade policy regime:

a) 1950-1975 –Phase of higher controls and Import substitution
b) 1976-1991-Phase of Partial Liberalization
c) 1992-onwards-Phase of deeper and more systematic Liberalization

a) Trends towards higher controls and import substitution 1950-75:

Initially India was relatively a more open economy in comparison to China. In 1947, government announced explicit restrictions on foreign exchange rate for Balance of Payments adjustments. The India Tariff (Second Amendment) Act of 1954 stepped up tariff rates for thirty two items and paved the way for liberalization of import quotas through additional licenses. But BOP and foreign exchange crisis of 1956-57 led to the reversal of liberalization programme and India resorted to tighter and comprehensive import controls. Political and bureaucratic consensus made this environment more protective which is based on public sector, large enterprises. A regime evolved under which producers needed to make only minimal efforts to get
absolute protection against imports. Rule of indigenous availability was applied as government denied the allocation of foreign exchange for importing a product if domestic import substitutes were available in sufficient quantity.

However this process hampered the quality of products, produced domestically. There were some major objectives of this protectionist policies in India as stabilisation of balance of payments, encouragement of industry. A major shift in policy came in June 1966 when India undertook devaluation of its currency from 4.7 rupee to 7.5 rupee to a dollar. Alongside, steps were taken towards liberalization of import licensing, tariffs and export subsidies. Fifty nine industries which covered 80 percent of output in formal sector got freedom to import raw material and components; however the need to obtain a license remained. But this liberalization unfortunately coincided with a second consecutive crop failure which led to recession in industry also. An intense criticism from political leadership and industry which stood to gains from protection led to reversal of policy in less than two years. Bhagwati and Desai (1970) describe this reversal totally as a result of the political economy.

“In a very real sense, the timing of import liberalization was not ideal in retrospect: a burgeoning economy would have increased the chances of making an effective dent in practice of granting automatic protection to every activity. On the other hand, it was clear that it was quite naïve to expect industrialist to agree to switch over to an efficient system involving competition. In this, the pressure groups were often in company of disinterested politicians (such as Finance Minister Morarji Desai) whose thinking had also been conditioned by the planning philosophy of the earlier period: that anything which could be produced and supplied from domestic capacity must automatically be protected from imports.”

Thus late 1960s saw a reversal of liberalization and import regime became more restricted. By mid -1970s, share of non-oil non-cereals imports in GDP fell from an already low 7 percent in 1957-58 to 3 percent in 1975-76.
The severity of the import controls was reflected in a decline in the proportion of non-oil and non cereal imports. Since consumer goods imports were banned, the incidence of decline was mainly borne by machinery, raw materials and components. Import substitution policies were followed regardless of costs. It resulted in an extremely diverse industrial structure and many high cost and inefficient industries. There was a general problem of poor quality and technological backwardness, which beset even low cost sectors with comparative sectors such as textiles, garments, leather goods and cotton (Prusell 1992). So in late 1970s, Indian industry started to feel adverse impact of restricted imports on their profitability and demanded liberalization of imports of the raw materials and machinery. Also an improved foreign exchange returns position as a result of increased remittances from overseas workers in Middle East, made policy makers comfortable with respect to the effect of liberalization on the balance of payments.

b) Partial Liberalization 1976-91:

Policy changes in late 1970s and early 1980 were influenced by the recommendations of a number of committees specially by the Report of the Committee on Import-Export Policies and Procedures (P.C. Alexander 1978) and the Report of the Committee on Trade Policies (Abid Hussain 1984). Selective import liberalization measures were initiated in late seventies primarily of capital goods based on the recommendations of the former. The later committee similarly supported growth led exports rather than export led growth and stressed the need of harmonisation of foreign trade policies with other economic policies arguing for phased reduction of effective protection. This committee also stressed on the announcement of trade policies for longer period for the sake of continuity and long-term planning of export business. The committee further emphasised on the need to develop an efficient system which would make exports less costly and more profitable. Likewise India needed to move away from discretionary system of quantitative import controls to a system based on tariffs (Chadha et.al 1998).
Thus realisation of drawbacks of excessively inward looking trade strategy on the one hand, and need of modernisation and technology up-gradation of Indian industry on the other, led to certain trade liberalization measures in the late 1970s. This new phase of trade liberalization started in 1976 with the introduction of open general licensing (OGL) list which contained only 709 capital goods items which increased 1179 capital goods items and 949 intermediate inputs by April 1988. Though tariff rates were raised during this period, but items on OGL list were exempted from these rates. So tariff did not significantly add to the restrictive effort of licensing. They mainly allowed the government to capture the quota rents which relieved the pressure on budget. The government also introduced several export incentives especially after 1985 which partly neutralized the antitrade bias of import controls. Indian rupee was devalued in nominal effective terms by 45 percent leading to a real depreciation of 30 percent (Panagariya 2004). The long term fiscal policy announced in 1985 envisaged the eventual removal of import licensing from all imports except consumer goods and also proposed simplification of the complex tariff structure. By 1990 thirty-one sectors had been freed from industrial licensing. This measure had a trade liberalizing dimension since it freed machinery imports in these sectors from industrial licensing clearance. Growth performance of the economy improved during this period from 3.5 percent in 1950-80 to 5.6 percent during 1981-91. But expansionary fiscal policy and external liberalization leading to supported internal and external borrowing was unsustainable and resulted in balance of payment crisis in June 1991. However, this time the government did not reverse the programme; rather it grabbed the opportunity by making reforms more comprehensive and systematic. So according to Garry Pursell (1992), “The available data on imports and import licensing are incomplete, out of date and often inconsistent. Nevertheless, whichever way they are manipulated, they confirm very substantial and steady import liberalization that occurred after 1977-78 and during 1980s.”
c) **Deeper and More Systematic Liberalization -1992 Onwards:**

In 1991, India initiated a wide ranging program of trade liberalization and economic deregulation. After the partial liberalization of 1980s, since 1991 policy became more outward oriented with the objective now of achieving stable, sustainable growth by “Integrating the Indian Economy with the world Economy” (Government of India 1996). These deeper and more systematic reforms were the result of some economic conditions that emerged in later eighties. There were some circumstances that led to external sector liberalization in 1991.

1. Current account deficit rose to 3.2 percent of GDP in 1990 and debt service payments amounted to as much as 35.3 percent of current foreign exchange receipts. The rate of inflation exceeded 10 percent in 1990. Expectations of imminent devaluation of the rupee led to withdrawal of deposits by non-resident Indian. Thus this external payments crisis provided the immediate impetus for change, while other political factors were pushing India towards radical policy reforms.

2. Country’s cautious and limited deregulation of 1980s had delivered more rapid growth. Although the growth did not turn out to be sustainable yet it made further liberalization of policy regime politically acceptable.

3. Collapse of Soviet Union not only eroded crucial external support for India’s position on matters of its security and national interest but also reduced its access to defence support on concessional terms. At the same time collapse of many centrally planned economies undermined India’s faith in central planning. Some economist such as Bhagwati and Desai (1970) and Srinivasan (1975) had drawn attention to the fact that state intervention in economic activity and import substitution had forced India to very slow growth.

4. China’s spectacular growth after 1978 reforms opened its planned economy to rest of the world and allowed a greater role for markets. The fear of being left behind China, led policy makers to realise that this
crisis unlike the earlier ones could not be handled without bringing about radical changes in economy policy regime.

Rajesh Mehta (1995) describes it as “while the objective of self reliance and self sufficiency influenced trade policy formulation in 1950s and 1960s, the factors like export led growth improving efficiency and competitiveness of Indian industry prevailed upon the trade policy making during the late 1970s and the early 1980s. The current trade policy reforms, on the other hand seem to have been guided mainly by concern over globalization of Indian economy, improving competitiveness of its industry and adverse balance of payments situation.”

In early 1991 restriction on trade were liberalised by the impetus given by IMF sponsored adjustment in the wake of balance of payments crisis of 1991. The main objectives of trade policies after 1991 were stimulation of sustained economic growth through provision of access to essential raw materials, capital and consumer goods, the technological improvement of production in order to increase efficiency and attain internationally acceptable quality standards and provision of high quality products at reasonable prices to consumers. Eighth five year plan (1992-97), called for movement of India’s trade policy regime “towards greater openness and to reap the full benefits of international trade”. There has been a gradual opening up of economy as items under quantitative import restrictions have been moved to special import license list and to the list of freely importable goods. Foreign direct investment has also been allowed in most sectors with varying restrictions on the share of equity that can be held by foreigners. India was a founding contracting party of GATT and founding member of WTO. Its commitments under WTO include binding 62 percent of its tariff lines on industrial products. India has also bound its agricultural tariff lines most ranging from 100 to 300 percent, with a few at zero percent. In addition to its tariff commitments, India is amending its laws on intellectual property right to bring them into conformity with its WTO obligations. India has also
made commitments under General Agreement on Trade in Services (GATS) in six services sectors including financial services, telecommunication services, tourism and some aspects of engineering and health services.

The trade reform of 1991 predominantly has consisted of (Sultan 2010):

- Significant reduction in tariff rates and their dispersion
- Devaluation of rupee and rationalisation of exchange rate policy
- Abolition of import licensing
- Phased Removal of Quota restrictions on imports
- Liberalization of restrictions on capital

3.3.2 Post WTO Trade policy:

India’s trade policy objectives are stipulated in its foreign trade policy (FTP) which is issued every five years but revised periodically to take into account internal and external factors. Some of the continuing objectives are as follows:

- To accelerate the country’s transition to a globally oriented, vibrant economy with a view to deriving maximum benefits from expanding global market opportunities.
- To stimulate sustained economic growth by providing access to essential raw material, intermediates, components, consumer goods and capital goods required for augmenting production.
- To enhance the technological strength and efficiency of Indian agriculture, industry and services thereby improving their competitive strength while generating new employment opportunities and to encourage the attainment of internationally accepted standards of quality.
- To provide consumers with good quality goods and services at internationally competitive prices while at the same time creating a level playing field for domestic producers.
• In its 2004-09 FTP India highlighted two objectives, One to double India’s foreign trade in next five years, Second to use trade expansion as a policy to promote economic growth and employment generation in context of global crisis.

• India’s short term objective in accordance with latest FTP is to achieve annual export growth 15 percent and long-term objective is to accelerate export growth to 25 percent per annum and double India’s share in world trade by 2020.

3.3.3. Foreign Direct Investment Policy:

Policy on foreign investment in India was guided in pre 1991 period by industrial considerations, investment having been channelled into those industries where foreign technology and foreign exchange was deemed necessary for economic growth. Foreign Exchange and Regulation Act (FERA) 1974 stipulated foreign firms to have equity holding only up to 40 percent. Setting up of branch plants was usually disallowed; foreign subsidiaries were induced to gradually dilute their equity holding to less than 40 percent in domestic capital market. This law also restricted use of foreign brands however hybrid domestic brands were encouraged as Hero-Honda. The 1980s witnessed a gradual relaxation of the foreign investment rules such as Pepsi and Suzuki motors entered Indian markets. After 1991 foreign investment became a source of scarce capital, technology and managerial skills that were considered necessary in an open, competitive world economy. India gradually permitted foreign investment in almost all sectors of economy except the following sectors:
Sectors where FDI is prohibited in India:

Lottery business

Gambling and betting activities (e.g. casinos)

Real estate business (except development of townships, housing, built-up infrastructure, and construction development projects) or construction of farm houses

Agricultural activities (except floriculture, horticulture, development of seeds, animal husbandry, fish farming, aqua culture, cultivation of vegetables and mushrooms under controlled conditions, and services related to agro and allied); and plantation activities (except tea plantation)

Business of chit fund

Nidhi company

Trading in transferable development rights

Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitute

Activities reserved for the public sector, i.e. atomic energy and railways

Source: Department of Industrial Policy and Promotion, Circular No. 1 of 2011

3.3.4 Rationalisation of Exchange Rate Policy:

In post Bretton Woods period, the rupee was effectively pegged to a basket of currencies of India’s major trading partners from September 1975 and this system was continued through the 1980s. But the balance of payments crisis of 1991 made it imperative to adjust exchange rate. The rupee was devalued by 22.8 percent, in the first week of July 1991, relative to basket of five currencies viz the US dollar, the Deutschmark, the British pound, the French franc and the Japanese yen. The purpose was to bridge the
gap between the real and the nominal exchange rates that had emerged on account of rising inflation and thereby to make exports competitive. Taking into account the withdrawal of most export subsidies at the same time, the devaluation of real effective exchange rate for exporters was around 16.3 percent (Srinivasan 2004). Now foreign exchange rate policy in India is guided by the broad principles of careful monitoring and management of exchange rates with flexibility and a preannounced target or a band while allowing the underlying demand and supply conditions to determine the exchange rate movements over a period in an orderly manner. In India exchange rate system has undergone a paradigm shift from a system of fixed exchange rate until March 1992 to a market determined regime in March 1993. Since the switch over to a market determined exchange rate regime in March 1993, the behaviour of exchange rate has remained largely orderly, interspersed by occasional episodes of pressures.

The transition to market determined exchange rate system took place in two stages. Firstly liberalised exchange rate management system (LERMS) instituted in March 1992 was a dual exchange rate arrangement under which 40 percent of current receipts were required to be surrendered to the Reserve Bank at the official exchange rate while the rest 60 percent could be converted at the market rate. The unified market determined exchange rate regime replaced the dual regime on March 1, 1993 and since then “the exchange rate policy is guided by the need to reduce excess volatility, prevent the emergence of destabilising speculative activities, help maintain adequate level of reserves, and develop an orderly foreign exchange market (Jalan 1999). In order to reduce excess volatility in the foreign exchange market ,RBI has undertaken market clearing sale and purchase operations in the foreign exchange market to moderate the impact on exchange rate arising from lumpy demand and supply (Uma Kapila 2009).

3.3.5 Freer Imports and Exports:

In pre-reform period, India’s trade policy was complex. There were
different categories of importers and different types of import licences, and also alternate ways of importing. The tariff line wise import policy was first announced on March 31 1996 and at that time 6,161 tariff lines were made free. Till March 2000, this total had gone up to 8066. EXIM policy of 2001-02 removed quantitative restrictions on the balance 715 items. Thus in line with India’s commitment to the WTO, quantitative restrictions on all import items has been withdrawn.

- **Rationalisation of Tariff Structure:** With the removal of licensing, these tariff rates became effective restrictions on imports. Therefore the main task of the reforms in 1990s and beyond has been to lower the tariffs. Chelliah committee (1993) had recommended drastic reduction in import duties. The committee was of the opinion that rupee depreciated by 57.45 percent during 1985-86 to 1992-93 and this increased the cost of imports leading to high level of protection of Indian industry. So there was a need to rationalise prevailing import duties and to be lowered by 1998-99 to maintain parity in prices of goods produced domestically and internationally. Hence trade liberalization was at the core of structural reforms launched during the period of eighth five year plan. Under this plan gradual unilateral tariff cuts were applied in all sectors and also non-tariff barriers and licenses were removed. During the same period India also became a member of WTO in 1995. The average tariff rate across all industries reached 34 percent in 1998. Tariffs increased slightly after 1998 as a result of conversion of non-tariff barriers into tariff barriers in compliance with title XI of GATT. The standard deviation of tariff rate computed using the tariff schedules at the 10 digit has fallen from 39.4 percent to 12.3 percent in 1999. The ratio of import duties to total imports which was 48.18% in 1990 fell to 21.05% in 1999. The peak import duty on non-agricultural goods is now only 10 percent.

- **Removal of Quantitative Restrictions:** The data for quantitative restrictions are less straightforward to interpret than tariff rates. The
coverage rate as a share of tariff lines and product categories is most commonly used as a measure. In India, phasing out of quantitative restrictions has been the most prominent step of all trade liberalization measures. Srinivasan (2001) cites data from Pursell (1992) “In the pre-reform period, the QRs protected share was as high as 93 percent in total tradable GDP and it had come down to 66 percent by May 1995”. The coverage rate of non-tariff barriers of all tariff lines that feature such restrictions was 62.6% in 1991-93 for India which significantly declined to 12.96 % in 2000 and further to 5.30 percent in 2001.

- **Anti Dumping:** Anti-dumping has been used as prime policy used by India to neutralise the impact of reduced tariff and phased out quantitative restrictions. In 2001, India initiated 116 measures and was one of the most active users of anti-dumping measures in the world. In contrast China has not initiated more antidumping measures since 1995, however, it was target of many Anti-dumping measures by other countries. In 2011, also India topped the list of countries initiating such investigations whereas India at fourth spot between 1995-2012. During the period of 1995-2012 India has initiated total 663 investigations whereas China has initiated total 195 investigations during the same period.

- **Decanalisation:** A large number of exports and imports used to be canalised through the public sector agencies in India. The supplementary trade policy announced on August 13, 1991, reviewed these canalised items and decanalised 16 export items and 20 import items. Successive EXIM policies have decanalised most of the items.

- **Special Economic Zones:** A scheme for setting up special economic zones to promote exports was announced by government in the EXIM policy 2000 and later the Special Economic Zone Act was passed by the parliament in May 2005, which was finally implemented in February 2006. In a span of about eight years since the SEZ Act and Rules were notified in February 2006, formal approvals have been granted for setting up of
566 SEZs, of which 388 have been notified. A total of 184 SEZs are exporting at present. In SEZs, 100 per cent FDI is allowed through the automatic route.

Following are the salient features of SEZs in India:

i. It is a designated duty free enclave to be treated as a foreign territory for trade operations and duties and tariffs.

ii. No licence is required for imports.

iii. SEZ units have to be positive net foreign exchange earners within three years.

iv. Domestic sales subject to free custom duty and import policy in force.

v. Full freedom for sub-contracting.

vi. No routine examination by custom authorities of export and import cargo.

- **Bilateral Regional Co-operation:** India favours multilateral trading system, however, it has also been active in regional trading arrangements to serve as a building block for achieving trade liberalization and complementing the multilateral trading system. So far India has signed 10 Free Trade Agreements and 5 Preferential Trade agreements. The FTA and PTAs are already in force. Further India is currently negotiating 17 FTAs. India’s main regional trade agreements are, SAFTA agreement, India-Thailand FTA, India-ASEAN comprehensive Economic Cooperation Agreement, Regional Comprehensive economic partnership agreement among ASEAN+6 (Australia, China, India, Japan, Korea and New Zealand), India-EU broad based trade and investment agreement etc.

3.4 **Comparison of Trade Policies of India and China:**

Both China and India, as noted in the preceding sections, have a history of import substitution and socialism. China had a command economy under one party political regime whereas India with a democratic political
economy followed the policy of control economy. In early 1980s both had more or less same per capita income level. The philosophical oriented policy of China, The Great Leap forward and Cultural Revolution led China to a state of near stagnation. When sustenance of socialistic philosophy for economic goals became difficult, China under the leadership of Deng Xiaoping changed policy stance towards market economy. China opted for export-led growth strategy in line with East Asian countries. It implemented and sequenced reforms in a gradual step-by-step approach. The beauty of Chinese policies lies in that they were not sure of what they were doing, so they adopted a trial and learn method and not the shock therapy based on textbook model. Today, China has a rare combination of communism in political system and largely market mechanism in economic system.

India also has a long history of planning, government enterprise and control economy based on import substitution. Exports as a source of growth was far from the sight of Indian planner, and they initially considered it necessary for foreign exchange earnings to pay for imports. When payment for capital goods became difficult, India partially liberalised its external sector but that led to surge in imports not in exports and resulted in a severe BOP crisis. In 1991, India adopted comprehensive economic liberalization programme under structural adjustment programme of World Bank and IMF.

One major difference between trade liberalization policies of China and India is that most of the trade reform measures were adopted unilaterally by China whereas India is founding member of both WTO and GATT and its major trade reforms are with respect to multilateralism. Despite this China’s level of trade liberalization is much higher as compared to India. The main feature of China’s trade reforms is that they were accompanied by administrative reforms. The decentralisation of administrative system was introduced at three levels, as rights and responsibilities were transferred to local authorities from central government to encourage local state owned companies to develop internal trade linkages. China also developed trade
related regulatory and international law system. All these reforms smoothened the process of international trade by bringing Chinese trade practices more in line with international standards. But Indian administrative system is not adapted to an open free market economy, so in absence of proper governance, regulatory system and transparency, big scams especially in market decisions come up.

China’s objectives regarding foreign trade policies are more qualitative in nature. China has used its trade and foreign investment policy actively to meet its industrial and development goals. For example utilization of foreign capital to improve industrial structure and technological capabilities by encouraging FDI into new and high technology industries, modern service and agriculture. China’s trade policy is a combination of import substitution and export promotion policies by encouraging export of those labour intensive industries in which it has comparative advantage and promoting development of those capital and technology intensive industries in which it has not. India’s trade policies objectives are more quantitative in nature as to double India’s share in global merchandise trade within five years and to accelerate export growth to 25 percent by 2020. So what India needed is to learn here that free trade is not an end in itself rather a useful mean to achieve more important goals like employment, efficiency, Industrial and agricultural development. China provides a conducive environment for foreign investment and has become biggest FDI recipient developing country. China also promotes outward investment to secure supplies of key raw material such as petroleum and iron ore. India has also allowed foreign investment in all sectors except some sectors due to health and safety considerations. Both nations have managed floating exchange rate system. In brief it can be concluded that despite joining WTO in 2001 only and that too after great efforts, China’s level of trade liberalization is certainly greater than that of India both quantitative and qualitative terms.

Another major difference between the trade policies is that Chinese trade
Policies have been largely dominated by export-promotion policies and simultaneous import restrictive policies. On the other hand, India’s trade liberalization policy has undergone different phases of emphasis. The 1980s were more dominated by export promotion policies while 1990s and 2000s saw more emphasis on import liberalization. Further, import liberalization policy in India has been sequential and cautious. Capital goods were lowered in the mid-1980s, followed by lowering of import duties on raw material and intermediate products in 1990s and eventually import duties were lowered for consumer goods in 2001.

3.4.1. Trade Reforms:

Let us make a comparative analysis of trade reforms in India and China in terms of certain indicators. The study of the overall trade restrictiveness index in Table 3.2 shows that China is more open as compared to India but India’s export face less tariff barriers in partner countries as compared to China (Market Access OTRI). Also it is to be noted that both in terms of applied tariff and MFN tariff rates, The trade restrictiveness for agriculture sector is much higher in India (69.5 percent and 71.7 percent) in comparison to China (14.4 percent and 16.4 percent).

**Table: 3.2 Trade restrictiveness index of India and China 2012**

| Country | Indices based on applied tariff | | Indices based on MFN tariff |
|---------|---------------------------------|---------------------------------|
|         | OTRI                             | Market Access OTRI               | OTRI                             |
|         | All AG MF                        | All AG MF                       | All AG MF                       |
| China   | 9.7% 14.4% 9.3%                  | 9.4% 29.6% 8.8%                 | 10.2% 16.4% 9.7%                |
| India   | 14.9% 69.5% 13.1%                | 8.4% 16.9% 7.4%                 | 15.3% 71.7% 13.4%               |

Source: World Bank  *OTRI= Overall Trade Restrictiveness Index  AG=Agriculture sector  MF= Manufacturing Sector
Table 3.3. Trends in Average MFN applied Tariff Rates (1981-2010)

unweighted in percentage

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Source: World Bank

Table 3.3 shows that both the countries have reduced average tariff rates drastically since 1980s but India’s tariff rates are higher than China. However the quantum of reduction has been much greater in case of India from 100 percent in 1986 to 13.7 in 2013.

Table 3.4 compares the trade policy of China and India in post WTO in terms of important parameters. India’s tariff trade restrictive index is higher as compared to China. MFN applied simple average tariff is also higher in all years from 1995 to 2010. Dispersion of tariffs is higher in India as compared to China. In China maximum tariff rate is 90.7 percent whereas in India it is 301 percent. Tariff rates are higher for agriculture products in both countries than non-agriculture products but in India both agriculture and non–agriculture products are more protected than China. Import duties as a percentage of total imports are less than 2 percent in China 2008 whereas in India 7.6 percent. China has removed all licensing, quotas and trading rights from its imports under the protocol of accession to WTO. Some products are prohibited from imports due to health and environmental safety reasons. Imports of some products like grain, vegetable oil, sugar, tobacco, crude oil and processed oil, Chemical fertilizer and cotton are reserved for state enterprise. Exports are prohibited due to domestic concern regarding environmental and human health protection and preservation of natural resources. Rare earth has been subject to quota and license. India has also removed all major non-tariff barriers on its imports and exports by 2001.
### Table: 3.4 Comparison of Trade policy of India and China

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<td>Tariff trade restrictiveness index (TTRI)–MFN applied rate (%)</td>
<td>China</td>
<td>-</td>
<td>14.5</td>
<td>5.5</td>
<td>5.3</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>-</td>
<td>27.1</td>
<td>13.4</td>
<td>12.0</td>
</tr>
<tr>
<td>Overall TRI including NTMs (%)</td>
<td>China</td>
<td>-</td>
<td>-</td>
<td>9.9</td>
<td>9.8</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>-</td>
<td>-</td>
<td>19.9</td>
<td>18.0</td>
</tr>
<tr>
<td>MFN applied tariff simple average (%)</td>
<td>China</td>
<td>18.9</td>
<td>13.7</td>
<td>9.9</td>
<td>9.7</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>31.5</td>
<td>31.8</td>
<td>16.3</td>
<td>14.1</td>
</tr>
<tr>
<td>Dispersion</td>
<td>China</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>0.4</td>
<td>0.5</td>
<td>1.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Maximum Rate (%)</td>
<td>China</td>
<td>77.6</td>
<td></td>
<td>90.7</td>
<td></td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>322.2</td>
<td></td>
<td>301.0</td>
<td></td>
</tr>
<tr>
<td>Agriculture simple average (%)</td>
<td>China</td>
<td>27.7</td>
<td>21.1</td>
<td>15.8</td>
<td>15.6</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>31.4</td>
<td>39.0</td>
<td>34.7</td>
<td>32.1</td>
</tr>
<tr>
<td>Non agriculture simple average %</td>
<td>China</td>
<td>17.6</td>
<td>12.6</td>
<td>9.0</td>
<td>8.8</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>31.6</td>
<td>30.7</td>
<td>13.5</td>
<td>11.4</td>
</tr>
<tr>
<td>Import Duties (% of imports)</td>
<td>China</td>
<td>2.3</td>
<td>2.4</td>
<td>1.9</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>21.7</td>
<td>12.1</td>
<td>7.6</td>
<td>7.4</td>
</tr>
<tr>
<td>Bound Tariff Frequency Ratio</td>
<td>China</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>74.9</td>
<td>73.9</td>
<td>73.8</td>
<td>73.8</td>
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<tr>
<td>Non Tariff Measure Frequency Ratio</td>
<td>China</td>
<td>-</td>
<td>19.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>40.2</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Anti Dumping Initiations</td>
<td>China</td>
<td>2.0</td>
<td>20.2</td>
<td>13.0</td>
<td>14.0</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>26.2</td>
<td>52.0</td>
<td>38.3</td>
<td>54.0</td>
</tr>
<tr>
<td>Anti Dumping Initiations faced</td>
<td>China</td>
<td>35.8</td>
<td>50</td>
<td>65</td>
<td>75</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>10.4</td>
<td>12.2</td>
<td>7.5</td>
<td>7.0</td>
</tr>
<tr>
<td>Export to FTA/CU partners(% of total exports)</td>
<td>China</td>
<td>47.1</td>
<td>42.9</td>
<td>35.4</td>
<td>30.2</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>0.0</td>
<td>1.7</td>
<td>26.3</td>
<td>46.5</td>
</tr>
<tr>
<td>Real effective Exchange Rate (% change ==apprec.)</td>
<td>China</td>
<td>5.3</td>
<td>-1.4</td>
<td>3.6</td>
<td>8.2</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>-1.0</td>
<td>0.2</td>
<td>0.6</td>
<td>-5.2</td>
</tr>
</tbody>
</table>

**Source:** World Trade Indicators
India has been the most active user of anti-dumping initiatives whereas China faces highest anti-dumping complaints against its exports in foreign countries. Another major feature of China’s trade policy that it is pursuing bilateral trade integration policy quite seriously; nearly 40 percent of its exports are headed towards its bilateral partners. Further the Chinese currency has appreciated in last two decades and sometimes Chinese government is blamed for this deliberate overvaluation.

Table 3.5 shows MFN applied tariff rate by product group in both of the Countries. It is evident from the table that except two products average applied tariff duties in India are higher in India as compared to China.

**Table: 3.5 MFN Applied Tariff Duties product wise imports of India and China: 2011**

<table>
<thead>
<tr>
<th>Sr. no</th>
<th>Product Groups</th>
<th>MFN applied Tariff Duties China</th>
<th>MFN applied Tariff Duties India</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Average</td>
<td>Duty Free in %</td>
</tr>
<tr>
<td>1</td>
<td>Animal Products</td>
<td>14.8</td>
<td>10.1</td>
</tr>
<tr>
<td>2</td>
<td>Dairy Products</td>
<td>12.0</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>Fruit, Vegetables Plants</td>
<td>14.8</td>
<td>5.8</td>
</tr>
<tr>
<td>4</td>
<td>Coffee &amp; Tea</td>
<td>14.7</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>Cereals &amp; Preparations</td>
<td>24.3</td>
<td>3.4</td>
</tr>
<tr>
<td>6</td>
<td>Oilseed, Fats &amp; oils</td>
<td>10.8</td>
<td>5.3</td>
</tr>
<tr>
<td>7</td>
<td>Sugar and confectionary</td>
<td>27.4</td>
<td>0</td>
</tr>
<tr>
<td>8</td>
<td>Beverage and Tobbaco</td>
<td>22.3</td>
<td>2.2</td>
</tr>
<tr>
<td>9</td>
<td>Cotton</td>
<td>14.9</td>
<td>0</td>
</tr>
<tr>
<td>10</td>
<td>Fish and Fish products</td>
<td>10.8</td>
<td>6.4</td>
</tr>
<tr>
<td>11</td>
<td>Minerals and Metals</td>
<td>7.4</td>
<td>8.9</td>
</tr>
<tr>
<td>12</td>
<td>Petroleum</td>
<td>4.4</td>
<td>23.6</td>
</tr>
<tr>
<td>13</td>
<td>Chemicals</td>
<td>6.6</td>
<td>1.7</td>
</tr>
<tr>
<td>14</td>
<td>Wood Paper etc.</td>
<td>4.4</td>
<td>35.3</td>
</tr>
<tr>
<td>15</td>
<td>Textiles</td>
<td>9.5</td>
<td>0</td>
</tr>
<tr>
<td>16</td>
<td>Clothing</td>
<td>16.0</td>
<td>0</td>
</tr>
<tr>
<td>17</td>
<td>Leather, Footwear etc.</td>
<td>13.1</td>
<td>0.6</td>
</tr>
<tr>
<td>18</td>
<td>Non-electrical machinery</td>
<td>8.0</td>
<td>8.9</td>
</tr>
<tr>
<td>19</td>
<td>Transport Equipments</td>
<td>11.5</td>
<td>0.8</td>
</tr>
<tr>
<td>20</td>
<td>Manufactures</td>
<td>11.9</td>
<td>9.6</td>
</tr>
<tr>
<td>21</td>
<td>Electrical Machinery</td>
<td>8.3</td>
<td>24.0</td>
</tr>
</tbody>
</table>

Source: World Trade Organisation
Thus China and India had their individual and diverse journey towards trade reforms. But China is much ahead in policy formulation as well as implementation as compared to India. China opened its economy voluntarily to get benefit of globalization whereas India forced in 1991 to adopt trade reforms due to the conditions of IMF and World Bank under Structural Adjustment Program. We shall analyse the impact of these policy changes on the trade structure of the two countries in the next chapter and assess how their relative strengths have changed overtime in the world trade scenario.