CHAPTER X
LONG TERM PROSPECTS: PERSPECTIVE PLANNING AND PROJECTIONS FOR INDIA'S FOREIGN TRADE BEYOND 2001
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It seems important and pertinent at this juncture to discuss the vision for the external sector beyond 2001. The ongoing changes in the world economy and the consequent impact the Indian economy would receive in the time to come make it necessary to ponder and deliberate over the long term projections that the external sector of the country would witness. The wind fall changes in the economy of the country after 1991 saw the external sector receiving the due care gradually. The inward looking orientation with which the Indian economy was seen to be suffering from in the pre 1990 era was definitely to get a massive change at the hands of the policy makers and the harbingers of the change. The dismantling of the license raj and the consequent opening up of the Indian economy necessarily required that the eye be kept on future portrait of country's International trade sector.

The government of Mr. Narasimha Rao laid the edifice upon which was to be built a strong external sector that was supposed to sincerely support the Indian economy. The succeeding governments made it a point that the honest intentions of liberalization are carried forward with the passage of time. With this vision in mind a five year term EXIM policy was started and made a coterminous with the Ninth plan. It was necessarily kept in mind that both the planning and execution process as regards the international trade should travel on the same track as decided by the planners of the nation.

Perspective planning and projections as regards the Indian foreign trade beyond 2,001 thus became important as they were supposed to draw the and impact upon the country's foreign trade. The projections that were made by the planning commission of the country innately proposed for the demand and supply side arrangements to be made. The external sector projections made by the tenth plan, as discussed below, throw important light on various aspects of the Indian foreign trade that would be in the coming time period.

The Tenth plan carries out an extensive picture of the projected dimensions of the country's external sector. The tenth plan states that the projected growth rates of acceleration clearly cannot take place without tapping the avenues being offered by the international economic scene as regards the markets, investment, and technologies. It places on records that the external demand needs to be tapped to ensure that the projected growth rate is caught up. On the supply side also the Plan has its visions as to the flow of the external funds and the technologies which would make up the resource requirements and efficiency
- Non-fuel prices are expected to remain broadly unchanged; but if global demand slows down more than expected, prices may decline, affecting adversely commodity producers, including many poor countries.

- With the possibility of oil prices declining and wage increases remaining moderate, inflation levels are likely to stabilise. This would allow fiscal maneuvering in many countries.

- While a number of countries continue to face serious difficulties, external and financial vulnerabilities in emerging markets have been generally reduced since the 1997-98 crisis, and the shift away from soft exchange rate pegs has improved their ability to manage external shocks.

- Over the past several years the strong expansion in the US economy has been instrumental in stabilising global activity in the face of weak demand elsewhere. Unfortunately, with the recovery in Japan stalling, and its potential growth being still modest, the present slow-down in the US is likely to be offset by higher demand growth elsewhere. In these circumstances, there would be greater risk of spillovers to other countries through financial market and confidence effects.

- Given that financial risks often tend to be underestimated in periods of rapid expansion, lower growth could expose fragility of financial markets. Further, downward revision to expectations of corporate profit growth could intensify pressures on equity markets in the United States and elsewhere, with adverse effects on wealth, investment, confidence and risk aversion.

- In emerging markets, prospects depend critically on maintaining investor confidence. External financing conditions have recently deteriorated. Given the global outlook, and continued economic difficulties in some emerging market countries, economies are likely to remain volatile in the period ahead. This underscores the need to maintain prudent macroeconomic policies and to press ahead with corporate, financial and institutional reforms.

(c) Post September 11, 2001 Situation Even before September 11, 2001, world's major economies had been witnessing a slow-down. In USA, growth rates had dropped to near-zero due to weakening consumption growth, declining investment and reduced imports, coupled with a dwindling manufacturing sector growth. Japan witnessed deflationary pressures and Europe's growth rate was slowing sharply. The events of September 11, 2001 further hit the global economy at a vulnerable point when it had fewer buffers to offer and
its resilience to absorb new shocks was suspect. As a result, world trade growth is anticipated
to decline from 12.6 per cent in 2000 to (-) 0.1 per cent in 2001, 2.1 per cent in 2002 and 6.1
per cent in 2003 (World Economic Outlook, September 2002). Insofar as India is concerned,
the post-September 11 developments have affected a few important sectors adversely. The
Nasscom had first estimated the software exports to grow by 52 per cent during 2001-02, but
the actual rate came down to only 13 per cent during the year. The civil aviation sector has
also been hit, apart from fall in demand, hike in insurance costs has increased the operational
cost. India's tourism industry, which serves 2.5 million tourists a year, has been adversely
affected. The flow of remittances has also declined during 2001-02. Adverse external
developments after September 11, and their effect on India's financial markets, necessitated a
quick response to provide appropriate liquidity and overall comfort to the markets. In order
to stabilise domestic financial markets, the Reserve Bank of India (RBI) ensured that interest
rates are kept stable with adequate liquidity.

The RBI also undertook sale/purchase of foreign exchange as and when it was
necessary to meet any unusual supply-demand gap. In view of the extraordinary
circumstances in the government securities market, the RBI opened a purchase window for
select government securities on auction basis. Indian companies were permitted to increase
the foreign institutional investment (FII) limit. A special financial package was announced for
large value exports of six select products, which were internationally competitive and had
high value addition.

The above measures had the desired effect of moderating possible panic reactions
and reducing volatility in financial markets, particularly in money, foreign exchange and
government securities markets. While financial markets are generally stable, liquidity is
adequate, and interest rate environment is favourable so far, the outturn of industrial output
has been limited. This continues to be a matter of serious concern. It is hoped that as global
markets gain back momentum after some time, it will have a favourable impact on the
investment climate in India as well.

The series of international disturbances, however, throw open a window of
opportunities that can be harnessed. The interest rates have been cut several times in the
USA giving an opportunity to off-load the interest burden. Excess capacity afflicts virtually
every capital goods sector across the globe, which presents an opportunity to import
machines and equipments at bargain prices. It may be possible for India to attract higher
FDI under the circumstances. This is a time for the Indian multinationals to look for cheap global acquisitions.

When US companies resort to cost-cutting exercises, they may also resort to outsourcing, due to which the IT-enabled services sector such as call centers, back-office operations, transcriptions, payroll accounting services etc., will get a boost.

EXTERNAL SECTOR PROJECTIONS

As indicated earlier, the macroeconomic dimensions targeting an 8 per cent growth in GDP would lead to an increase in the investment rate to 32.3 per cent by the year 2006-07, as against the present investment rate of 24.3 per cent. It is expected that this growth rate will be achieved with improvement in efficiency in the economy, and by including higher capacity utilisation. The savings ratio is expected to increase to 29.4 per cent by 2006-07, as against a level of 23.5 per cent in 2001-02. For the Plan as a whole, the savings rate has been targeted at 26.8 per cent. The implied current account deficit, seen in terms of the gap between investment requirement and domestic savings by the end of the Tenth Plan, would be an estimated 2.9 per cent of the GDP by 2006-07 and an average 1.6 per cent for the Plan as a whole. This gap is to be met from a combination of inflows of foreign investment, external commercial borrowings and other forms of external assistance. In order to look at the behavioural side of the current account deficit, in this section we look at the projections of exports, imports and flow of invisibles. These projections are built on the experiences of the Eighth and Ninth Plan periods. The actual balance of payments outcome will no doubt depend on developments in the world economy and internal macro-economic balances, but the policy stance regarding external variables will also have an important role to play.

On the basis of the more liberalized balance of payments policy to be pursued and taking into account past trends in exports and imports as well as other determining variables, projections have been made for exports and imports for the Tenth Five Year Plan period. Exports in the Indian context are still seen to be primarily supply-side determined. Although demand-related factors, like relative prices (including exchange-rate movements) and world incomes, are becoming progressively more important, particularly for specific export items, the dominant factor continues to be the ability of the economy to produce adequate volumes of exportables to address international markets. Analysis of the recent export performance indicates that the share of tradables in GDP continues to exert a strong influence on export behaviour, with exchange rate variations and relative prices also playing significant roles.
International income levels still do not appear to matter significantly, reflecting the low share of Indian exports in international trade.

Using the results of the analysis and taking the projected growth in GDP and its constituents during the Tenth Plan period and certain assumptions for trends in the independent variables during the Ninth Plan period, export projections have been made. The results indicate that if the Tenth Plan growth targets are met, exports are likely to increase from $44,915 million in 2001-02 to $80,419 million by 2006-07. This would mean a compound growth rate of 12.4 per cent during the Tenth Plan, with an elasticity of 1.5. It needs to be noted, however, that these projections are based on the assumption that the REER will be maintained at more or less the current level. Thus, some flexibility does exist in increasing exports further with a more aggressive exchange rate policy, if necessary.

On the basis of these projections, the sector-wise export vector has been estimated for about 53 broad commodity groups, as may be seen in Annexure-I. The sector-wise break up is based on shares and growth rates of these sectors during the Ninth Plan period. It is observed that fishery products, other food and beverages, textiles, readymade garments, other non-metallic minerals (including pearls, precious and semi-precious stones), leather products, petroleum products, chemicals, iron and steel, machinery and communication and electronic items are expected to constitute the highest share of exports. At the same time, the highest growth during the Tenth Plan is expected in petroleum products, followed by communication and electronic equipments, electrical machinery, other non-metallic minerals, chemicals, paints, drugs and cosmetics, textiles, readymade garments, food and beverages, etc. As far as the projections for export of food items is concerned, it may be mentioned that these are subject to availability of surpluses, and priority would be given to domestic nutritional requirements. However, with an increase in agricultural production of 4 per cent during the Tenth Plan and with limited domestic demand (due to constraints in purchasing power), efforts would be on to increase export of processed items. This could include exports of horticulture products, particularly processed foods and vegetables, cashew nuts, spices, manufactured tobacco, castor oil and oil meals, apart from dairy products, poultry, processed meat and other processed foods and beverages. The projections for agricultural exports take these aspects into account. The overall growth in export of agriculture and allied products has been projected to be around 9 per cent. Imports
In India, imports are primarily demand determined, and are also very sensitive to changes in average tariffs. The customs tariffs have been reduced gradually as a part of the reforms process.

The average tariff duty in 1991-92 was 128 per cent, along with a very large number of separate tariff rates across commodity groups and also coupled with many exemptions. In 1996-97, the average (total) duty rates were 38.6 per cent with a standard deviation of 19. The highest duty rate was in the intermediate goods sector, and with substantial variation. By 2001-02, the average import duty (total) was reduced to 37.1 per cent, which has been further reduced to 33.7 per cent in 2002-03 (the average basic import duty is 28.9 per cent in 2002-03). While there is scope for further rationalization of tariff structure to bring it in line with other East Asian countries, the sensitivity of imports to the tariff rates demands that care be taken not to place undue pressure on the macro-economic balances. It becomes necessary, therefore, to examine the implications of alternative tariff reform scenarios on balance of payments.

The behaviour of aggregate import demand in the country is expected to be strongly driven by domestic growth rates. In addition, the average level of tariffs also exerts a strong influence.

Unexpectedly, the exchange rate effects were not particularly significant over the recent past. A possible explanation for this is that average tariff rates in India are still too high for the exchange rate to make any material difference in the decision to undertake imports. It is expected that as tariff rates are reduced, exchange rate movements will become progressively more important.

The projection of imports during the Tenth Plan period has been made on the basis of two likely scenarios. In the first (scenario-1), the average (total) tariff rate is assumed to come down to the East Asian level of 15 per cent in the terminal year of the Plan. In scenario-2, the indicative target announced by the government has been assumed to obtain, which yields an average duty rate of 18 per cent in the terminal year. The time phasing of these two sets of tariff reductions are also different.

In scenario-1, tariff reductions are assumed to follow a pattern where the present average of total duty rate is brought down from 33.7 per cent to 27 per cent in the next year, then to 22 per cent and 18 per cent subsequently, and finally to 15 per cent by 2006-07. In
scenario-2, the gradual reductions assume 28 per cent in 2003-04, and 24 per cent, 20 per cent and 18 per cent respectively by 2006-07. In both the scenarios, GDP growth has been taken at the Plan target of 8 per cent per annum. Using the results of the analysis imports were projected.

In scenario-1, with tariffs reduced to 15 per cent by 2006-07, total imports are likely to increase from $ 57,618 million in 2001-02 to $ 1,32,058 million by 2006-07, implying an annual growth of 18 per cent and an elasticity of 2.3. However, if tariffs are reduced only to 18 per cent, the imports are likely to reach up to $ 1,22,846 million by 2006-07, i.e. an annual increase of 16.3 per cent and an elasticity of 2.0. The details of the sector-wise projections for imports are provided in Annexure-2. The methodology used for estimation is the same as commodity-wise projections for exports. It is expected that crude petroleum would continue to have the highest share, followed by other metallic (including gold and silver) and non-metallic minerals, chemicals, machinery and transport equipments. Import of food items is projected to be relatively low, except edible oils. The highest growth in imports during the Tenth Plan is likely to be from communication and electronic equipments, followed by electrical and non-electrical machinery, edible oils, non-metallic minor minerals, tea and coffee and leather and leather products.

**Trade Balance:** The trade balance, derived on the basis of the projected exports and imports under different scenarios, is expected to increase to $ (-) 1,64,341 million in scenario-1 and to $ (-) 1,41,352 million in scenario-2. Invisibles The net invisibles are projected exogenously and are expected to grow broadly at the rate of 11 per cent from the base position of $ 14,054 million in 2001-02, comprising $ 35,612 million receipts and $ 21,558 million payments. It is expected that the projected net-invisibles would increase to $ 23,716 million by 2006-07.

**Current Account Balance:** Based on the projected trade balance and the net invisibles, the status of current account balance is arrived at in different scenarios and given in Table10.1 It may be observed that the CAB is likely to increase sharply with lowering of
tariffs from an average 33.1 per cent in 2001-02 and 33.7 per cent in 2002-03 (the first year of the Tenth Plan), to bring it in line with East Asian levels, i.e. to 15 per cent. Reduction of tariffs to 18 per cent by 2006-07 would be most consistent with this. The CAB would be relatively more manageable if the tariffs are reduced to 18 per cent as may be seen from the status of the CAB/GDP ratios.

Capital Account The capital account projections show the financing of the current account balance, as in Table 10.2, which gives the details of foreign savings.

These projections for the external assistance and foreign investment during the Tenth Plan estimates are worked out on the basis of the past trends and likely developments in the future. In particular, the repayment of Resurgent India Bonds and the India Millennium Depositories has been fully taken into account.

As may be observed from Table 10.3, the sustainable current account deficit and balance of payments situation at present are likely to be substantially compromised if average tariffs are brought down sharply to East Asian levels. Concerted effort would, of course, be required to increase exports. Since structural changes (in terms of changing share of tradables and relative prices) can be a medium to long-term option, it is the nominal exchange rate that would need to be suitably adjusted from time to time to keep balance of payments under control. It is the financing of the current account deficit that is important for sustained
enhancements. However, the plan cautions the policy makers to be aware of the vulnerabilities that are there as the country links itself with international economy. The tenth plan speaks of the worries and the benefits that are associated with the twin processes of globalization and liberalization because they seem to reshape the new system of international economic relations. It says that the ability of the developing countries to influence the pace and direction of global policy initiatives is still weak, while their vulnerability to the economic policy decisions taken by major developed countries, and more so by major market institutions, has increased. It speaks of the problems as:

Decline in Overseas Development Assistance (ODA), heavy debt burden, uncertainties in capital flow, and restrictions on high costs of technology transfer. In order to benefit from globalisation, developing countries like India will need themselves more actively in shaping the contours of the international economic order.

Before the tenth plan dwells upon the projections it examines the external economic situation faced by the country in the emerging global context. Detailed analyses of the status of balance of payments position, trade and tariff policy and important World Trade Organisation (WTO) related issues are subsequently presented. Based on the overall situation, the projections about various dimensions relating to the balance of payments in different scenarios that have been made for tenth plan period are then presented.

RECENT EVENTS IN INTERNATIONAL ECONOMY

During the Ninth Five Year Plan, there have been a number of events in the international economy that have influenced the behavioural pattern of the international economic relationship significantly, especially from the Indian point of view. These primarily include the East Asian crisis of 1997-98, global slow-down since 1999-2000, and the September 11, 2001 event. These are outlined below.

(a) East Asian Crisis Prior to the Ninth Five Year Plan, the East Asian Countries were visualized as the harbinger of economic growth – their performance being described as the East Asian Miracle. The scenario, however, changed in 1997 when financial and corporate sector weaknesses combined with macroeconomic vulnerabilities sparked off a crisis. The weakness can be explained as exposure of financial institutions to a variety of external threats including decline in asset values, market contagion, speculative attacks, and a reversal of capital flows. Formal and informal
As may be observed from Table 10.3, the sustainable current account deficit and balance of payments situation at present are likely to be substantially compromised if average tariffs are brought down sharply to East Asian levels. Concerted effort would, of course, be required to increase exports. Since structural changes (in terms of changing share of tradables and relative prices) can be a medium to long-term option, it is the nominal exchange rate that would need to be suitably adjusted from time to time to keep balance of payments under control. It is the financing of the current account deficit that is important for sustained development during the Tenth Plan. Flow of foreign investment into productive sectors is essential.

Moreover, as has been learnt from the experience in East Asian countries, the present trend of limited reliance on the ‘flighty’ short-term debt needs to be continued. Flow of foreign exchange reserves to short-term debt and, even more so, from the short term debt to export of goods and services, needs to be maintained at viable levels to maintain buoyancy in the international capital markets.
Since late 2001, a global recovery has been under way, with trade and industrial production picking up across the globe. However, after a strong first quarter, concerns about the pace and sustainability of the recovery have risen significantly. Financial markets have weakened markedly, with equity markets falling sharply since end-March accompanied by a depreciation of the U.S. dollar; financing conditions for emerging markets have deteriorated, particularly in South America and Turkey; and incoming data in both the U.S. and the euro area have fallen short of expectations. The recovery is still expected to continue, but global growth in the second half of 2002 and in 2003 will be weaker than earlier expected, and the risks to the outlook are primarily on the downside. With inflationary pressures generally subdued, macroeconomic policies in advanced countries will now need to remain accommodative for longer than had earlier seemed necessary; if incoming data were to suggest that the recovery is faltering, additional monetary easing would need to be considered. Attention also needs to focus on policies to reduce dependence on the United States as the global engine of growth, and to support an orderly reduction in the global imbalances, which remain a serious risk to the world economy.
In India, a cyclical recovery is now under way, although agriculture has been negatively affected by a poor monsoon and the regional security situation and higher oil prices are sources of risk. Inflation remains moderate and the external position is comfortable. However, trend growth has declined since the mid-1990s as the benefits of earlier structural reform have faded. With the fiscal deficit among the highest in the world, fiscal consolidation has become urgent, and pending fiscal responsibility legislation offers an opportunity to set out a clear and explicit medium-term fiscal consolidation path. Recent efforts to strengthen state finances are welcome, but the FY2002/03 budget envisages only modest deficit reduction, and even this may be difficult to achieve given relatively optimistic revenue projections.

On the structural side, significant progress has been made in privatization, more market-based pricing of petroleum products, and interest rate liberalization. However, a large unfinished agenda remains, including further opening up to trade and foreign investment, removing restrictions on agricultural and industrial activity, and strengthening the financial system. (Source: IMF, World Economic Outlook, September 2002)

Elsewhere on the subcontinent, Pakistan has continued to make progress toward macroeconomic stability, reflected in rising GDP growth and a strengthened external position, although the deterioration in the regional security situation is again a risk. The proposed FY2002/03 budget will help arrest adverse debt dynamics and shift expenditure toward human development.

Higher military expenditures as a result of regional tensions have complicated the outlook, however, and enforcing higher tax collection will require strong political resolve. Fiscal reform—linked to financial and public enterprise restructuring—is also critical in Bangladesh, where expansionary macroeconomic policies and loss of structural reform momentum have increased the risks to the outlook. In both countries, continued efforts to strengthen governance are also a priority.

IMF further states that in India growth has strengthened in 2002 despite the drought affecting the agricultural output. Inflation is reported to be modest. With a strengthened external sector the WEO calls for a greater exchange rate flexibility and acceleration of the trade liberalization process. (IMF, The World Economic Outlook April 2003). The following Table nos.10.5,10.6 &10.7 clarify the future scenario.